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Globalisation and India[1]

Mr. Anjaneya Reddy, Professor Prasanna Kumar, Professor K.C. Reddy, distinguished academics and friends,

I am thankful to the organisers for giving me this opportunity to be with friends here. My association with Visakhapatnam goes back to 1965 when I was Assistant Collector here. I had the benefit of long friendship with Professor Sarveswara Rao, Parthasarathy, Ramana, Gopalakrishna Reddy, Chandrasekhar, K.V. Ramana of Economics Department, in addition to Professor N.S. Reddy garu of Anthropology and Professor Ramana of Social Work. I have many pleasant memories of Vizag, in particular being trained by redoubtable Abid Hussain as my Collector.

At that time, Vizag was a small University cum Port town with Hindustan Shipyard and Bharath Heavy Vessels as major industrial units. At that time, Indian Airlines had to be subsidised to run one flight a day connecting Hyderabad. Today, it is part of Indian network of cities, on the way to becoming part of global network of metropolis. Globalisation is very powerful, and if not well managed by governments and people, the bad may be more than good. In this lecture, I want to share with you my experience in dealing with globalisation in different capacities.

1 Foundation Day Lecture by Y.V. Reddy at Centre for Policy Studies, Visakhapatnam, Feb. 14, 2017. This is based on several lectures and articles that Dr. Reddy had delivered in the past. They are available at www:\yvreddy.com

Before doing so, let me clarify what globalisation is for our purpose today, and also give a review of India's approach to globalisation since independence.

Globalisation may be defined as the process by which greater connectivity is achieved in regard to ideas, goods, services, finance, and people, across the borders of nation states. The restrictions on movement of people is a phenomenon of early 20th century while globalisation as a concept came into prominence in later part of 20th century. 21st century so far has seen explosion of global finance, then a crisis, followed by uneven recovery and more recently a dampening of the process of globalisation especially in growth of trade and capital flows.

Cross-border integration can have several inter-related dimensions: cultural, social, political and economic. For the purpose of this presentation, however, only economic integration is considered. Broadly speaking, economic integration occurs through three channels, viz., movement of people, of goods and, of finance or capital.

Firstly, on the aspect of movement of people, the most notable achievement of globalisation is the freedom granted to many, if not all, from the tyranny of being restricted to a place and being denied the opportunity to move and connect freely.

Secondly, in regard to trade in or movement of goods across the national boundaries, two types of barriers are observed, viz., natural barriers and artificial barriers. Of late, while the multilateral trade agreements are encouraging reduction in such artificial barriers, the developments in technology are also making it difficult for national authorities to enforce artificial barriers. The spread and depth of global

supply chain networks has resulted in making it very difficult to identify country of origin of a product.

The third dimension relates to capital movements for which also, the interplay between technology and the public policy becomes relevant. There have been, however, some special characteristics of capital flows in recent years mainly led by revolutionary changes in telecom and computing capabilities. These have highlighted the phenomenon of what is described as "contagion", which implies the risk of a country being affected by the developments totally outside of its policy ambit: though domestic policy may, to some extent, influence the degree of its vulnerability to the contagion.

Indian Approach: Review of Past (1950-80)

During the first three decades of planned development, successive plans emphasized the need for financing development largely from resources mobilized domestically. Firstly, Indian planners shared the export pessimism then pervading the developing world. Secondly, the existence of a large domestic market provided scope for internalising forward and backward linkages. Thirdly, development strategy hinged upon a programme of industrialization to break through the vicious circle of backwardness. Fourthly, the availability of foreign exchange was a major constraint, especially after the running down of the Sterling balances during the 1950s. Export pessimism dominated the policy stance throughout the early decades of our planning. Accordingly, exports were regarded as a residual, a vent-for-surplus on those occasions when such surpluses were available. Import substitution

was the principal instrument of trade policy and was regarded in the early years as not only the correct strategy but also inevitable in a continental economy like India.

