

Justice Konda Madhava Reddy Memorial Lecture

Globalization And Challenges Before India

Memorial Lecture - Globalization And Challenges Before India

"GLOBALIZATION AND CHALLENGES BEFORE INDIA"

Sixth Justice Konda Madha Reddy Memorial Lecture

By

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On

20th December 2003

Hyderabad

I deem it a great honour to deliver the Sixth Justice Konda Madhava Reddy Memorial Lecture. I did not have the privilege of knowing Konda Madhava Reddy personally. However, I have heard of him and read about him. He was a legal luminary who became the Chief Justice of High Courts of Andhra Pradesh and Bombay. It was philosopher Whitehead who said, "The art of progress is to preserve order amid change and to promote change amid order". Judiciary has an important role to play in maintaining order and promoting change. If the judiciary in India emerged as a strong pillar supporting the democratic society, it is because of the legacy of eminent jurists like Justice Madhava Reddy. It is a great privilege to be invited to deliver the lecture named after him. I propose to speak to you this evening on "Globalization and Challenges before India".

Globalization has become an expression of common usage. While to some, it represents a brave new world with no barriers, for some others, it spells doom and destruction. It is, therefore, necessary to have a clear understanding of what globalization means and what it stands for, if we have to deal with a phenomenon that is willy-nilly gathering momentum.

Globalization and its Meaning

Broadly speaking the term 'globalization' means integration of economies and societies through cross country flows of information, ideas, technologies, goods, services, capital, finance and people. Cross border integration can have several dimensions-cultural, social, political and economic. In fact, some people fear cultural and social integration even more than economic integration. The fear of "cultural hegemony" haunts many. Limiting ourselves to economic integration, one can see this happen through the three channels of (a) trade in goods and services, (b) movement of capital and (c) flow of finance. Besides, there is also the channel

through movement of people.

Historical Development

Globalization has been a historical process with ebbs and flows. During the Pre-World War I period of 1870 to 1914, there was rapid integration of the economies in terms of trade flows, movement of capital and migration of people. The growth of globalization was mainly led by the technological forces in the fields of transport and communication. There were less barriers to flow of trade and people across the geographical boundaries. Indeed there were no passports and visa requirements and very few non-tariff barriers and restrictions on fund flows. The pace of globalization, however, decelerated between the First and the Second World War. The inter-war period witnessed the erection of various barriers to restrict free movement of goods and services. Most economies thought that they could thrive better under high protective walls. After World War II, all the leading countries resolved not to repeat the mistakes they had committed previously by opting for isolation. Although after 1945, there was a drive to increased integration, it took a long time to reach the Pre-World War I level. In terms of percentage of exports and imports to total output, the US could reach the pre-World War level of 11 percent only around 1970. Most of the developing countries which gained Independence from the colonial rule in the immediate Post-World War II period followed an import substitution industrialization regime. The Soviet bloc countries were also shielded from the process of global economic integration. However, times have changed. In the last two decades, the process of globalization has proceeded with greater vigour. The former Soviet bloc countries are getting integrated with the global economy. More and more developing countries are turning towards outward oriented policy of growth. Yet, studies point out that trade and capital markets are no more globalized today than they were at the end of the 19th century. Nevertheless, there are more concerns about globalization now than before because of the nature and speed of transformation. What is striking in the current episode is not only the rapid pace but also the enormous impact of new information technologies on market integration, efficiency and industrial organization. Globalization of financial markets has far outpaced the integration of product markets.

Gains and losses from Globalization

The gains and losses from globalization can be analyzed in the context of the three types of channels of economic globalization identified earlier.

Trade in Goods and Services

According to the standard theory, international trade leads to allocation of resources that is consistent with comparative advantage. This results in specialization which enhances productivity. It is accepted that international trade, in general, is beneficial and that restrictive trade practices impede growth. That is the reason why many of the emerging economies, which originally depended on a growth model of import substitution, have moved over to a policy of outward orientation. However, in relation to trade in goods and services, there is one major concern. Emerging economies will reap the benefits of international trade only if they reach the full potential of their resource availability. This will probably require time. That is why international

trade agreements make exceptions by allowing longer time to developing economies in terms of reduction in tariff and non-tariff barriers. "Special and differentiated treatment", as it is often called, has become an accepted principle.

