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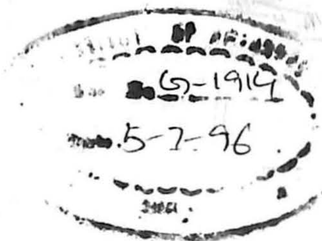

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About the Author

Dr. C.T. Kurien, currently Emeritus Professor in the Madras Institute of Development Studies was the Director of the Institute for a decade during its formative period. For many years prior to it, he was professor of economics at the Madras Christian College.

Professor Kurien is the author of more than a dozen widely acclaimed books, all of them dealing with aspects of the Indian economy. His latest publications have been *Growth and Justice* (OUP, 1992). *The Economy : An Interpretative Introduction* (Sage, 1992) and *Global Capitalism and the Indian Economy* (Orient Longman, 1994). The last one, situating India's economic reforms in the context of the emerging global capitalist economy, and written in a manner that any interested reader can follow, received overwhelming welcome.

Recognized as one of the top economists in the country, Dr.Kurien has always viewed the economy as essentially a study of human interactions and has shown a special concern in communicating how economic policies affect the weaker sections in the land.

Preface

This booklet is meant for those who are not familiar with professional economics and yet are eager to know something about the current economic reforms and their impact on different sections of the population. The stated objective of the reforms has been to release the economy from bureaucratic controls and to open it up to external influences, particularly foreign capital. These measures, it is claimed, will enhance efficiency, provide a stimulus to economic growth, and lead to the well-being of the people at large.

What, indeed, has happened during the past four years and more since the reforms were launched in mid-1991? A performance audit of that kind is what the booklet attempts after giving a brief account of the background to the reforms. It is my hope that readers will find it helpful to arrive at an informed assessment of the ongoing economic policies.

The seven chapters of the booklet initially appeared as a series of articles in *Frontline* and were written during November 1995 to January 1996. I have not attempted to update the statistical information for the simple reason that in a rapidly changing situation it is virtually impossible to make all the data up to date. What is important is to get an idea of the underlying rationale and of the sense of direction that the new policies are giving to the economic processes.

I am grateful to Mr N. Ram, Editor of *Frontline* at whose invitation these pieces were written and to Mr. Kavaljit Singh of Madhyam Books who has been responsible for bringing them out in the present form.

C.T. KURIEN

1

Big Claims, Little Preparations

The current economic reforms, claimed to be an attempt to alter the basic parameters of economic policies since Independence and to restructure the economy drastically, were launched a few days after a Government under the leadership of P. V. Narasimha Rao was formed at the Centre following the 10th general elections of May-June 1991. The Congress(I), whose leader Narasimha Rao became after Rajiv Gandhi was assassinated, had not gone to the polls with any proposals for deep-rooted structural changes or radical policy revisions. As will be shown below, the party's election manifesto did not give indications of any major departure from past policies; what it promised was a continuation of what the party in office had pursued in the 1980s. Hence, it is reasonable to state that the reforms taken up by the new Government were not considered by the electorate prior to their sudden initiation.

In the elections to the State Assemblies held since June 1991, the Congress(I) was thrown out of power in Karnataka, Andhra Pradesh, Gujarat and Maharashtra. It regained Madhya Pradesh and Himachal Pradesh. Its performance in Uttar Pradesh was

miserable and in Rajasthan it did not fare much better. It failed to come to power in the newly-formed State of Delhi. Whether such poor performance at the State level of the party ruling at the Centre should be interpreted as a rejection of one of its major policies by the people will continue to be debated. But it is at least evident that the policies of the Congress(I) have not enthused the people at large. Be that as it may, there can be no doubt that in the elections to the Lok Sabha to be held in the first half of 1996, the economic reforms will figure as a prominent issue. It is, therefore, important that there must be an informed debate about the nature and implications of the reforms. While the reforms are basically about the economy, the decisions relating to them have been primarily political. The economy has some regularities (often referred to as "laws") within it, but economic decisions, especially those relating to its structure and parameters of economic policy, are larger social decisions finding expression through the political processes. Hence the first to be noted is the political background to the reforms.

