Chapter 3: Liberalisation, Privatisation and Globalisation: An Appraisal

Exercises — Liberalisation, Privatisation and Globalisation

Q1 Why were reforms introduced in India?

SOLUTION

India introduced economic reforms in 1991 primarily because of a severe financial and balance of payments crisis. The origin of this crisis can be traced to the inefficient management of the Indian economy in the 1980s.

Government expenditure had been exceeding its revenue by large margins. Development programmes required continued spending even though revenues were very low. The government was spending heavily on areas like social sectors and defence which did not generate immediate returns, and income from public sector undertakings was insufficient to meet growing expenditure.

In the late 1980s, prices of many essential goods rose sharply, imports grew at a very high rate without matching growth in exports, and foreign exchange reserves declined to a level not adequate to finance imports for even more than two weeks. There was also insufficient foreign exchange to pay interest on international borrowings, and no country or international lender was willing to extend further credit to India.

The government approached the World Bank (IBRD) and the IMF, received $7 billion as loan to manage the crisis, and in return agreed to liberalise and open up the economy. India then announced the New Economic Policy (NEP), which consisted of wide-ranging reforms aimed at creating a more competitive environment, removing barriers to entry and growth of firms, and correcting weaknesses in the balance of payments and inflation.

Answer: Reforms were introduced in 1991 due to a severe balance of payments crisis — foreign exchange reserves had fallen below two weeks of import cover, prices were rising, and no further credit was available. As a condition of World Bank and IMF loans, India launched the New Economic Policy.

Q2 Why is it necessary to become a member of WTO?

SOLUTION

The World Trade Organisation (WTO) was founded in 1995 as the successor to the General Agreement on Trade and Tariff (GATT), which was established in 1948 with 23 countries as the global trade organisation.

Membership of the WTO is considered necessary because it administers all multilateral trade agreements and provides equal opportunities to all countries in the international market for trading purposes. It aims to establish a rule-based trading regime in which nations cannot place arbitrary restrictions on trade.

The WTO's purpose also includes enlarging the production and trade of services, ensuring optimum utilisation of world resources, and protecting the environment. Its agreements cover trade in goods as well as services and facilitate international trade — both bilateral and

multilateral — through removal of tariff as well as non-tariff barriers and providing greater market access to all member countries.

As an important member of WTO, India has been in the forefront of framing fair global rules and regulations and advocating the interests of the developing world. India has kept its commitments towards liberalisation of trade made in the WTO by removing quantitative restrictions on imports and reducing tariff rates.

Answer: WTO membership provides countries equal access to international markets under a rule-based trade regime, helps remove tariff and non-tariff barriers, facilitates bilateral and multilateral trade, and allows developing countries like India to advocate their interests in framing fair global trade rules.

Q3 Why did RBI have to change its role from controller to facilitator of financial sector in India?

SOLUTION

Before reforms, the RBI regulated all banks and financial institutions through various norms and regulations. It decided the amount of money that banks could keep with themselves, fixed interest rates, and determined the nature of lending to various sectors.

One of the major aims of financial sector reforms introduced after 1991 was to reduce the role of RBI from regulator to facilitator. The idea was that excessive regulatory control was limiting the efficiency and flexibility of the financial sector.

As a facilitator, the financial sector is allowed to take decisions on many matters without consulting the RBI. This shift was intended to encourage greater competition and efficiency in banking, allow private sector banks (both Indian and foreign) to operate more freely, and let market forces play a larger role in determining interest rates and allocation of credit.

However, certain managerial aspects have been retained with the RBI to safeguard the interests of account-holders and the nation, ensuring that financial liberalisation does not compromise stability.

Answer: The RBI's role changed from controller to facilitator so that the financial sector could operate more efficiently, take decisions without excessive government oversight, and respond to market forces — while the RBI still retains oversight powers to protect depositors and national interests.

Q4 How is RBI controlling the commercial banks?

SOLUTION

The RBI controls commercial banks through various norms and regulations. Specifically, the RBI decides the amount of money that the banks can keep with themselves (cash reserve requirements), fixes interest rates, and determines the nature of lending to various sectors.