Movement of Capital

Capital flows across countries have played an important role in enhancing the production base. This was very much true in 19th and 20th centuries. Capital mobility enables the total savings of the world to be distributed among countries which have the highest investment potential. Under these circumstances, one country's growth is not constrained by its own domestic savings. The inflow of foreign capital has played a significant role in the development in the recent period of East Asian countries. The current account deficit of some of these countries had exceeded 5 per cent of the GDP in most of the period when growth was rapid. In fact, at the peak, the foreign capital inflow into Malaysia in 1993 was 17.4 per cent of its GDP, while in Thailand in 1995 it was 12.7 per cent of the GDP. Capital flows can take either the form of foreign direct investment or portfolio investment. For developing countries the preferred alternative is foreign direct investment. Portfolio investment does not directly lead to expansion of productive capacity. It may do so, however, at one step removed. Portfolio investment can be volatile particularly in times of loss of confidence. That is why countries want to put restrictions on portfolio investment. However, in an open system such restrictions cannot work easily. Even in relation to foreign direct investment, one concern has been expressed. There is the fear that some part of the domestic economy will be controlled by external factors. In India, it is very often referred to as the "East India Company Syndrome". However, there is an increasing realization on the part of transnational companies not to act in a manner inconsistent with the policies of countries in which investment is made. Even in the recent East Asian crisis, it was found that foreign direct investment was a stable element. While to some extent fresh capital inflow was moderated, there was no outflow of foreign direct investment.

Financial Flows

The rapid development of the capital market has been one of the important features of the current process of globalization. While the growth in capital and foreign exchange markets have facilitated the transfer of resources across borders, the gross turnover in foreign exchange markets has been extremely large. It is estimated that the gross turnover is around \$ 1.5 trillion per day worldwide. (Frankel 2000). This is of the order of hundred times greater than the volume of trade in goods and services. Currency trade has become an end in itself. The expansion in foreign exchange markets and capital markets is a necessary pre-requisite for international transfer of capital. However, the volatility in the foreign exchange market and the ease with which funds can be withdrawn from countries have created often times panic situations. The most recent example of this was the East Asian crisis. Contagion of financial crises is a worrying phenomenon. When one country faces a crisis, it affects others. It is not as if financial crises are solely caused by foreign exchange traders. What the financial markets tend to do is to exaggerate weaknesses. Hard instinct is not uncommon in financial markets. When an economy becomes more open to capital and financial flows, there is even greater compulsion to ensure that factors relating to macro-economic stability are not ignored. This is a lesson all developing

countries have to learn from East Asian crisis. As one commentator aptly said "The trigger was sentiment, but vulnerability was due to fundamentals".

Concerns and Fears

On the impact of globalization, there are two major concerns. These may be described as even fears. Under each major concern there are many related anxieties. The first major concern is that globalization leads to a more inequitable distribution of income among countries and within countries. The second fear is that globalization leads to loss of national sovereignty and that countries are finding it increasingly difficult to follow independent domestic policies. These two issues have to be addressed both theoretically and empirically.

The argument that globalization leads to inequality is based on the premise that since globalization emphasizes efficiency, gains will accrue to countries which are favourably endowed with natural and human resources. Advanced countries have had a head start over the other countries by at least three centuries. The technological base of these countries is not only wide but highly sophisticated. While trade benefits all countries, greater gains accrue to the industrially advanced countries. This is reason even in the present trade agreements, a case has been built up for special and differential treatment in relation to developing countries. By and large, this treatment provides for longer transition periods in relation to adjustment. However, there are two changes with respect to international trade which may work to the advantage of the developing countries. First, for a variety of reasons, the industrially advanced countries are vacating certain areas of production. These can be filled in by developing countries. A good example of this is what East Asian countries did in the 1970s and 1980s. Second, international trade is no longer determined by the distribution of natural resources. With the advent of information technology, the role of human resources has emerged as more important. Specialized human skills will become the determining factor in the coming decades. Productive activities are becoming "Knowledge intensive" rather than "resource intensive". While there is a divide between developing and the advanced countries even in this area - some people call it the digital divide - it is a gap which can be bridged. A globalized economy with increased specialization can lead to improved productivity and faster growth. What will be required is a balancing mechanism to ensure that the handicaps of the developing countries are overcome.

Apart from the possible inequitable distribution of income among countries, it has also been argued that globalization leads to widening income gaps within the countries as well. This can happen both in the developed and developing economies. The argument is the same as was advanced in relation to inequitable distribution among countries. Globalization may benefit even within a country those who have the skills and the technology. The higher growth rate achieved by an economy can be at the expense of declining incomes of people who may be rendered redundant. In this context, it has to be noted that while globalization may accelerate the process of technology substitution in developing economies, these countries even without globalization will face the problem associated with moving from lower to higher technology. If the growth rate of the economy accelerates sufficiently, then part of resources can be diverted by the state to modernize and re-equip people who may be affected by the process of technology upgradation.