When the 1991 elections were announced, the Congress(I) was out of power, had been out of power since November 1989. The Prime Minister who recommended to the President the dissolution of the Lok Sabha and the holding of fresh elections (long before the term of the ninth Lok Sabha was to end) was Chandra Shekhar. He, along with a few MPs who owed allegiance to him, had broken away from the Janata Dal and had come to power with the support from outside of the much larger Congress(I) in the Lok Sabha. This followed the collapse of the National Front Government under the leadership of V. P. Singh, which remained in power for less than a year with the support of the Bharatiya

Janata Party (BJP) on the one hand and the Left parties on the other. The Chandra Shekhar Government fell when the Congress(I), which had initially propped it up, withdrew that support.The Congress(I) went to the polls with Rajiv Gandhi as its leader. Rajiv Gandhi had introduced his New Economic Policy (NEP) after he came to power late in 1984. The accent of the NEP of 1985 was a liberalisation of the economy, particularly removing some of the restrictions on industrial production which had remained in vogue from the time of the Second Five Year Plan in the mid-1950s. The economic aspects of the Congress(I)'s election manifesto of 1991 were essentially a celebration of the achievements of Rajiv Gandhi's NEP, mainly of the over 5 per cent annual rate of growth the economy had come to have during his term as Prime Minister. The manifesto reaffirmed its "commitment to the path of planning for development, the seeds of which were sown during the freedom struggle" though there was also a recongition of the need for the "simplification of the regulatory system bringing in new technology and increasing competitiveness for the benefit of the common man" and for a "leaner, more dynamic and profit-oriented public sector".

If the economic reforms announced after the party formed the Government in June 1991 amounted to a "U-turn" in economic policy—export promotion as against import substitution, reliance on the market in place of direction by the state, prominence for the private sector instead of dominance by the public sector, openness to the international economy and to foreign capital rather than accent on protected domestic activities—as has frequently been claimed by the ardent supporters of the reforms, there is little trace of it in the party's manifesto. On the other

hand, the two governments since 1989 were criticised for the mismanagement of the economy and for derailing the economic policies established by Rajiv Gandhi. The accent was clearly on *restoring* the economy to the "stability and progress" of 1984-89 and not on *reversing* the economic regime built up since Independence, for which the Congress party claimed credit. The National Front Government and its successor were blamed for their "profligacy" which left the coffers empty and for the sharp increase in prices of early 1991, for burdening the country "with a huge fiscal deficit", for leading it to a major balance-of-payments crisis, and for meeting "the entire development expenditure and part of consumption expenditure from borrowed resources".

These aspects will have to be examined in detail subsequently, but let us continue with the political background to the reforms. The 1991 elections started in May in the northern States. The expectations about the final outcome of the elections differed, but there was a general feeling that as in 1989, no single party would command a majority in the Lok Sabha. There were even doubts as to whether the Congress(I) would emerge as the party with the largest number of seats. Then came the tragic assassination of Rajiv Gandhi, and the holding over of the elections by a few weeks. After an initial attempt to persuade Sonia Gandhi to accept the leadership of the party failed, the struggle for leadership which followed made it clear that there was no obvious leader. P. V. Narasimha Rao, the senior most among the leaders, but by no means the most prominent, was elected president of the party.

The second part of the elections was held in June, and when all the results were known, it turned out that the Congress did emerge as the largest single party with 224 seats. Though it could

command 240 votes with the help of its allies, mainly the All-India Anna Dravida Munnetra Kazhagam (AIADMK) with 11 members, it was still about 20 short of a majority. The leadership of the party in Parliament became an issue, and the more serious contenders, Sharad Pawar and Arjun Singh, each realising that there was no chance for him in the event of an open contest, finally decided in favour of Narasimha Rao as a "consensus" candidate. Narasimha Rao, it is important to recall, had not contested the Lok Sabha elections, and till the assassination of Rajiv Gandhi dramatically turned the events, was considered an elderly man, practically fading out of active politics. It was he who became the Prime Minister, late in June 1991, leading a minority Congress(I) party in the Lok Sabha.