Even after financial sector reforms, certain managerial aspects have been retained with the RBI to safeguard the interests of account-holders and the nation. Banks that fulfil certain conditions have been given freedom to set up new branches without RBI approval and rationalise their

existing branch networks, but this is conditional on meeting the prescribed criteria.

Foreign investment limits in banks were raised to around 74 per cent under reforms, and banks were given permission to generate resources from India and abroad, but within the regulatory framework maintained by the RBI.

Answer: The RBI controls commercial banks by deciding how much money they can retain with themselves, fixing interest rates, determining the nature of lending to various sectors, and setting conditions under which banks can open new branches or raise resources from domestic and foreign markets.

Q5 What do you understand by devaluation of rupee?

SOLUTION

Devaluation of the rupee refers to an official reduction in the value of the Indian rupee relative to foreign currencies. It means that more rupees are needed to buy the same amount of foreign currency.

In 1991, as an immediate measure to resolve the balance of payments crisis, the rupee was devalued against foreign currencies. This devaluation led to an increase in the inflow of foreign exchange because Indian exports became relatively cheaper and more competitive in the international market.

The devaluation also set the tone for freeing the determination of the rupee's value in the foreign exchange market from government control. Now, more often than not, markets determine exchange rates based on the demand and supply of foreign exchange, rather than through government-fixed rates.

Answer: Devaluation of the rupee means officially reducing the value of the rupee against foreign currencies. In 1991, the rupee was devalued to resolve the balance of payments crisis, which increased foreign exchange inflows and initiated a shift toward market-determined exchange rates.

Q6 Distinguish between the following: (i) Strategic and Minority sale (ii) Bilateral and Multi-lateral trade (iii) Tariff and Non-tariff barriers.

SOLUTION

(i) Strategic and Minority sale: Privatisation of public sector enterprises involves selling government equity to the public, known as disinvestment. In a strategic sale, the government transfers a majority stake and management control of a PSE to a private buyer, giving the buyer decisive influence over the company. In a minority sale, the government sells only a small portion of its equity — less than 50 per cent — while retaining majority ownership and management control. The chapter states that privatisation through disinvestment was aimed at improving financial discipline and facilitating modernisation, and that private capital and managerial capabilities could be utilised to improve PSU performance.

(ii) Bilateral and Multi-lateral trade: Bilateral trade refers to trade between two countries based

on mutual agreements between those two nations. Multi-lateral trade refers to trade involving multiple countries under a common set of rules and agreements. The WTO agreements facilitate international trade — both bilateral and multilateral — through removal of tariff and non-tariff barriers and providing greater market access to all member countries.

(iii) Tariff and Non-tariff barriers: Tariff barriers are taxes or duties imposed on imported goods, which raise the price of imports and thereby protect domestic industries. Non-tariff barriers are restrictions on trade that do not involve a tax — such as quotas, licensing requirements, and other administrative measures. For example, the chapter notes that although India has removed quantitative (non-tariff) restrictions on textile exports, the USA has not removed its quota restrictions on imports of textiles from India and China.

Answer: (i) Strategic sale transfers majority control of a PSE to a private buyer; minority sale retains government majority with only a small equity portion sold. (ii) Bilateral trade is between two countries; multilateral trade involves many countries under common rules. (iii) Tariff barriers are import duties; non-tariff barriers are non-tax restrictions such as import quotas and licensing requirements.

Q7 Why are tariffs imposed?

SOLUTION

Tariffs are taxes levied on imported goods. They are imposed primarily to protect domestic industries from foreign competition by making imports more expensive relative to domestically produced goods.

Before the 1991 reforms, India was following a regime of quantitative restrictions on imports, encouraged through tight control over imports and by keeping tariffs very high. This was done to protect domestic industries.

However, these high tariffs reduced efficiency and competitiveness, which led to slow growth of the manufacturing sector. One of the trade policy reforms initiated after 1991 was therefore a reduction of tariff rates, aimed at increasing international competitiveness of industrial production and promoting efficiency of local industries.