The second concern relates to the loss of autonomy in the pursuit of economic policies. In a highly integrated world economy, it is true that one country cannot pursue policies which are not in consonance with the world wide trends. Capital and technology are fluid and they will move where the benefits are greater. As the nations come together whether it be in the political, social or economic arena, some sacrifice of sovereignty is inevitable. The constraints of a globalised economic system on the pursuit of domestic policies have to be recognised. However, it need not result in the abdication of domestic objectives.

Another fear associated with globalization is insecurity and volatility. When countries are inter-related strongly, a small spark can start a large conflagration. Panic and fear spread fast. The downside to globalization essentially emphasizes the need to create countervailing forces in the form of institutions and policies at the international level. Global governance cannot be pushed to the periphery, as integration gathers speed.

Empirical evidence on the impact of globalization on inequality is not very clear. The share in aggregate world exports and in world output of the developing countries has been increasing. In aggregate world exports, the share of developing countries increased from 20.6 per cent in 1988-90 to 29.9 per cent in 2000. Similarly the share in aggregate world output of developing countries has increased from 17.9 per cent in 1988-90 to 40.4 per cent in 2000 (IMF, 2001 and table 4B). The growth rate of developing countries both in terms of GDP and per capita GDP has been higher than those of the industrial countries. These growth rates have been in fact higher in 1990s than in the 1980s. All these data do not indicate that the developing countries as a group have suffered in the process of globalization. In fact there have been substantial gains. But within developing countries, Africa has not done well and some of the south Asian countries have done better only in the 1990s. While the growth rate in per capita income of the developing countries in the 1990s is nearly two times higher than that of industrialized countries, in absolute terms the gap in per capita income has widened. As for income distribution within the countries, it is difficult to judge whether globalization is the primary factor responsible for any deterioration in distribution of income. We have had considerable controversies in our country on what happened to the poverty ratio in the second half of 1990s. Most analysts even for India would agree that the poverty ratio has declined in the 1990s. Differences may exist as to what rate at which this has fallen. Nevertheless, whether it is in India or any other country, it is very difficult to trace the changes in the distribution of income within the countries directly to globalization.

India and the External Sector

India's economic policy towards foreign trade and foreign investment in the first four decades after India's Independence was restrictive. Import substitution constituted a major element of country's foreign trade and industrial policies. The approach to foreign investment was equally constrained. The deficit on the current account was met mainly by borrowing and particularly from official sources. India's share in world exports which stood at 1.85 per cent in 1950 fell to 0.58 per cent in 1992. In the wake of the economic crisis that overtook the country in 1991, the approach to and content of economic policy underwent a far-reaching change. This change was reflected in trade and investment policies. An outward orientation began to emerge. Tariff rates have been steadily brought down while quantitative controls have been dismantled. Foreign

investment policy has become proactive. Majority ownership by foreign investors is allowed over a wide spectrum of industries. Authorised foreign institutions are allowed to invest in Indian stock markets. The exchange rate of the rupee is by and large determined by the forces of supply and demand, although the central bank does intervene to avoid instability and volatility.

How has the Indian economy fared as a result of the steady opening up? India's growth rate has definitely been higher in the period following 1992-93, even though there are concerns about falling growth rate in the recent years. The current year is expected to show a sharp increase in growth rate. In relation to the external sector, the situation has been comfortable. In fact the management of the external sector is a success story of the post liberalization period. The current account deficit which peaked to 3.2 per cent of GDP in 1990 has been declining and has remained low. The foreign exchange reserve of the country has been increasing and is close to \$ 100 billion. The import growth rate has not shown any alarming rise. In fact, the average annual growth rate of non-oil imports during the last five years (1997-98 to 2001-02) is just 5.4 per cent. The increasing integration has not resulted in a jolt to the economy. However, many concerns have been raised in relation to the impact of globalization on Indian industries, agriculture in general and food security in particular and on the stability of the financial sector.

While recognizing the fact that the Indian economy in the last decade has become more open, it is also necessary to note that the Indian economy is much less open than many other economies. Taking the most commonly used indicator of openness which is the proportion of import and export of goods and services to GDP, it is seen that this ratio has increased from 15 per cent in 1980 to 25 per cent in 1998. However, this ratio of 25 per cent is much smaller than many other countries. For small countries like Malaysia and Singapore with a high outward orientation, this ratio exceeds 200 per cent. Among the industrially advanced countries, the United States is the only country which has ratio similar to that of India. Tariff levels are another indicator of openness. Here again, while India's weighted mean tariff rate has come down from 49.8 per cent in 1989-90 to 29.5 per cent in 1999, it is still high compared with many other countries. While the weighted average tariff rate is nil for Hong Kong and Singapore, it is as low as 2.7 per cent in European Union countries and 2.8 per cent in the US. However, it is of significance to note that the standard deviation of the tariff rates in US is high at 11.4 per cent which means that the rates on certain products are very high.