But as later events have shown over and over again, Narasimha Rao is an astute politician with exceptionally high skills to protect his political survival and leadership. It was his reckoning that if he could remain Prime Minister, there would be little threat to his position in the party. He figured also that neither the BJP, which with 123 members had emerged as the second largest party in the Lok Sabha, nor the National Front-Left combine with a strength of around 130 could seriously challenge his position as long as they could be prevented from joining hands against him and his party. He was confident too that the newly-elected members of Parliament and political parties in general would not favour an immediate dissolution of the Lok Sabha. On these considerations Narasimha Rao felt relatively secure, though he was leading a party that did not have majority strength in the Lok Sabha. Consolidating his position as Prime Minister and as the undisputed leader of the party was the real issue. This task, he

perceived, called for some dramatic action. The economic situation presented him an excellent opportunity to demonstrate decisive and brave action.

In the economic sphere there was a crisis, and an unprecedented one in some respects. The foreign exchange reserves of the country in June 1991 had reached a dangerously low level, around $1 billion, hardly sufficient to meet the import bill for a fortnight. Imports were going up, and the cost of import too was increasing because of the rise in the price of oil following the Gulf war. The Gulf war had also led to a sharp fall in remittances from abroad that added to the payments problem. It was further confounded by the withdrawal of the foreign exchange that NRIs had deposited in the country. In the meanwhile, India's borrowing from other countries, especially from private parties, had reached a conspicuous level and it was not certain how repayments that were due at that time would be met. Taking all these into account, international credit rating agencies had expressed doubts about India's creditworthiness. That became a signal for the reluctance of private foreign creditors to lend to India any more, particularly because of the palpable political uncertainties.

Narasimha Rao had to act and act soon Where was he to turn to for advice on a variety of technical aspects of the problems? It is not easy to know for sure who his advisors were at that time, the few days he had in which decisions had to be made, but in a recent study, a Delhi-based economist, presumably with some inside information on these matters, has said: "The most comprehensive critique of the Indian economy and specific advice for restructuring Indian economy is contained in the often cited Report of the World Bank on the Indian Economy (1990).

This Report is said to have served as a reliable guide for designing several of the post-1991 economic reforms in India. A confidential paper originating from the Prime Minister's Office (believed to have been authored by Montek Singh Ahluwalia) circulated in 1990 seems to have greatly influenced the designing of post-June 1991 economic reforms". (Charan D. Wadhva, *Economic Reforms in India and the Market Economy,* 1994, p.29).

Several countries in the world, especially from Latin America, had experienced acute balance of payments problems and external debt crises in the 1980s, and the two international institutions, the International Monetary Fund (IMF) and the World Bank, had worked out a formula, usually known as the Fund-Bank formula, to deal with the situation. A balance of payments problem, according to these two powerful agencies, reflects a malfunctioning of the price system, the price in this case being that of the concerned national currency. If the price of the currency were free to move up and down, it would regulate the quantity of exports and imports and their values would balance as a fall in the price of the currency would favour exports and a rise would quicken imports. But if the price of the currency is artificially maintained high by the interference of the state, the excess of imports over exports will precipitate a payment problem. Hence, a sure remedy for dealing with a country's balance of payments problem is devaluation of the currency. This, briefly, is a very simplified statement of the Fund-Bank formula.

Its underlying assumption is that the economy (at all levels, national and international) works best when prices—all prices—are free to move as the forces of the market indicate. It has implications too. Interferences with the price mechanism, such

as subsidies, must go. The state which, in most instances, imposes such interferences must withdraw from economic activities except to the extent that is absolutely necessary. Symbolising such withdrawal is the dismantling of public sector enterprises where they exist. The economy must, thus, be left substantially to private enterprises which will ensure that resources (particularly capital) are used in the most efficient manner. But capital does not respect national boundaries; it is global. The free movement of capital into and out of countries and the unhindered operation of the market in all spheres are, therefore, the operational counterparts of the Fund-Bank formula or doctrine. It takes different names, globalisation, liberalisation, privatisation, and so on, all covered by a most appealing word "reform".

