Coping with Globalisation

Speaking Points
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- Globalisation, as we all know, offers both opportunities and challenges. To cope with globalisation, one has to first of all recognize the potential opportunities and challenges, and accordingly pursue appropriate policies to harness the benefits while containing the costs. In the sphere of public policy debate, one often comes across quite contrasting views on globalisation. While some view globalisation as a means to higher growth and prosperity, to some others globalisation appears to be the harbinger of poverty, inequality and financial instability. In the context of the fact that globalisation seems to be increasingly irreversible, the important policy challenge that the policy makers confront today is how to manage globalisation more effectively so that it can benefit all those who participate in the process, whether voluntarily or out of compulsion.
- Globalisation leads to convergence of economies. As a result, every country gets access to larger markets, more capital, and better technology, each of which can potentially raise the capacity of a country to grow faster. It has been observed that countries pursuing sound macroeconomic policies and having strong and resilient financial systems can reap the benefits of globalisation. Conversely, bad policies in a globalised world may bring with them more severe and several adverse effects on growth and development, and in some cases even economic/financial crises. Severity of financial crises that affected several emerging markets in the last decade involving notable loss of output and employment, and concerns about globalisation induced growing inequality – both across countries and within economies – have brought to the fore the adverse effects of globalisation more than the benefits delivered by globalisation so far. The need for creating the right policy environment to contain the spillover of these

adverse effects has often been reflected in the speed, sequencing and content of reforms implemented by the globalising economies.

- The need for coping with globalisation at the policy level primarily arises from three factors: (a) growing synchronisation of business cycles, (b) the fear of contagion affecting countries with sound economic fundamentals, and (c) the transitional dislocations arising from economic restructuring undertaken under globalisation induced competition, which often give rise to loss of income and employment for certain sections of the society.
- During a global economic slowdown, insulating domestic growth from the global effects becomes difficult, as is being experienced by several countries in the last two years or so. Degree of economic integration with the global economy becomes a key factor in such occasions in determining the extent to which a country can be insulated. Synchronisation of business cycles has also led to some degree of convergence in the stance of both monetary and fiscal policies, leading to some loss of policy independence stemming directly from growing economic interdependence.
- With increasing globalisation, exchange rate developments have also become more contagious, partly resulting from change in competitive conditions brought about by change in exchange rate of a competing country, and largely on account of change in sentiments guided by broad generalization of assessments by investors across countries having somewhat similar economic structures but completely different levels of exposure to vulnerabilities. Globalisation of finance has also been a prominent feature of the recent phase of globalisation, and sudden shifts in portfolios by international investors from a number of countries guided by developments in any particular country has also made contagion a major source of risk. Appropriate sequencing of liberalization of the capital account, right choice of an exchange rate regime, small size of the short-term debt, and a credible self-insurance policy in the form of comfortable

reserve level can help in limiting the exposure of a country to contagion, particularly when it has sound fundamentals and a strong financial system.

- As regards the social costs of globalisation, the policy approach could be to put in place appropriate compensatory system, to compensate the section that suffers output and employment loss as a result of globalisation, with the majority who benefit from globalisation contributing in an operationally meaningful manner to finance and sustain the compensatory financing arrangements. Such arrangements in the form of safety nets need to be strengthened at both global and national level to deal with inequality across countries and within economies.
- A global system that aims at addressing the adverse effects of globalisation must necessarily emphasise higher and more effective aid, greater market access for the less developed countries, transfer of appropriate technology and less restrictive immigration policies in developed countries to facilitate freer movement of both skilled and unskilled labour. At the national level, the role of the state must necessarily change alongside growing globalisation so as to give a new dimension to the notion of welfare state over time. Besides being vigilant to avoid market failures, preparing the weaker sections to face the globalisation better amid rising living standards for the masses must become the primary goal of a welfare state. In view of the fact that the unskilled and underprivileged may have to suffer the most due to globalisation, public expenditure on education and health becomes a key component of the strategy to make the state more effective in dealing with the challenges of globalisation.
- It has often been viewed that global economy requires global governance to cope with the challenges of globalisation. In this context, I would reiterate my earlier position[1] that international institutions and international community must play a supportive role in resolving a crisis whenever it

[1] Remarks at the symposium of Central Bank Governors hosted by the Bank of England in London on July 05, 2002

occurs in any country. IMF, which is one of the key institutions in the present system of global governance, can play such role if it can meet the following essential requirements:

A substantial increase in its lendable resources in line with increase in the size of international capital flows in the 1990s.

A greater automaticity in the availability of finance, subject to a country following reasonable macro-economic policies.

Much larger voting power for the developing countries. It is one of the ironies of the last fourty years that, although developing countries as a group have grown much faster than the developed countries and their relative economic strength in terms of output and trade has increased substantially, their actual voting power in Bretton Woods institutions has tended to decline.

- Having joined the process of globalisation relatively late, India benefited from the experiences of early globalisers. As I have mentioned on earlier occasions[2], even though there are extreme views on globalisation – both for and against – neither is correct. The only rational view could be to accept it as an emerging and powerful global reality which has a momentum of its own. Our job as an independent nation/state is to ensure that we maximize the advantage for our country and minimize the risks. Unlike the earlier phases of globalisation, at least our destiny is in our own hands in this phase of globalisation. From our own experience, as I have mentioned earlier[1], there are three fundamental requirements for a country to prevent a financial crisis.

Careful monitoring and management of exchange rates without – I emphasise without – a fixed target or a preannounced target or band. Flexibility in exchange rates is essential, so also is the ability to intervene, if and when necessary.