Framework of Policy

What should be India's attitude in this environment of growing globalization? At the outset it must be mentioned that opting out of globalization is not a viable choice. There are at present 148 members in the World Trade Organisation (WTO). Some 25 countries are waiting to join the WTO. China has recently been admitted as a member. What is needed is to evolve an appropriate framework to wrest maximum benefits out of international trade and investment. This framework should include (a) making explicit the list of demands that India would like to make on multilateral trade system, (b) measures that rich countries should be required to undertake to enable developing countries to gain more from international trade and (c) steps that India should take to realize the full potential from globalization.

Demands on the Trading System

There is considerable concern about the series of negotiations in the WTO. Developing countries including India should project strongly their viewpoint at these negotiations. Without being exhaustive, the demands on the multilateral trading system should include (1) establishing symmetry as between the movement of capital and natural persons, (2) delinking environmental standards and labour related considerations from trade negotiations, (3) zero tariffs in industrialized countries on labour intensive exports of developing countries, (4) adequate protection to genetic or biological material and traditional knowledge of developing countries, (5) prohibition of unilateral trade action and extra territorial application of nation laws and regulations, and (6) effective restraint on industrialized countries in initiating anti-dumping and countervailing action against exports from developing countries.

The failure of the last Ministerial Round in Cancun is fresh in the memory of everyone. The failure brought out sharply the differences between the developing and developed countries regarding the approach to multi-lateral trade. The breakdown of negotiations was due to two sets of issues. The first related to agriculture and the second to the so-called 'Singapore -Issues' covering investment, competition policy, transparency in government procurement and trade facilitation. The developing countries have long claimed that agriculture in the industrially rich countries has been enormously subsidized preventing the developing countries an access into these markets. What the developing countries demanded at Cancun was to eliminate the distortions in the trade in agriculture commodities created through the high level of subsidies in the developed countries. However, the developed countries showed no inclination to reduce the agriculture subsidies. Under these circumstances a level playing field was impossible. Similarly, the developing countries have also argued for a long time that the so-called Singapore issues were not related to trade directly and had to be dealt with, if at all, in other fora. The failure of the Cancun negotiations should not be treated by anybody as a triumph. There are gains to be achieved from multi-lateral trade. All efforts should be made to bring the warring parties together and an attempt made to bridge the gaps.

To some extent, conflicts among countries on trade matters are endemic. Until recently, agriculture was a major bone of contention between U.S. and E.U. countries. Frictions are also bound to arise among developing countries as well. When import tariffs on edible oil were increased in India, the most severe protest came from Malaysia which was a major exporter of Palm Oil. Entrepreneurs in India complain of cheaper imports from China. In the export of rice, a major competitor of India is Thailand. If development is accepted as the major objective of trade as the Doha declaration proclaimed, it should be possible to work out a trading arrangement that is beneficial to all countries.

Rich Country Initiatives

The purpose of new trading system must be to ensure "free and fair" trade among countries. The emphasis so far has been on "free" rather than "fair" trade. It is in the context that the rich industrially advanced countries have a role to play. They have often indulged in "double speak". While requiring developing countries to dismantle barriers and join the main stream of international trade, they have been raising significant tariff and non-tariff barriers on trade from

developing countries. Very often, this has been the consequence of heavy lobbying in the advanced countries to protect 'labour'. Although average tariffs in the United States, Canada, European Union and Japan—the so called Quad countries—range from only 4.3 per cent in Japan to 8.3 per cent in Canada, their tariff and trade barriers remain much higher on many products exported by developing countries. Major agricultural food products such as meat, sugar and dairy products attract tariff rates exceeding 100 per cent. Fruits and vegetables such as bananas are hit with a 180 per cent tariff by the European Union, once they exceed quotas. The tariffs collected by the US on \$ 2 billion worth of imports from Bangladesh are higher than those imposed on imports worth \$ 30 billion from France. Even in the case of dismantling the Multi-Fibre Agreement (MFA), it is stretched up to 2005 and has been back loaded so that much of the benefits will accrue to countries like India only towards the end. In fact, these trade barriers impose a serious burden on the developing countries. It is important that if the rich countries want a trading system that is truly fair, they should come forward to reduce the trade barriers and subsidies that prevent the product of developing countries from reaching their markets. Otherwise the pleas of these countries for a competitive system will sound hollow.