Narasimha Rao, who was searching for something spectacular, must have found this formula backed by the prestige, authority and power of the two global agencies, quite appealing mainly because it was available ready-made. All he needed was someone who would implement it. And he made a brilliant choice: Manmohan Singh, with his record as one of the country's ablest economic technocrats, a former Deputy Chairman of the Planning Commission, a former Governor of the Reserve Bank, wellknown in international circles as the former Secretary-General of the South Commission and, above all, a person with a clean record and one known for his sense of compassion.

Manmohan Singh apparently had serious reservations about the Fund-Bank doctrine. The South Commission's Report of 1990, which should be presumed to have had his concurrence as Secretary-General, recalled the fact that in the closing years of the 20th century the leading countries of the North were practising in the

economic sphere the 'gunboat diplomacy' of the 19th century. Manmohan Singh must have endorsed the view expressed in the Report: "A network of relationships has been built up among private entities—banks, investment houses, transnational companies—in the leading developing countries. This has served to strengthen the influence of decisions made by private bodies on world economic activity, and to that extent to limit the effectiveness of governmental policy decisions." Also that the IMF/World Bank policies had left developing countries "with almost no discretion in determining their economic policies" and that "although both institutions now officially endorse the concept of growth oriented adjustment, the truth is that... their increased involvement in domestic policies of developing countries in the 1980s did not promote either growth or equity in the South." Whatever his position had been on these matters, when the call of duty came, he accepted it and agreed to be Narasimha Rao's Finance Minister to implement the reforms whose author, he repeatedly acknowledges, has been his leader, P. V. Narasimha Rao. Such is the political background to the instant economic reforms launched in June 1991.

The economic background to the reforms may also be recalled. Planned economic development since Independence, in which the state took an active role to stimulate economic growth through a more active utilisation of the human and physical resources, had made a perceptible difference to the economy. The country had overcome the chronic threat of inadequate foodgrains to meet the needs of a rapidly growing population, and had become practically self-sufficient as far as consumer goods were concerned. The industrial base had expanded and become

substantially diversified. Infrastructural facilities had vastly improved though they were still inadequate in some crucial aspects.

However, in the early 1980s, after three decades of largely state-directed development, there was a feeling that the time had come for the private sector of the economy to play a more active role in the development process. Since agriculture was almost entirely under private auspices, the change was to be reflected essentially in the industrial sector. In particular, it was felt that controls and regulations that were necessary when the economy was weak were hindering productive activity under the new circumstances. A shift from planning the economy to the management of the economy was considered necessary and possible. Changes in this direction were initiated by Indira Gandhi after she came back to power in 1980.

What was started by her was taken further by Rajiv Gandhi in the second half of the decade and was given the name, the New Economic Policy. Its thrust was to let the more affluent sections in the country influence the pattern of industrial production by exercising their purchasing power and to enable industry to respond to such indications. There was a sudden spurt in industrial production, mostly in the sphere of consumer durables, and a corresponding "consumer boom". For a while, it appeared that the Indian economy was on a new growth path, but it was rather short-lived. The annual rate of growth, which had moved to the vicinity of 5.5 per cent, considerably above the average growth rate of about 3.5 per cent during the 1950-1980 period, suddenly came down in 1989-90, industrial production being the biggest casualty.

