



## The pros and cons of liberalization, privatization and globalization: An overview

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### Abstract

The economy of India had undergone significant policy shifts in the beginning of the 1990s. This new model of economic reforms is commonly known as the LPG or Liberalisation, Privatisation and Globalisation model. The primary objective of this model was to make the economy of India the fastest developing economy in the globe with capabilities that help it match up with the biggest economies of the world. The concepts of liberalization, globalization and privatization are actually closely related to one another. This LPG phenomenon was first initiated in the Indian Economy in 1990 when the Indian Economy experienced a severe crisis. At that time the government decided to introduce the New Industrial Policy (NIP) in 1991 to start liberalizing the Indian economy. The chain of reforms that took place with regards to business, manufacturing, and financial services industries targeted at lifting the economy of the country to a more proficient level. These economic reforms had influenced the overall economic growth of the country in a significant manner.

**Keywords:** impact of LPG, economic reforms, Indian economy

### Introduction

India opened up the economy in the early nineties following a major crisis that led by a foreign exchange crunch that dragged the economy close to defaulting on loans. The country ran out of foreign exchange reserves. To face the crisis situation, the government decided to bring about major economic reforms to revive Indian economy. These reforms were popularly known as 'structural adjustments' or 'liberalization' or 'globalization'. The government announced a New Economic Policy on July 24, 1991. This new model of economic reforms is commonly known as the LPG or Liberalisation, Privatisation and Globalisation model. Liberalisation refers to process of making policies less constraining of economic activity and also reduction of tariff or removal of non-tariff barriers. The term "Privatisation" refers to the transfer of ownership of property or business from a government to a private owned entity. Globalisation refers to the expansion of economic activities across political boundaries of nation states. More importantly perhaps it refers economic interdependence between countries in the world economy. Prime Minister of the country, P V Narasimha Rao initiated ground breaking economic reforms. Dr. Manmohan Singh was the Finance Minister at that time he assisted Narasimha Rao and played a key role in implementing these reform policies. The reforms did away with the License Raj, reduced tariffs and interest rates and ended many public monopolies, allowing automatic approval of foreign direct investment in many sectors. The primary objective of this model was to make the economy of India the fastest developing economy in the globe with capabilities that help it match up with the biggest economies of the world.

### Literature review

Mukesh kumar (2014) <sup>[1]</sup> in their paper entitled "Impact of Economic reforms on India" made study with objective to find out the impact of Globalization on India and also study

Performance of the corporate sector after 1991. Finding shows that during the 11-year period 1995-2006 India's merchandise exports increased at the rate of 13.3 percent per annum and corporate sectors growth rate in sales and net profits is increased.

Dr. Thakur B., Sharma V K., Som Raj (2012) <sup>[3]</sup> in their paper entitled "Had Economic Reforms had an Impact on India's Industrial Sector?" threw the light on impact of Economic reforms on Industrial sector. Findings shows that Economic reforms had started showing positive impact on current Indian industrial performance in the last few years in terms of increase in level of productivity and reasonable rate of growth of industrial sector because of Liberalisation.

Vaghela Dharini Ishvarsinh (2014) <sup>[2]</sup> in their paper entitled "New Economic Policies: Liberalization, Privatization, Globalization" made study on new economic policy of India under this descriptive study made on basis of secondary data he had given conceptual study of Liberalization, Privatization and Globalization concepts and advantages and disadvantages of those concepts.

Dr. Meenu (2013) <sup>[4]</sup> in their paper entitled "Impact of Globalisation and Liberalisation on Indian Administration" study was made with objective to analyse the impact of globalisation and liberalisation on different aspects of Indian administration and changes introduced at different levels in Indian administration due to globalisation and liberalisation In this paper researcher has attempted to analyse the impact of LPG on Indian Economy on various elements like GDP, Per capita Income, Employment, Foreign Direct Investment etc.

### Objectives of the study

Liberalisation refers to the slackening of government regulations. The economic liberalisation in India denotes the continuing financial reforms which began since July 24, 1991. Or in other words you can say that Liberalization means elimination of state control over economic activities.