Answer: Tariffs are imposed to protect domestic industries by making imported goods more expensive. Before 1991, India maintained very high tariffs to shield domestic producers, but this reduced efficiency. Post-1991 reforms included reducing tariff rates to encourage competition and improve industrial competitiveness.

Q8 What is the meaning of quantitative restrictions?

SOLUTION

Quantitative restrictions are non-tariff measures that limit the physical quantity or volume of goods that can be imported or exported. They are a form of direct control over trade flows, as opposed to tariffs which operate through the price mechanism.

India was following a regime of quantitative restrictions on imports prior to 1991 reforms. This

was encouraged through tight control over imports and was intended to protect domestic industries.

Trade policy reforms after 1991 aimed at dismantling these quantitative restrictions. Quantitative restrictions on imports of manufactured consumer goods and agricultural products were fully removed from April 2001. Export duties were also removed to increase the competitive position of Indian goods in international markets.

Answer: Quantitative restrictions are limits on the physical amount of goods that can be imported or exported. India used them before 1991 to protect domestic industries; post-1991 reforms dismantled them, and quantitative restrictions on manufactured consumer goods and agricultural products were fully removed by April 2001.

Q9 Those public sector undertakings which are making profits should be privatised. Do you agree with this view? Why?

SOLUTION

The chapter provides arguments both for and against this view, and students may take a reasoned position.

Those who disagree with privatising profitable PSUs argue that many of these profitable enterprises were originally formed during the 1950s and 1960s when self-reliance was an important element of public policy. They were set up to provide infrastructure and direct employment, so that quality end-products reach the masses at a nominal cost, and the companies themselves were made accountable to all stakeholders.

Scholars have alleged that instead of facilitating public enterprises in their expansion and enabling them to become global players, the government partly privatised them through disinvestment. The assets of PSEs have been reported to be undervalued and sold to the private sector, resulting in a substantial loss to the government. Moreover, the proceeds from disinvestment have been used to offset the shortage of government revenues rather than for the development of PSEs and building social infrastructure.

On the other hand, the chapter notes that privatisation was envisaged to improve financial discipline and facilitate modernisation, and that private capital and managerial capabilities could be effectively utilised to improve performance. The government has also improved efficiency of PSUs by granting them greater autonomy through the maharatna, navratna, and miniratna status.

On balance, it can be argued that profitable PSUs need not necessarily be privatised; instead, giving them greater operational and financial autonomy (as done through the ratna policy) while keeping them in public hands serves both efficiency and public interest goals.

Answer: This view is debatable. The chapter suggests that profitable PSUs can be made more efficient through greater autonomy (maharatna/navratna/miniratna status) rather than privatisation. Critics of disinvestment point out that PSU assets were undervalued, proceeds were not reinvested in their development, and these enterprises were originally set up to serve public welfare goals.

Q10 Do you think outsourcing is good for India? Why are developed countries opposing it?

SOLUTION

Outsourcing has been beneficial for India in several ways. In outsourcing, a company hires regular services from external sources, mostly from other countries. Many services such as voice-based business processes (BPO or call centres), record keeping, accountancy, banking services, music recording, film editing, book transcription, clinical advice, and even teaching are being outsourced by companies in developed countries to India.

India's advantages — low wage rates and availability of skilled manpower — have made it a destination for global outsourcing in the post-reform period. This has created employment opportunities and contributed to India's growth as a successful exporter of IT software and related services.

Developed countries, however, oppose outsourcing because it leads to a transfer of jobs from their economies to countries like India. When multinational corporations outsource services to India because of cheap manpower, people living in the countries where the companies are located face unemployment or job insecurity. This makes outsourcing a politically sensitive issue in developed nations.

Answer: Outsourcing is generally good for India as it creates employment and leverages India's low wages and skilled workforce. Developed countries oppose it because it shifts jobs abroad, causing unemployment among their workers.

Q11 India has certain advantages which makes it a favourite outsourcing destination. What are these advantages?

