

LPG POLICY OF INDIA AND ITS EFFECTS

For M.Com 3rd Semester

SUBJECT

(BUSINESS ENVIRONMENT)

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**Concept and meaning of Liberalization,
Privatization and Globalization**

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.

Highlights of the LPG Policy

Given below are the salient highlights of the Liberalisation, Privatisation and Globalisation Policy in India:

Foreign Technology Agreements

Foreign Investment

MRTP Act, 1969 (Amended)

Industrial Licensing

Deregulation

Beginning of privatisation

Opportunities for overseas trade

Steps to regulate inflation

Tax reforms

Abolition of License -Permit Raj

Liberalisation

Liberalisation refers to the slackening of government regulations. The economic liberalisation in India denotes the continuing financial reforms which began since July 24, 1991. 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.

Reforms under Liberalisation

- Deregulation of the Industrial Sector
- Financial Sector Reforms
- Tax Reforms
- Foreign Exchange Reforms
- Trade and Investment Policy Reforms
- External Sector Reforms
- Foreign Exchange Reforms
- Foreign Trade Policy Reforms

Economic Reforms during Liberalisation

Several sectors were affected by the outburst of the impact of Liberalization. Few economic reforms were:

- Financial Sector Reforms
- Tax Reforms / Fiscal Reforms
- Foreign Exchange Reforms / External Sector Reforms
- Industrial Sector Reforms

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.

Objective of Privatisation

Providing strong momentum to the inflow of FDI

- Privatisation aims at providing a strong base to the inflow of FDI.
- Increased inflow of FDI improves the financial strength of the economy.

Improving the efficiency of public sector undertaking (PSU's)

- The efficiency of PSU's was improved by giving them the autonomy to make decisions.
- Some companies were given a special category of Navratna and Mini-Ratna.

Ways of Privatisation:

Government companies are transformed into private companies in 2 ways,

Transfer of Ownership

- Government companies can be converted into private companies in two ways :
- By withdrawal of the government from ownership and management of public sector companies.
- By outright sale of public sector companies.

Disinvestment

- Privatisation of the public sector undertakings by selling off part of the equity of PSUs to the private sector is known as disinvestment.
- The purpose of the sale is mainly to improve financial discipline and facilitate modernization.

However, there are six methods of Privatisation:

- The public sale of shares
- Public auction
- Public tender
- Direct negotiations

- Transfer of control of State or municipally controlled enterprises
- Lease with a right to purchase

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.’

LPG and the Economic Reform Policy of India

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 groundbreaking 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.

Narasimha Rao Committee's Recommendations

The recommendations of the Narasimha Rao Committee were as follows:

Bringing in the Security Regulations (Modified) and the SEBI Act of 1992 which rendered the legitimate power to the Securities Exchange Board of India to record and control all the mediators in the capital market.

Doing away with the Controller of Capital matters in 1992 that determined the rates and number of stocks that companies were supposed to issue in the market.

Launching of the National Stock Exchange in 1994 in the form of a computerised share buying and selling system which acted as a tool to influence the restructuring of the other stock exchanges in the country. By the year 1996, the National Stock Exchange surfaced as the biggest stock exchange in India.

In 1992, the equity markets of the country were made available for investment through overseas corporate investors. The companies were allowed to raise funds from overseas markets through issuance of GDRs or Global Depository Receipts.

Promoting FDI (Foreign Direct Investment) by means of raising the highest cap on the contribution of international capital in business ventures or partnerships to 51 per cent from 40 per cent. In high priority industries, 100 per cent international equity was allowed.

Cutting down duties from a mean level of 85 per cent to 25 per cent, and withdrawing quantitative regulations. The rupee or the official Indian currency was turned into an exchangeable currency on trading account.

Reorganisation of the methods for sanction of FDI in 35 sectors. The boundaries for international investment and involvement were demarcated.

The outcome of these reorganisations can be estimated by the fact that the overall amount of overseas investment (comprising portfolio investment, FDI, and investment collected from overseas equity capital markets) rose to \$5.3 billion in 1995-1996 in the country) from a microscopic US \$132 million in 1991-1992. Narasimha Rao started industrial guideline changes with the production zones. He did away with the License Raj, leaving just 18 sectors which required licensing. Control on industries was moderated.

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.

Impact of Globalisation on Indian Economy.

In the Economic welfare, globalisation refers to the unique economically interdependent international Environment. Each countrys prosperity is interlinked with the rest of the world. A further development will be the super national enterprise.It serves all nation without being specially attached to any of the.

The Impacts of Globalisation are as follows:

1. **Economical Impact:-** The implications of globalisation for a national economy are many. Globalisation has intensified interdependence and competition between economies in the world market. This is reflected in Interdependence in regard to trading in goods and services and in movement of capital. As the globalization attracted foreign investors to invest in the financial market (like stock market, share market), the commodity market also expanded. International trade leads to an increase in the world's prosperity and welfare of each trading nation and living standard of trading nation by way of foreign direct investment by one country in to other country. The economy will boost by the FDI, especially for the developing country. Globalisation also gives a chance to IT Sector, Pharma Sector, Agro Products ect. It has also some bad effects especially on small scale sectors and local markets.

2. **Cultural Effects:-** Due to globalization is multi dimensions, have been formed various outlooks about impact of it on culture. coexistence with different cultures isn't possible. Globalization is figure on broadcast and dominates a special culture on other cultures in the world. Spread of education has influenced the life style of people and standard of living has been improved. By going global, corporation has extended their products lines to other cultures. A company can both improve product quality and achieve its goal by sharing technology and information. There are so many differences between cultures that it is impossible to cover them all. The global company is becoming the most viable force in the world trade and international relation.

3. **Political Effects:-** Globalization by removing geographical, political and cultural borders, and also by pass dame of time and place has changed attitudes, behavior and action of individuals, nations, states and even socio-political structure of societies. In politics scope, globalization has created several evolution the scientific and academic societies, especially political science, and some other matters like political systems, states, and democracy, has conceptual redefined by globalization.

4. **Technological Changes:-** Technology is understood to be the driving force of globalization. This technological development has helped globalise the world economy the tends of technological changes that have taken place since the industrialization revolution, relating from production, distribution and communication,

that has fulfilled the globalization. It has brought about innovation and interaction between nations that weren't possible before. That has led to some of the greatest invention that revolutionized trade, communication and interaction to a whole new level and increased globalization.

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