It implies greater autonomy to the business enterprises in decision-making and removal of government interference. It was believed that the market forces of demand and supply would automatically operate to bring about greater efficiency and the economy would recover. This was to be done internally by introducing reforms in the real and financial sectors of the economy and externally by relaxing state control on foreign investments and trade.

### Objectives

- To boost competition between domestic businesses
- To promote foreign trade and regulate imports and exports
- Improvement of technology and foreign capital
- To develop a global market of a country
- To reduce the debt burden of a country
- To unlock the economic potential of the country by encouraging the private sector and multinational corporations to invest and expand.
- To encourage the private sector to take an active part in the development process.
- To reduce the role of the public sector in future industrial development.
- To introduce more competition into the economy with the aim of increasing efficiency

### Impacts of Liberalisation in India

#### Positive impacts of liberalisation in India

1. **Free flow of capital:** Liberalisation has improved flow of capital into the country which makes it inexpensive for the companies to access capital from investors. Lower cost of capital enables to undertake lucrative projects which they may not have been possible with a higher cost of capital pre-liberalisation, leading to higher growth rates.
2. **Stock Market Performance:** Generally, when a country relaxes its laws, taxes, the stock market values also rise. Stock Markets are platforms on which Corporate Securities can be traded in real time. Impact of FDI in Banking sector: Foreign direct investment allowed in the banking and insurance sectors resulted in decline of government's stake in banks and insurance firms.
3. **Political Risks Reduced:** Liberalisation policies in the country lessens political risks to investors. The government can attract more foreign investment through liberalisation of economic policies. These are the areas that support and foster a readiness to do business in the country such as a strong legal foundation to settle disputes, fair and enforceable laws.
4. **Diversification for Investors:** In a liberalised economy, Investors gets benefit by being able to invest a portion of their portfolio into a diversifying asset class.
5. **Impact on Agriculture:** In the area of agriculture, the cropping patterns has undergone a huge modification, but the impact of liberalisation cannot be properly measured. It is observed that there are still all-pervasive government controls and interventions starting from production to distribution for the produce

#### Negative impacts of liberalisation in India

1. **Destabilization of the economy:** Tremendous redistribution of economic power and political power leads to Destabilizing effects on the entire Indian

economy. Threat from Multinationals: Prior to 1991 MNC's did not play much role in the Indian economy. In the pre-reform period, there was domination of public enterprises in the economy. On account of liberalisation, competition has increased for the Indian firms. Multinationals are quite big and operate in several countries which has turned out a threat to local Indian Firms.

2. **Technological Impact:** Rapid increase in technology forces many enterprises and small scale industries in India to either adapt to changes or close their businesses.
3. **Mergers and Acquisitions:** Acquisitions and mergers are increasing day-by-day. In cases where small companies are being merged by big companies, the employees of the small companies may require exhaustive re-skilling. Re-skilling duration will lead to non-productivity and would cast a burden on the capital of the company.
4. **Impact of FDI in banking sector:** Foreign direct investment allowed in the banking and insurance sectors resulted in decline of government's stake in banks and insurance firms.

### Privatisation

Privatisation refers to the participation of private entities in businesses and services and transfer of ownership from the public sector (or government) to the private sector as well. Privatization is the transfer of control of ownership of economic resources from the public sector to the private sector. It means a decline in the role of the public sector as there is a shift in the property rights from the state to private ownership. The public sector had been experiencing various problems, since planning, such as low efficiency and profitability, mounting losses, excessive political interference, lack of autonomy, labour problems and delays in completion of projects. Hence to remedy this situation with Introduction of NIP'1991. Another term for privatization is Disinvestment. The objectives of disinvestment were to raise resources through sale of PSUs to be directed towards social welfare expenditures, raising efficiency of PSUs through increased competition, increasing consumer satisfaction with better quality goods and services, upgrading technology and most importantly removing political interference.

### Impact of privatisation

#### Positive aspect-

1. **Improved efficiency:** The main argument for privatisation is that private companies have a profit incentive to cut costs and be more efficient. If you work for a government run industry managers do not usually share in any profits. However, a private firm is interested in making a profit, and so it is more likely to cut costs and be efficient. Since privatisation, companies such as BT, and British Airways have shown degrees of improved efficiency and higher profitability.