SOLUTION

The chapter identifies two key advantages that have made India a favourite outsourcing destination in the post-reform period.

First, India has low wage rates. Multinational corporations and even small companies outsource their services to India where they can be availed at a cheaper cost compared to what it would cost in their home countries.

Second, India has the availability of skilled manpower with a reasonable degree of skill and accuracy. India's large pool of English-speaking, technically educated workers makes it particularly well suited for services like voice-based business processes (BPO/call centres), record keeping, accountancy, banking services, IT software, and other knowledge-based services.

These two factors together — cost competitiveness and skilled human resources — have been the primary drivers making India a global outsourcing hub.

Answer: India's two key advantages as an outsourcing destination are (1) low wage rates — services can be obtained more cheaply than in developed countries, and (2) availability of skilled manpower with reasonable accuracy — a large educated, English-speaking workforce suited for IT, BPO, and knowledge services.

Q12 Do you think the navaratna policy of the government helps in improving the performance of public sector undertakings in India? How?

SOLUTION

Yes, the navaratna policy has been designed to improve the performance of public sector undertakings. In order to improve efficiency, infuse professionalism and enable PSEs to compete more effectively in the liberalised global environment, the government identifies PSEs and declares them as maharatnas, navratnas, and miniratnas.

These PSEs are given greater financial, managerial, and operational autonomy in taking various decisions to run the company efficiently and thus increase their profits. This autonomy reduces the need to seek government approval for routine decisions, allowing these enterprises to operate more like competitive businesses.

The granting of such status has resulted in better performance of these companies. Examples include Maharatnas such as Indian Oil Corporation Limited and Steel Authority of India Limited, Navratnas such as Hindustan Aeronautics Limited, MTNL, and IRCTC, and Miniratnas such as BSNL and Airport Authority of India.

Of late, the government has decided to retain these enterprises in the public sector and enable them to expand in global markets and raise resources by themselves from financial markets, rather than privatising them.

Answer: Yes, the navaratna policy helps by giving selected PSEs greater financial, managerial, and operational autonomy, allowing them to make decisions independently and operate efficiently without constant government approval. The granting of maharatna, navratna, and miniratna status has resulted in better performance of these companies.

Q13 What are the major factors responsible for the high growth of the service sector?

SOLUTION

The chapter indicates that during the reform period, while the growth of agriculture has declined and the industrial sector has recorded fluctuation, the growth of the service sector has gone up. GDP growth has been mainly driven by growth in the service sector.

Globalisation has been a major factor. As an outcome of globalisation, outsourcing has intensified because of the growth of fast modes of communication, particularly Information Technology (IT). Services such as BPO (call centres), record keeping, accountancy, banking services, music recording, film editing, and clinical advice are being outsourced to India.

Low wage rates and availability of skilled manpower made India a destination for global outsourcing in the post-reform period. Reforms that opened up the financial sector, removed restrictions on private banks and foreign institutional investors, and liberalised trade and investment also contributed to growth in finance, real estate, and trade services.

The chapter specifically notes that growth has been concentrated in select areas in the services sector such as telecommunication, information technology, finance, entertainment, travel and hospitality services, real estate, and trade.

Answer: The service sector's high growth is driven by globalisation and expansion of IT-enabled outsourcing (BPO, software, finance), India's low-wage skilled workforce, financial sector reforms opening up banking and investment, and liberalisation of trade and foreign investment — leading to rapid growth in telecom, IT, finance, real estate, and hospitality.

Q14 Agriculture sector appears to be adversely affected by the reform process. Why?

SOLUTION

Reforms have not been able to benefit agriculture, and its growth rate has been decelerating in the reform period.

Since 1991, public investment in the agriculture sector, especially in infrastructure — which includes irrigation, power, roads, market linkages, and research and extension (which played a crucial role in the Green Revolution) — has fallen. The partial removal of fertiliser subsidy has led to an increase in the cost of production, which has severely affected small and marginal farmers.