Actions by India

The third set of measures that should form part of the action plan must relate to strengthening India's position in international trade. India has many strengths, which several developing countries lack. In that sense, India is different and is in a stronger position to gain from international trade and investment. India's rise to the top of IT industry in the world is a reflection of the abundance of skilled manpower in our country. It is, therefore, in India's interest to ensure that there is a greater freedom of movement of skilled manpower. At the same time, we should attempt to take all efforts to ensure that we continue to remain a frontline country in the area of skilled manpower. India can attract greater foreign investment, if we can accelerate our growth with stability. Stability, in this context, means reasonable balance on the fiscal and external accounts. We must maintain a competitive environment domestically so that we can take full advantage of wider market access. We must make good use of the extended time given to developing countries to dismantle trade barriers. Wherever legislations are required to protect sectors like agriculture, they need to be enacted quickly. In fact we had taken a long time to pass the Protection of Plant Varieties and Farmer's Rights Bill. We must also be active in ensuring that our firms make effective use of the new patent rights. South Korea has been able to file in recent years as many as 5000 patent applications in the United States whereas in 1986, the country filed only 162. China has also been very active in this area. We need a truly active agency in India to encourage Indian firms to file patent applications. In effect, we must build the complementary institutions necessary for maximizing the benefits from international trade and investment.

Changes in the foreign trade and foreign investment policies have altered the environment in which Indian industries have to operate. The path of transition is, no doubt, difficult. A greater integration of the Indian economy with the rest of the world is unavoidable. We must recognise that there are many countries, which are knocking at the doors of World Trade Organization (WTO) to enter. It is important that Indian industry be forward looking and get organized to

compete with the rest of the world at levels of tariff comparable to those of other developing countries. Obviously, the Indian Government should be alert to ensure that Indian industries are not the victims of unfair trade practices. The safeguards available in the WTO agreement must be fully utilized to protect the interests of Indian industries.

Indian industry has a right to demand that the macro economic policy environment should be conducive to rapid economic growth. The configuration of policy decisions in the recent period has been attempting to do that. It is, however, time for Indian industrial units to recognise that the challenges of the new century demand greater action at the enterprise level. They have to learn to swim in the tempestuous waters of competition and away from the protected waters of the swimming pools. India is no longer a country producing goods and services for the domestic market alone. Indian firms are becoming and have to become global players. At the minimum, they must be able to meet global competition. The search for identifying new competitive advantages must begin earnestly. India's ascendancy in Information Technology (IT) is only part by design. However, it must be said to the credit of policy makers that once the potential in this area was discovered, the policy environment became strongly industry friendly.

Over a wide spectrum of activities, India's advantage, actual and that which can be realized in a short span of time must be drawn up. Of course, in a number of cases, it will require building plants on a global scale. But this need not necessarily be so in all cases. In fact the advent of IT is modifying the industrial structure. The revolution in telecommunications and IT is simultaneously creating a huge single market economy, while making the parts smaller and more powerful. What we need today is a road map for the Indian industry. It must delineate the path different industries must take to achieve productivity and efficiency levels comparable to the best in the world.

Globalization, in a fundamental sense, is not a new phenomenon. Its roots extend farther and deeper than the visible part of the plant. It is as old as history, starting with the great migrations of people across the great landmasses. Only recent developments in computer and communication technologies have accelerated the process of integration, with geographic distances becoming less of a factor. Is this 'end of geography' a boon or a bane? Borders have become porous and the sky is open. With modern technologies which do not recognise geography, it is not possible to hold back ideas either in the political, economic or cultural spheres. Each country must prepare itself to meet the new challenges so that it is not being bypassed by this huge wave of technological and institutional changes.

Nothing is an unmixed blessing. Globalization in its present form though spurred by far reaching technological changes is not a pure technological phenomenon. It has many dimensions including ideological. To deal with this phenomenon, we must understand the gains and losses, the benefits as well as dangers. To be forewarned, as the saying goes, is to be forearmed. But we should not throw the baby with bath water. We should also resist the temptation to blame globalization for all our failures. Most often as the poet said, the fault is in ourselves.

Risks of an open economy are well known. We must not, nevertheless, miss the opportunities that the global system can offer. As an eminent critic put it, the world cannot marginalize

India. But India, if it chooses, can marginalize itself. We must guard ourselves against this danger. More than many other developing countries, India is in a position to wrest significant gains from globalization. However, we must voice our concerns and in cooperation with other developing countries modify the international trading arrangements to take care of the special needs of such countries. At the same time, we must identify and strengthen our comparative advantages. It is this two-fold approach which will enable us to meet the challenges of globalization which may be the defining characteristic of the new millennium.

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