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## ROLE OF LIBERAL IDEOLOGY IN ECONOMIC REFORMS AND FOREIGN POLICY OF INDIA

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### ABSTRACT:

*In the era of Globalisation, Indian foreign policy has enmeshed itself in liberal ideology paradigm. It has led Indian foreign policy makers to take specific domestic reforms at the domestic level and to compete itself in the global market. Essentially these economic reforms became a part of its economic diplomacy to pursue the economic growth of the country. This paper is looking into the process of India's economic diplomacy in post liberalization era. This is analysed in the broader framework of the role of Indian economic diplomacy in economic liberalization and growth of its economy.*



**KEY WORDS:** *Globalisation, Indian Foreign Policy, Liberal Ideology, Economic Reforms and Growth.*

### INTRODUCTION:

Indian economic foreign policy took a new shift to pursue its national economic interest in 1990s. It gradually embraced more liberalist principles. Major drivers of Indian foreign policy are based on the principles of liberalisation (Ogden 2014:53) related to the deregulation of economy from the public sector. In the history of liberalization in India, some minor shifts were introduced in the mid-1980s in the domestic economy through partial liberalization. This process was speeded up after balance of payment crisis in 1991. It forced India to introduce new changes in the domestic economy. It led the way to a free market economy. This led India to abandon economic independence as a national policy in favour of an open economy. India's increasing political and economic engagement with key players of the global politics can be seen as a natural outcome to economic liberalization. Raja Mohan (2003) pointed that it was felt essential to derive the full benefit of economic diplomacy and to discontinue the thinking which sees national security and trade policy in separate and compartmentalised manner. No doubt, from the strategic point of view the issue of the economy has traditionally been sidelined. But in 21<sup>st</sup> century, these issues are also playing a major role in the liberal strategy of India. The debate over foreign policy continues to focus on issues such as the nuclear test, war and peace with Pakistan, dissimilarities with China in context of India's military capability, continuous disputes with small neighbouring countries, the cross border terrorism and forming strategic partnerships with key powers. These issues have remained central focus of India's current diplomacy. But along with it, the access to market and the issue of trade has opened up unprecedented prospects of integration with world market. The market integration at global level led Indian foreign policy makers to reorient foreign policy based on liberal economic ideas.

## Tracing the Foreign Policy of Economic Reforms and Growth in Industrial Policy and Foreign Direct Investment

After independence, state led economic growth model was adopted by India. The time period between 1950s to the mid 1980s was dominated by the idea of more centralised planning and regulated system. As a result economy stagnated at 3.5% what is to grow at the Hindu rate of growth (Sisodia 2014:182). The Swadeshi approach which was adopted by the Indian leaders on the basis of principle of self-sufficiency, emphasised on domestic production and limited international engagement. The strategy was intended to make India strong and to discourage the interest of the outsiders (Ogden 2014:54). It is to be illustrated that at the beginning of reforms period, India's tariff were among the highest in the world. Most of the service sector in India for a long time have been in the public realm. It suffered not only from the high barriers to trade but also from local restraints.

The liberalisation of economy beyond 1991 led to a boom in India's economic growth. The earlier approach was grounded on import substitution model of development. Indian economy came under twin crisis faced through uncontrollable balance of payments crisis and high rate of inflation. The root cause might be drawn from macro-economic mismanagement. It instigated high fiscal shortfall and in particular the revenue deficit. The more fundamental change in Indian economy was precipitated by the gulf war that led to a spurt in the oil price and the balance of payment crisis of 1991. In this situation, India was left with only a two billion dollars of reserves. These reserves were only sufficient to cover two weeks of imports. It took India to take the recourse of structural adjustment policies of International Monetary Fund. When India faced the crisis of external balance of payment obligations, the Indian government got a US\$2.2 billion from IMF and promised to reduce state control and integrate Indian economy with global economy (Ogden 2014:57). At this stage, Indian economic foreign policy started to adopt those measures in foreign relations which were beneficial for India's economic growth. These measure were seen as the major instruments of economic diplomacy of Indian foreign policy.

The Rao government in 1991 recognised that it is necessary to redesign India's economic strategies and built a more export oriented and globally linked policies. These policies were earlier practiced by South Korea and Japan and after that by South East Asian tigers Singapore, Indonesia, Thailand and Malaysia to a certain extent. In just two decade these countries got the high growth in their economy that led to the improvements in the living standards of the society. The People's Republic of China which had adopted the principles of liberal economy under the leadership of Deng Xiaoping was progressing speedily in world economy. In this situation, India had to adopt a policy which would enable to retain the position of a major player in international politics. It ushered for new economic reforms in India. Manmohan Singh, then finance minister in his address in parliament described the results of excessive government control and indiscriminate protection to domestic industry. He explained the need to expose the Indian industries to world market and foreign direct investment. Since then many structural reforms have taken place. Many initiatives were taken to liberalise foreign direct investment and trade policy. Through these major steps Indian economy tried to integrate with global economy.