Policy changes such as reduction in import duties on agricultural products, low minimum support prices, and lifting of quantitative restrictions on imports of agricultural products have adversely affected Indian farmers as they now have to face increased international competition from cheaper imported goods.

Moreover, because of export-oriented policy strategies in agriculture, there has been a shift from production for the domestic market towards production for the export market, focusing on cash crops in lieu of food grains. This puts pressure on prices of food grains.

Cheaper imports have also replaced the demand for domestic agricultural products, and domestic producers now face competition from imports while infrastructure facilities including power supply have remained inadequate due to lack of investment.

Answer: Agriculture has been adversely affected because: (1) public investment in irrigation, roads, research and extension has fallen since 1991; (2) partial removal of fertiliser subsidies raised production costs for small farmers; (3) removal of import restrictions exposed Indian farmers to cheaper international competition; and (4) export-oriented strategies shifted focus to cash crops, pressuring food grain prices.

Q15 Why has the industrial sector performed poorly in the reform period?

SOLUTION

Industrial growth has recorded a slowdown in the reform period due to several interconnected reasons.

First, there has been a decrease in demand for industrial products due to availability of cheaper imports. When trade was liberalised, domestic manufacturers began facing competition from imported goods. Developing countries are compelled to open up their economies to greater flow of goods and capital from developed countries, rendering their industries vulnerable to imported goods.

Second, there has been inadequate investment in infrastructure. Infrastructure facilities,

including power supply, have remained inadequate due to lack of investment. This increases the cost of production for domestic industries and reduces their competitiveness.

Third, developing countries like India still do not have access to developed countries' markets because of high non-tariff barriers. For example, although quantitative restrictions on exports of textiles and clothing have been removed in India, the USA has not removed its quota restrictions on imports of textiles from India and China. This limits the export growth that could have driven industrial expansion.

Answer: The industrial sector has performed poorly due to: (1) cheaper imports reducing demand for domestically produced goods; (2) inadequate infrastructure investment (especially power supply) raising production costs; and (3) continued non-tariff barriers in developed countries limiting India's export growth despite India reducing its own trade restrictions.

Q16 Discuss economic reforms in India in the light of social justice and welfare.

SOLUTION

Economic reforms introduced since 1991 have produced positive as well as negative results from the perspective of social justice and welfare.

On the positive side, the reforms led to rapid GDP growth — rising from 5.6 per cent during 1980-91 to 9.4 per cent during 2021-22. Foreign investment increased from about US $100 million in 1990-91 to US $23 billion in 2022-23. Foreign exchange reserves rose from about US $6 billion in 1990-91 to about US $646 billion in 2023-24. Rising prices have also been kept under control.

However, critics argue that reform-led growth has not generated sufficient employment opportunities. The reform process has been widely criticised for not addressing basic problems in employment, agriculture, industry, infrastructure development, and fiscal management.

Economic reforms placed limits on the growth of public expenditure, especially in social sectors. Tax reductions aimed at curbing evasion have not resulted in an increase in tax revenue, and tariff reductions have curtailed the scope for raising revenue through customs duties. This has had a negative impact on developmental and welfare expenditures.

In agriculture, the reduction in public investment and removal of subsidies has severely affected small and marginal farmers. The growth of agriculture has been decelerating. In industry, cheaper imports have affected employment in domestic manufacturing.

Studies have stated that market-driven globalisation has widened economic disparities among nations and people. Growth has been concentrated in select service sector areas such as telecommunication, IT, finance, and real estate, rather than in vital sectors like agriculture and industry that provide livelihoods to millions. Critics argue that this has increased the income and quality of consumption only of high-income groups.

Thus, while reforms have boosted GDP, foreign exchange, and exports, their benefits have not been equitably distributed, raising serious concerns about social justice and the welfare of the poor, farmers, and the unorganised sector.

Answer: Economic reforms boosted GDP growth, foreign investment, and foreign exchange reserves, and kept inflation under control. However, they reduced public expenditure on social sectors, adversely affected agriculture and small farmers, slowed industrial employment, and concentrated gains in select high-income service sectors — raising serious concerns about equitable distribution and social welfare.