The objective of self-reliance did not find an explicit commitment in the second and third five-year plans (1956 to 1966) which were mainly concerned with generating the foreign exchange resources required for the plans. The third plan reflected the first signs of rethinking in the policy strategy by dedicating itself to 'self-sustaining growth' which required 'domestic savings to progressively meet the demand of investment and for the balance of payments gap to be bridged over'. The fourth plan (1969-74) contained an articulated approach to achieving self-reliance. It was in the fifth plan (1974-78) that self-reliance was recognised as an explicit objective. After a brief period of Rolling Plan (1978-80), the sixth plan (1980-85) emphasized the strengthening of the impulses of modernization for the achievement of both economic and technological self-reliance.

My first serious encounter started with World Bank and IMF when I joined Ministry of Finance in 1977. In one year I got familiar with India's relations with them. But, it was my move to World Bank that gave me a good perspective.

World Bank (1978-83)

I was Technical Assistant / Adviser to the Executive Director in World Bank. I was performing dual functions, viz., attend every Board Meeting (twice a week) to assist the Executive Director on all affairs relating to the World Bank. This gave me a global perspective. Further, as a leading country among the developing countries, I was involved in the meeting of G-9 (Group of 9). In parallel, I was representing

Indian interest and advising Indian authorities in regard to the relationship between India and World Bank.

This was a period of great transition in global thinking and globalisation, but we missed the bus.

Why do I say this?

Firstly, China joined the World Bank. Russia also joined the World Bank signifying beginnings of changed world economic order. We did not renew our relationship with global economy.

Secondly, many of the developing countries were adopting outward oriented policies particularly in regard to trade. We continued the illogical self-reliance policies.

Thirdly, Reagenomics and Thacherism were bringing about fundamental rethinking about the relationship between the State and the market, and public enterprises and privatisation. We were not even willing to discuss these issues in our policy circles.

Fourthly, some Committees were appointed, which made suggestions for marginal changes, viz., nature of control, fiscal or financial. Control mentality itself was not questioned.

Finally, we applied for a big loan from IMF under Extended Fund Facility (EFF). In Indian Parliament, there was a criticism about India going to IMF for a loan, but nobody questioned why we came to a situation that forced us to go to

IMF. In fact, the Finance Minister was happy with IMF being blamed by the Parliament and not the Government.

Perhaps, we lost a valuable opportunity to learn, reorient and review our own policies.

Ministry of Finance (1990-93)

After a few years in government and academics, I went back to the Ministry of Finance as Joint Secretary in 1990. By then, we were under severe balance of payments stress. This turned into a crisis in 1991. We had to initiate reforms immediately. I was involved in both crisis and reform from the point of view of balance of payments and external sector management.

There are several lessons that can be drawn from this experience.

Firstly, being a closed economy does not guarantee that we will not be affected by external sector problems. In fact, we were a closed economy but we have been continuously facing shortage of foreign exchange, and in this case, a crisis.

Secondly, the crisis was triggered by war in Iraq and jump in global oil prices on top of disruption of trade with Russia. However, it was the domestic vulnerabilities that got us into the problems. We had been living on borrowed time and borrowed money. We liberalised imports and entry conditions for industry, but did not make corresponding adjustments in other aspects, namely, exports and exit from sick units.

Thirdly, the endorsement of International Monetary Fund was critical to our managing the crisis, even after using our gold.

Fourthly, a number of studies conducted by IMF and World Bank on Indian economy, in a way, helped us prepare our own version of managing the crisis and managing the reform. In particular, we had differences with IMF on raising NRI deposits to meet the crisis and on capital account management. Yet, it did not hurt our relationship.

Finally, from the reform point of view, we believed in relatively open trade regime, in gradual development of foreign exchange markets and carefully calibrated capital account liberalisation. The foreign exchange budget was dispensed with.