A policy to build a high level of foreign exchange reserves which takes into account not only anticipated current account

[2] Speech on "India and Globalisation" delivered at the Thirty Sixth Convocation Address of the Indian Statistical Institute, Kolkata, on January 15, 2002.

deficits but also “liquidity at risk” arising from unanticipated capital movements.

A judicious policy for management of capital account. While short term debt capital for financing investment and growth has to be avoided, non-debt capital – both in the form of foreign direct investment and portfolio investment have to be encouraged.

These three principles have been the hallmark of our policy framework for managing our external sector in the last one decade, particularly after the Asian crisis of 1997. This crisis prevention framework has worked well in the face of growing globalisation of the economy.

- India can not be viewed as a highly globalised economy in terms of any commonly used indicator of globalisation. India’s shares, for example, in world trade and global FDI flows are only about 0.7 per cent and 0.4 per cent, respectively. The policy environment in India today, however, is much more globalisation friendly than what it used to be a decade ago. At every stage of major external sector liberalization, starting from the switchover to the flexible exchange rate, to full liberalization of current account transaction, to the dismantling of tariff and non-tariff barriers, there were concerns that large scale outflows may give rise to significant volatility in the exchange rate. In reality, not only India’s exchange rate exhibited notable stability in a market determined regime, but there has been continuous accretion to the foreign exchange reserves. One must take note of the fact that despite two major shocks to the economy – in the form of a drought and in the form of high and rising international oil prices – Indian economy continued to achieve one of the highest growth rates in the World with inflation remaining low and stable. High foodgrain stocks and comfortable foreign exchange reserves represent the two key domestic safety nets to deal with such shocks to the economy.
- The sources of comparative advantage of nations – which can largely determine the capacity of a country to benefit from globalisation – have

changed dramatically in this phase of globalisation. Earlier sources of such comparative advantage such as factor endowments, geographical location and early starts in industrialization continue to be relevant today. Due to “services revolution”, “mobility of capital” and the “death of distance” caused by advances in technology, however, the importance of the traditional sources of comparative advantage has waned considerably. India can benefit immensely from such developments because: (a) India has a tremendous advantage in the supply of knowledge-based services because of its developed structure of technological and other educational institutions, and (b) it is possible to unbundle production of different types of goods and services so that India need not always depend on low-cost production of certain types of goods when it can efficiently supply services required for the production/maintenance/use of such products. We must recognize that the primary sources of comparative advantage today are skills and ability to adapt to change and India possesses the skills, entrepreneurship and managerial competence to strengthen the comparative advantage of India in this current phase of globalisation. Transition to a more globalised economy , however, can take place only over time and the process need not always be painless. In this context, we must recognize that there is no uniform brand of globalisation that could suit the requirement of every country. Our public policies have to respond to our own requirements rather than to any fixed global ideology or a predetermined and internationally prescribed model of economic progress. In India, the approach of gradualism that characterizes its globalisataion process and the appropriate policy responses to deal with adverse shocks induced by globalisation have yielded the desirable results.

- India’s average growth in the last one decade remained one of the highest in the world and this growth performance was achieved amidst declining poverty, low inflation, and a stable exchange rate. This phase of globalisation witnessed significant liberalization of restrictions facilitating greater integration in the trade and capital account. Peak tariff rates fell from 355 per cent in 1990-91 to just 30 per cent in 2002-03. Quantitative restrictions on imports were also liberalized progressively. Restrictions retained earlier on BoP considerations were also phased out. Despite these liberalization of restrictions on imports and removal of restrictions on the payments and transfers in the current account that made the current account convertible, the BoP position continued to remain sustainable and in fact showed modest surplus in the recent quarters. Even though import dependence of the economy increased during this period – which is reflected in the increase in the import to GDP ratio from 8.8 per cent in 1990-91 to 11.9 per cent in 2001-02 – exports also exhibited strong performance resulting in an increase in export to GDP ratio from 5.8 per cent to 9.3 per cent during the corresponding years. In recent years, strong performance of software exports and remittances – both reflecting the importance of investment in education and skill acquisition – have clearly demonstrated the benefits of globalisation to India, particularly in terms of their role in imparting significant strength and resilience to India's BoP.

- Liberalisation of restrictions on capital account transactions were initially guided by the consideration of altering the composition of capital flows in favour of non-debt flows, and within the category of debt flows in favour of long-term flows. The response to liberalisation has been heartening so far, with the non-debt flows in the form of FDI and portfolio flows accounting for more than 50 per cent of total capital flows to India. Share of short-term debt in total debt is also as low as only about 3 per cent now. FDI flows to India have increased from less than US$100 million in 1990-91 to US$ 3900 million in 2001-02. Portfolio flows during the corresponding period have gone up from less than US$ 10 million to about US$ 2000 million. Non-debt flows have in fact been more than sufficient to finance the modest deficit in the current account in the last several years.

- This phase of globalisation has also seen notable improvement in the poverty scenario of the economy. The number of people living below poverty line declined from 36.0 per cent in 1993-94 to 26.1 per cent in 1999-2000. There are different views in India on what happened to income-inequality and regional disparity during the last decade of reform. Higher growth is the only instrument that can cope with these challenges in the most effective and durable manner. Globalisation can more directly enhance the growth prospects of an economy, and by delivering higher growth it can also address other social concerns, particularly using the functions of a welfare state.
- In India, the benefits of globalisation need to be communicated more effectively with the masses to evolve consensus on several critical policy decisions. We must recognize that those who are against globalisation in reality want a better globalisation that delivers egalitarian prosperity to the masses. The benefits of globalisation, therefore, have to be realized and demonstrated so as to elicit greater support for policies aimed at deepening the process of globalisation.