The economy was liberalised to resume the growth at a higher rate. With the subsequent reforms in Indian economy, this higher rate of growth has been maintained. These reforms in Indian policy contributed to the growth of Indian economy. India took a shift in economic policies in the 1990s to become an outward economy. Increased openness of the economy was felt that it will speed up the process of modernization of the economy. It was also hoped that India will be able to get the access of the world market and develop the world standard skills (Baru 2006: 115). These reforms opened vista to integrate the Indian economy with the global market. Achieving major economic stabilisation was the major priority for India. It was identified that macro-economic balance based on the careful integration of Indian economy with global economy would deliver a rigorous substance for long term reforms. These reforms tried to reduce fiscal and revenue deficits. Before the reforms in Indian economy, national budget was marked by revenue and capital account deficits. The revenue deficit reflected the yearly consumption spending by the government over its yearly revenue. The main reasons of this

revenues deficit were excessive employment in the government sectors, a growing interest burden, regulation of prices of goods and services by public sector enterprises, mounting subsidies and rising defence expenditure. After reforms budgetary exercise was concentrated on increasing tax bases by counting services, dropping rates of direct taxes for corporations and individuals, eliminating most export subsidies, taking down import duties, rationalizing sales taxes by announcing a modified value added tax, rationalising both direct and indirect tax, tax incentive for infrastructure and export leaning sectors containing special economic zones, simplification of processes and efforts for refining the competence of administrative system through digitalization.

### **Industrial Policy Reforms and Foreign Direct Investment:**

The primary object of the government was seen as enlarging and creating foreign capital inflows and technology acquisition and market access appear as secondary objective. Earlier foreign investment policy of India was very selective and it was observed by foreign investors as unfavorable. The percentage of equity permitted to foreign stakeholders was limited to a maximum of 40% excluding few high technology areas. It was discouraging in the consumer goods sector. Since the liberalisation, India has liberalised the foreign investment policy at a faster rate. As a result, most of the sectors have been covered under the foreign direct investment. Rao Government announced the industrial policy reform in 1991. It put an end to the licensing system. It opened up the foreign investment in wider area. At a single point of time, the statement of industrial policy dated July 24, 1991 abolished investment licensing. This provision terminated the public sector control in various sectors. Along with it, it started a policy of automatic endorsement for foreign direct investment up to 51% (Panagariya 2008:104). Many of industries in India were freed from licensing and other restrictions. At the same time, international collaboration was encouraged. At that time of reform period, the new policy restricted the public sector control to eight areas. These sectors were chosen on security and strategic ground. These areas were arms; ammunition; defence equipment including warships and aircrafts; coal and lignite; atomic energy; mining of ferrous; minerals oil and railway transport. All other areas were unrestricted to private players. Different kind of provisions were incorporated in Companies Act (Panagariya 2008: 104). Companies Act aimed at streamlining and updating the legal outline for governing cooperate sector. At that time even many critical areas were opened for private sector. For example, hydrocarbon sector, electric generation, production and refining petroleum exploration have brought under private sector. Telecommunication also came under the ambit of private sector (Ahluwalia 1994:4). After the new industrial policy statement of 1991, government policies ended on power, oil, hydrocarbons, air transport and telecommunication, and licensing requirement were abolished (Ogden 2014:57-58). The new industrial policy opened new vistas for liberalization of Indian economic foreign policy by inviting foreign direct investment and relaxing the norms of foreign direct investment in different sectors. Now, the foreign direct investment is allowed across several industries in India. The norms for FDI in many sectors like telecom, oil refineries, defense, public sector units has been relaxed. The cap on foreign direct investment has increased in different industrial sectors. FDI cap was increased in insurance from 26% to 49%. FDI in telecom sector was raised to 100%. In defence, FDI limit is 49%. Foreign direct investors can go up to 100% equity in India.

There are two types for the restrictions on FDI. In 11 sectors, foreign direct investment is not allowed to invest and at the same time some sectors are subject to ceiling on FDI and it needs specific approval from the government (Rao and Dhar 2011:66). The new policy is more supportive to foreign direct investment up to 51%. FDI was allowed up to 51% in multiple priority areas and direct and indirect taxation reduced (Ogden 2014:58). The capital market opened up to foreign institutional and portfolio investors. Foreign investors were allowed to buy into stocks and mutual funds. At the same time, Indian companies were allowed to list on stock markets abroad (Baru 2006:116). In present time, the Modi government has tried to reach out to the United States, Japan, Australia, China, and Southeast Asian Countries for foreign direct investment in India. The campaign of "Make in India" is one important aspect of the foreign direct investment in India. It can be said as the most important tenant in the foreign policy of India. The FDI inflow to India is increasing over the period. It was 1705 million US

dollars in 1990. This has increased to 16881 US dollars in 2006. This has increased from 0.5% to 5.7% in the same period (Sen 2008: 10).

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