In a way, thanks to the crisis and response from IMF, globalisation was thrust upon us for our own good, in early 1990s; but we were sensible enough to manage globalisation in our own way.

Ministry of Commerce (1993-95)

In Ministry of Commerce, I had three important subjects which related to the global integration.

Firstly, I was designated as the first Anti-Dumping Authority. I had to work on establishing procedures and processes for its work. The Authority was empowered to levy duties in case of imports which are considered to be "dumped"; that is sold at less than its cost to capture market. This is a safeguard that

accompanies when we reduce tariffs and move towards global integration in trade. China and Japan used to be the main suspects in dumping, needing actions by the Authority.

Secondly, I had to deal with overseas investments of Indian corporates. Our experience in the past during control regime was miserable. Yet, I was pleading for liberalisation of rules for our corporates to acquire companies in other countries on the ground that global integration cannot be one way street. We succeeded in liberalising, to some extent, though it happened after I left the Ministry.

In those days, prevailing view which I opposed was that our corporates will take away valuable exchanges; and in any case, what is the point in exporting capital when we were importing capital to bridge our current account deficit.

Thirdly, we had to deal with licensing of export oriented units. While it might have been advisable for China which was a sea of socialist economy, for us it did not make sense. We were a sea of inefficient market economy. We don't require islands of market economy. In the modern system, it is difficult to differentiate the domestic sector and the external sector since the production processes are parts of huge supply chains.

IMF / World Bank (1993-95)

I was a consultant for a few weeks during this period on fiscal affairs in China, Tanzania, Bahrain and Ethiopia. What impressed me most, in my five weeks in China, was their keenness to learn from others. They stated that their goal was to beat U.S.A. in every aspect of economic strength by 2020.

In India, my friends in China told me, we tend to think that we know a lot.

<u>Deputy Governor, RBI</u> (1996-2002)

As Deputy Governor, Reserve Bank of India, for six years I was in charge of the external sector. Hence, I was closely associated with the most rapid phase of globalisation of our finance.

We started feeling the effects of global developments on us and vice versa. Even though our level of integration was still at the initial stage, we had to manage the contagion due to the Asian crisis, global reactions to nuclear tests, particularly, U.S. sanctions, developments in Russia and Brazil and Y2K uncertainties. Fundamental and structural changes were brought about in the foreign exchange regime in anticipation of changes in the law.

The new law, viz., Foreign Exchange Management Act (FEMA) only formalised this policy.

<u>Self-reliance Redefined</u>

Our view of self reliance changed dramatically. I articulated in detail. Let me give an extract from a speech delivered in Chennai on July 13, 2000.

> *"An exploratory redefinition of self reliance could be as follows: First, the reality of global trends in trade in goods and services warrants international competitiveness as a key to a sustainable trade regime. In other words, a differential approach to export sector and import of goods or services is becoming increasingly difficult to operationalise. Consequently, barriers to efficiency, especially physical and*

institutional infrastructure would operate against economic strength and thus against self reliance. It must be recognised that large scale poverty and illiteracy and malnutrition undermine a nation's capacity to achieve and maintain competitiveness.

Second, as Governor Bimal Jalan has been emphasising, adequacy of level of reserves is a key component for managing our external sector. Furthermore, an appropriate exchange rate policy, coupled with price stability as a component of macroeconomic policies is also critical to maintain competitiveness of economy both to facilitate exports and fine-tune imports.

Third, the remotely possible vulnerability on trade account is mainly on import front and it relates to food (for which there is a more than adequate buffer stock); fuel (POL on which imports are still large); and fertilisers (which are essential). Policy initiatives to ensure economies in managing such potential shocks, taking advantage of emerging instruments of hedging would add to a sense of comfort and thus to self reliance.

Fourth, on capital account, there are several developments in regard to international trade in goods and services, international business, technology, cross border flows of capital, etc. that would necessitate a more active management of capital account, with a view to continuously assessing the costs and benefits of liberalisation vis-à-vis control or regulation.