2. **Lack of political interference:** It is argued governments make poor economic managers. They are motivated by political pressures rather than sound economic and business sense. For example, a state enterprise may employ surplus workers which is inefficient. The government may be reluctant to get rid of the workers because of the negative publicity involved in job losses. Therefore, state-owned

enterprises often employ too many workers increasing inefficiency.

**3. Short term view:** A government many think only in terms of the next election. Therefore, they may be unwilling to invest in infrastructure improvements which will benefit the firm in the long term because they are more concerned about projects that give a benefit before the election. It is easier to cut public sector investment than frontline services like healthcare.

**4. Shareholders:** It is argued that a private firm has pressure from shareholders to perform efficiently. If the firm is inefficient then the firm could be subject to a takeover. A state-owned firm doesn't have this pressure and so it is easier for them to be inefficient.

**5. Increased competition:** Often privatisation of state-owned monopolies occurs alongside deregulation – i.e. policies to allow more firms to enter the industry and increase the competitiveness of the market. It is this increase in competition that can be the greatest spur to improvements in efficiency. For example, there is now more competition in telecoms and distribution of gas and electricity.

- However, privatisation doesn't necessarily increase competition; it depends on the nature of the market. e.g. there is no competition in tap water because it is a natural monopoly. There is also very little competition within the rail industry.

**6. Government will raise revenue from the sale:** Selling state-owned assets to the private sector raised significant sums for the UK government in the 1980s. However, this is a one-off benefit. It also means we lose out on future dividends from the profits of public companies.

#### Negative Aspect

**1. Natural monopoly:** A natural monopoly occurs when the most efficient number of firms in an industry is one. For example, tap water has very significant fixed costs. Therefore, there is no scope for having competition amongst several firms. Therefore, in this case, privatisation would just create a private monopoly which might seek to set higher prices which exploit consumers. Therefore, it is better to have a public monopoly rather than a private monopoly which can exploit the consumer.

**2. Public interest:** There are many industries which perform an important public service, e.g., health care, education and public transport. In these industries, the profit motive shouldn't be the primary objective of firms and the industry. For example, in the case of health care, it is feared privatising health care would mean a greater priority is given to profit rather than patient care. Also, in an industry like health care, arguably we don't need a profit motive to improve standards. When doctors treat patients, they are unlikely to try harder if they get a bonus.

**3. Government loses out on potential dividends:** Many of the privatised companies in the UK are quite profitable. This means the government misses out on their dividends, instead going to wealthy shareholders.

**4. Problem of regulating private monopolies:** Privatisation creates private monopolies, such as the water companies and rail companies. These need regulating to prevent abuse of monopoly power. Therefore, there is still need for government regulation, similar to under state ownership.

**5. Fragmentation of industries:** In the UK, rail privatisation led to breaking up the rail network into infrastructure and train operating companies. This led to areas where it was unclear who had responsibility. For example, the Hatfield rail crash was blamed on no one taking responsibility for safety. Different rail companies has increased the complexity of rail tickets.

**6. Short-termism of firms:** As well as the government being motivated by short term pressures, this is something private firms may do as well. To please shareholders, they may seek to increase short term profits and avoid investing in long term projects. For example, the UK is suffering from a lack of investment in new energy sources; the privatised companies are trying to make use of existing plants rather than invest in new ones.

#### Globalisation

Globalization essentially means integration of the national economy with the world economy. It implies a free flow of information, ideas, technology, goods and services, capital and even people across different countries and societies. It increases connectivity between different markets in the form of trade, investments and cultural exchanges. The concept of globalization has been explained by the IMF (International Monetary Fund) as 'the growing economic interdependence of countries worldwide through increasing volume and variety of cross border transactions in goods and services and of international capital flows and also through the more rapid and widespread diffusion of technology.' Following its freedom on August 15, 1947, the Republic of India stuck to socialistic economic strategies. In the 1980s, Rajiv Gandhi, the then Prime Minister of India, started a number of economic restructuring measures. In 1991, the country experienced a balance of payments dilemma following the Gulf War and the downfall of the erstwhile Soviet Union. The country had to make a deposit of 47 tons of gold to the Bank of England and 20 tons to the Union Bank of Switzerland. This was necessary under a recovery pact with the IMF or International Monetary Fund. Furthermore, the International Monetary Fund necessitated India to assume a sequence of systematic economic reorganisations. Consequently, the then Prime Minister of the country, P V Narasimha Rao initiated ground-breaking economic reforms. However, the Committee formed by Narasimha Rao did not put into operation a number of reforms which the International Monetary Fund looked for. Dr Manmohan Singh, the then Prime Minister of India, was the Finance Minister of the Government of India. He assisted Narasimha Rao and played a key role in implementing these reform policies.