The short-lived industrial boom of the second half of the

1980s, however, gave rise to at least two major problems. The first was a colossal increase in public expenditure and the deficits of the governments, especially the Central Government. The total expenditure of the Central Government was about Rs. 17,800 crores in 1979-80. It moved to Rs. 22,000 crore in 1980-81 and to a massive Rs. 82,000 crore in 1989-90. Since reduction of taxes was part of the NEP, the increase in expenditure could be met only by a sharp increase in public borrowing and by an equally sharp increase in deficit financing. Even the revenue account of the budgets of the Central Government, which till the early 1980s showed a modest surplus available to finance capital expenditure, turned out to be in deficit from the mid-1980s. The overall (fiscal) deficit touched an all-time high of 9.0 per cent of gross domestic product (GDP) in 1986-87, and though it declined a bit thereafter remained still critically high.

Secondly, the sudden increase in industrial production was made possible by pushing up the growth of imports far more than could be covered by exports, necessitating foreign borrowings at rates of interest far higher than what obtained till the early 1980s. This was a reflection of changed conditions in the international financial markets. India's external debt was little less than $20 billion in 1980, reached $40 billion in 1985 and shot up to $82 billion in 1990, giving the country the dubious distinction of being one of the top debtor nations in the world. It also meant that about 40 per cent of export earnings had to be devoted entirely to the servicing of the debt. It order to meet international commitments short-term loans had to be frequently resorted to between 1987 and 1990, a signal to lenders and depositors that a crisis was imminent. It was at this time that the World Bank's Report

of October 1990 advocated a 20 per cent devaluation of the rupee to correct the balance of payments problem. There is not enough evidence to suggest that it was meant as a warning to depositors, but a flight of capital, especially from the Foreign Currency Non-Resident accounts started immediately thereafter. The flight, which amounted to a little over $100 million in October 1990, slowed down in the next few months, but was $370 million in April 1991, $230 million in May and $330 million in June 1991.

There sure was a crisis and that was what Narasimha Rao and Manmohan Singh set out to redeem. But they have been attempting more than that. For, the reforms have been meant not only to solve a temporary crisis, but to correct many of the economy's long-term maladies also. A noble attempt, indeed, except that the problems now detected were caused by the economic policies of the 1980s, which were the policies of their party and in which they had an active role to play. Stranger still, they found it possible in a matter of a few days to figure out what was wrong with the Indian economy and what had to be done to rectify it. An unprecedented change in the economic policy was thus set in motion with little preparation to support it.

2

Structural Adjustments

P. V. Narasimha Rao and Manmohan Singh had decided that the only way to deal with the balance of payments crisis that they were confronted with in June 1991 was to go by the Fund-Bank formula and to ask the International Monetary Fund, of which India is a member, for a standby loan. The IMF as lender has some conditions better known as "conditionalities" attached to such loans. The first of these is that the currency of the country concerned must be devalued. This is rather ironic because one of the main purposes for which the IMF was established towards the end of the Second World War was to help countries faced with balance of payments problems to avoid devaluation of the currency. There are other conditions too. Among them the most prominent are a commitment to reduce the deficits in government's budget, to bring down subsidies and the involvement of the government in economic activities, to encourage private enterprise to be more actively involved in the economy on the basis of market signals and to ensure that foreign capital has freedom of entry into and exit from the country.

It is somewhat strange that though the loans are made available to tide over balance of payment problems, the country concerned is not required to make any firm commitment that that problem will be directly dealt with and rectified within a specified period. The somewhat roundabout procedures indicated to achieve that objective are justified on the grounds that problems relating to external payments are only symptoms of the malfunctioning of the economy as a whole. For instance, large deficits of government normally lead to inflationary pressures within the economy which become a disincentive for exports. And since high levels of taxation are likely to have adverse effects on production and investment, the appropriate way to reduce deficits is to reduce government's expenditure which implies cutting down subsidies. Such are the arguments justifying the package of conditionalities referred to as the Structural Adjustment Programme (SAP).