In this context, management of the capital account involves management of control, regulation and liberalisation. Gradualism in liberalisation implies that the mix between controlled, regulated and liberalised capital transactions keeps changing gradually in favour of the latter. In fact, if the option of re-imposing controls to meet

an emergency is contemplated, the management of capital account should always contain control, regulatory and liberalisation options.

Fifth, as an economy becomes more sophisticated, we need to recognise that as other countries find it profitable to invest in India, we too can benefit from selective investments abroad. It is in this context that we have to view Indian investments abroad. It is erroneous to equate all capital outflows with capital flight. In fact, selective investments abroad which are being progressively liberalised could ultimately make a significant contribution to the resilience of Indian industry.

Sixth, there is a need to recognise the resource and other limitations on multilateral and other official bodies to extend adequate support if a large economy like India were to face a highly vulnerable situation. The resource and other constraints on international financial institutions and systems have been demonstrated in the recent Asian crises and hence India has to take extra precautions to minimise vulnerability and continue to be risk averse in this area.

Finally, it is clear that while several initiatives are proposed at the global level, the task of preventing a crisis is essentially a national responsibility though an enabling international environment is sought to be put in place to facilitate action by individual countries. No doubt, in today's globalised world, prevention of crises as well as mitigating the effects require multilateral efforts, but the social consequences of such crisis are to be met by the national governments concerned. In this sense, the ultimate responsibility in regard to crisis prevention and management rests primarily on the policy makers of the countries concerned."

Thus, the concept of self reliance can no longer be defined in terms of degree of openness but in terms of competitive strength in trade in goods and services on

the one hand, and managing balance of payments (supply shocks on trade account and capital flows) to avoid vulnerability on the other.

Briefly stated, currently, self reliance of a country lies in its economic strength and resilience to potential vulnerabilities.

I M F (2002 – 2003)

I moved out of RBI to become an Executive Director in IMF. I was now on the Board of IMF as an important member in managing the IMF. This is a cooperative institution. However, it was a cooperative with unequal membership. We could command respect because we became a lender in 2002-03, in ten years, from being a borrower after pledging gold.

On close quarters, I understood the Fund's programme in Turkey, Brazil, Argentina and Mexico. The most important lesson was very clear. All systemic risks that arise out of globalisation will have to be borne by the government of the country concerned. The only exception may be USA because U.S. Dollar is virtually the world currency. Major sources of risk for a country are government's borrowing in foreign currencies from non-residents and banking system.

Governor (2003-2008)

On the basis of the lessons learnt from the IMF, we from the RBI took a highly nuanced position in regard to external sector.

We differentiated the balance sheets of households, corporates, government and financial intermediaries. We were fairly liberal in regard to households and

corporates, but tight with regard to foreign currency exposure in regard to government and finance. Further, we were not willing to take any chances with global imbalances. Inspite of all the precautions taken, our economy was affected to some extent, that is because the channels of contagion are several, viz., trade channel, finance channel and sentiment channel.

We increased global integration in a dramatic manner while building a war chest of reserves.

Global Perspective of Globalisation (2008-2012)

There are several areas of global economy and national policies that would be subjected to rebalancing as a result of the global financial crisis. Such a rebalancing will have to be based on three factors, viz., the lessons of experience from the events leading to the crisis; the after affects of policies undertaken to manage the crisis; and, the evolving socio-political and economic factors in different parts of the world, including in particular demographic profiles. Rebalancing has to include capital, trade, employment, monetary system, financial architecture, and above all, global power balances. I will summarise views, as expressed in various fora by me at that time (2008-2012).

First, it was assumed that globalization of finance will result in the capital flowing from advanced economies to developing economies, thus helping the developing economies to accelerate the growth potential. However, the global capital has moved uphill, viz., from poor countries to advanced economies, on a net basis. This phenomenon may persist and even intensify in future.