#### Advantages of Globalisation in India

**1. Increase in Employment:** With the opportunity of Special Economic Zones (SEZ), there is an increase in the number of new jobs availability. Including Export Processing Zones (EPZ) Centre in India is very useful in employing thousands of people. Another additional factor in India is cheap labour. This feature motivates big companies in the west to outsource employees from other region and cause more employment.

**2. Increase in Compensation:** After Globalisation, the level of compensation has increased as compared to domestic companies due to the skill and knowledge a

foreign company offers. This opportunity also emerged as an alteration of the management structure.

3. **High Standard of Living:** With the outbreak of Globalisation, Indian economy and the standard of living of an individual has increased. This change is notified with the purchasing behaviour of a person, especially with those who are associated with foreign companies. Hence, many cities are undergoing a better standard of living along with business development.
4. **Extension of Market:** Due to globalisation any company can extend their limits the size of business. Now no nation can any longer hope to lead an existence of solitude and isolation in which only domestic industries can function.
5. **Development of Infrastructure:** Its help in the improvement and development of infrastructure. For example, growing financial facilities, faster communication, rapid technology changes, new sources of industrial energy etc.
6. **Development of healthy competition:** Integration of global markets reduces manufacturing costs, improves quality, reduces processing time, and business becomes dominant drivers.
7. **Multiplicity of Manufacturing Plants:** In globalisation, an MNC by operating in more than one country gains research and development production, marketing and financial advantages in its cost and reputation that are not available to purely domestic marketeers.

#### Disadvantages of Globalisation

1. **Inequality:** Globalisation has been linked to rising inequalities in income and wealth. Evidence for this is the growing rural–urban divide in countries such as China, India and Brazil. This leads to political and social tensions and financial instability that will constrain growth. Many of the world’s poorest people do not have access to basic technologies and public goods. They are excluded from the benefits.
2. **Inflation:** Strong demand for food and energy has caused a steep rise in commodity prices. Food price inflation (known as agflation) has placed millions of the world’s poorest people at great risk.
3. **Vulnerability to external economic shocks:** national economies are more connected and interdependent; this increases the risk of contagion i.e. an external event somewhere else in the world coming back to affect you has risen / making a country more vulnerable to macro-economic problems elsewhere.
4. **Threats to the Global Commons:** Irreversible damage to ecosystems, land degradation, deforestation, loss of bio-diversity and the fears of a permanent shortage of water afflict millions of the world’s most vulnerable.
5. **Trade Imbalances:** Global trade has grown but so too have trade imbalances. Some countries are running big trade surpluses and these imbalances are creating tensions and pressures to introduce protectionist policies such as new forms of import control. Many developing countries fall victim to export dumping by producers in advanced nations (dumping is selling excess output at a price below the unit cost of supply.)
6. **Unemployment:** Concern has been expressed by some that capital investment and jobs in advanced economies will drain away to developing countries as firms switch

their production to countries with lower unit labour costs. This can lead to higher levels of structural unemployment.

7. **Standardisation:** Some critics of globalisation point to a loss of economic and cultural diversity as giant firms and global multinational brands dominate domestic markets in many countries.

#### Conclusion

Economic reforms have an important impact on Indian economy. There are many changes in Indian economy, after adaptation of the policy of LPG i.e. Liberalisation, Privatisation and Globalisation in 1991. Because of these reforms many good things are happen like increase in the India’s GDP growth rate, Foreign direct Investment and Per Capita Income. Policy has facilitated the flow of foreign capital, technology and managerial expertise thereby improving efficiency of industry. Also, unemployment rate is reduced. Though there are certain negative impacts are also there like low growth of agriculture sector, adverse impact on environment etc. Lastly, we can say that development in India is takes place because of implementation of this policy.

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