Second, the global trade continues to be a source of hope for growth for many developing countries. However, the enthusiasm for globalised trade is getting moderated in advanced economies due to the crisis and high levels of unemployment. The extent of current unemployment in advanced economies may be partly cyclical and significantly structural. The technical solution to solve this problem is improving the productive capacity of the labour force in advanced economies to match their current standards of living, but their age profiles make it difficult to improve the skills among them. The economic activity in developing countries and in the global economy are likely to increase significantly, and hence trade among developing countries is likely to grow faster than trade between advanced and developing economies. Some of the developing economies may shift their demand to consumption from investment, while in some others, investment may gain priority. The labour costs are likely to increase in some of the developing economies. Overall, replacement of advanced economies as the locomotives of growth in global economy by the emerging market economies may be inevitable, but may occur over a longer term than widely believed.

Third, the employment trends in global economy have been particularly disturbing after the global financial crisis. The globalization of capital has enabled capital to move to areas where labour is least expensive. This also brought about unionization of global capital along with deunionisation of labour at the national level. The bargaining power of labour has been considerably eroded both by technological progress and breakdown of its union power (capital is mobile across countries, but labour is not), though this phenomenon is more prevalent in advanced economies than developing economies. The interplay of employment,

demography, migration, and globalization may be more challenging for public policy in future. In addressing these issues, inequalities and social cohesion within each country may dominate the discourses.

Fourth, the international monetary system is described as non system because the dominant global reserve currency, viz., U.S. Dollar is not subjected to market discipline, and is not bound by any globally agreed set of rules. The weaknesses have been recognised, but no feasible new system is on the horizon. Replacement of one national currency with another will not solve the fundamental problems of such a non-system. Replacement of one currency with multiple currencies may diversify the risks, but the externalities will push the system towards dominance of one currency. SDR is essentially an accounting unit and not a currency. A global currency is not feasible without a global monetary authority endowed with powers to expand money supply, contract money supply and act as a lender of last resort, when essential. In fact, the problems arising out of current monetary non-system may be more complex in future than those before the crisis because of the threat to U.S. Dollar position over the medium to long terms, without a viable alternative.

The limitations of the present global financial architecture comprising IMF, World Bank, WTO, and possibly G20, are well-known. Improvements in their resources as well as governance have been made, but by all accounts they are marginal. There are signs of diminishing returns from G20, though there is promise of greater role in future. These considerations give rise to a strong possibility of lack of substantial improvement in global monetary and financial systems, and

possibility greater uncertainties and tensions in the global monetary system and financial architecture.

Fifth, there are efforts to improve the financial regulation in the global economy, and in particular designing minimum standards of regulation in different countries. Regulation of cross-border activities and financial conglomerates, has gained attention, particularly after the recent developments. There is considerable skepticism about effective regulatory regimes in the major international financial centres simply because they can continue to be global financial centres mainly through soft regulation. Further, globalization of finance without globalization of fiscal management may pose problem as illustrated by the experience in Euro Zone. Experience has shown that financial sector problem spillover into fiscal, and fiscal problem can impact financial sector in a variety of ways.

Finally, there is an increasing recognition that global power balances would shift from West to the East, and in particular, to Asia. There is considerable consensus that incremental economic activity in the global economy and incremental trade will shift considerably to the developing economies, in particular, Asia. It is not very clear whether financial intermediation will undergo a corresponding shift. More important, in terms of institutional capital and human capital, the advanced economies are way ahead of the developing economies. The shift of global power balances is also influenced by the social and cultural factors.

India will inevitably be an important part of the shift in power balances.

Conclusion

I want to place on record my appreciation for the work done by Centre for Policy Studies since its launch on 2nd October 1995. I am expecting that it will have an influential future not only because of the growing importance of Visakhapatnam as a Metropolitan city, but also because of the interaction between intellectuals, academics, experts and practitioners that the Centre is trying to promote.

I wish the Centre and all those closely associated with it, all the very best.

Thank you.