While the arguments are buttressed by a great deal of sophisticated theory, some of the crucial considerations escape attention, deliberately or otherwise. For instance, the balance of payments problem is still treated as being primarily related to trade, of imports exceeding exports in value. But it is overlooked that in the contemporary situation, balánce of payments problems are frequently precipitated by the "free" movement of capital unrelated to transactions in goods and services, and that in such instances devaluation need not be the best remedy. But the SAP package is considered to have stood the test of time, and major variations are not usually made. In any case, as both the Fund and the Bank are committed to the view that the health and efficiency of the global economy depends on the free movement

of global capital, any problems that such movements may cause to particular national economies are not likely to figure seriously in their reckoning. As a writer has observed, the international lending agencies have a 'key message' which they use to appraise every situation, and the message is: "The primary development objective is maximising growth by allocating funds based on the criteria of highest money rate of return, when prices of goods and factors will reflect their respective scarcity values not only in domestic but in the global context." (S.P. Gupta in *Liberalisation : Its Impact on the Indian Economy,* 1993, p.3). What is being conveyed is that the performance of economies is best judged by the rate of returns to capital and hence the freedom given to capital to move across national boundaries and within national economies is the appropriate operational criterion for evaluating economic performance. The Key Message, of course, will be justified with the help of high-sounding theoretical propositions.

However, only one simple consideration is enough to understand its true implications. The returns to capital are earnings of the owners of capital. Whatever may be its theoretical justification, it thus becomes clear whose interests the Key Message is trying to protect. There is a rather feeble rider to it which goes under the name of the "percolation process", that what is good for the owners of capital will, in the long run, prove beneficial to all. In other words, those who are already in command of capital must be allowed and encouraged to become richer because that is the best way to benefit society as a whole. This exposition should enable a proper appreciation of the many policy thrusts of the Fund-Bank doctrine and the "adjustments" it calls

for which are the conditions under which funds are made available for stablisation and growth.

There is considerable debate as to whether the Fund-Bank combine imposes those conditions on countries that turn to it for support under crisis situations. It depends on how "imposition" is viewed. The sanction of the loan comes on the basis of a round of discussions between the country concerned and the two agencies. A Letter of Intent, or Memorandum, is first submitted by the country when it applies for a loan; it indicates how the country proposes to deal with the problem with the support of the loan. What eventually turns out to be conditionalities are often contained in the document; hence in a formal sense, the conditionalities are suggested by the country concerned. But, of course, those who seek the loan are fairly familiar with the conditions acceptable to the lender.

Whether designed by the lenders or suggested by the borrower, the Indian attempt at stabilisation and structural adjustments on the basis of the loan from the Fund-Bank combine appeared to follow the copy book. The first step was a formal devaluation of the rupee by approximately 20 per cent in terms of the dollar and other major currencies on July 1 and 3, 1991. This was followed by the IMF providing a standby loan of approximately $2.3 billion in eight instalments over a 20-month period; the World Bank approving a Structural Adjustment Loan of $500 million specifically to help in the process of reforms in industrial and trade policy and a further loan of $250 million from the Asian Development Bank. These loans served the immediate purpose of having enough foreign exchange to avoid a payments crisis, but it should be noted that it amounted to fighting the

problem of debts by more borrowing.

The immediate crisis thus resolved, the 'adjustments' of the reform process were taken on in quick succession. The Central Budget for 1991-92 presented by the Finance Minister to Parliament on July 24, 1991 set the tone. Its most drastic and striking feature was the proposal to bring down the fiscal deficit from 8.5 per cent of GDP to 6.5 per cent during the fiscal year, which meant a correction to the tune of about Rs. 12,000 crore during the eight months left before March 1992. This was to be achieved by the abolition of the export subsidies (as the devaluation was expected to provide enough incentives for exports), an increase in fertilizer prices to reduce the element of subsidy, major cuts in non-Plan expenditure of the government, sale of a part of the government equity in selected public sector enterprises and through additional taxation of about Rs. 2,000 crore.

These measures amounted to applying sudden brakes on the economic processes and the jolt was quite clearly felt. But the prime target of the reduction of the fiscal deficit was more than fully met: by the end of 1991-92 it had come down to 5.9 per cent of GDP. But this tightening affected the performance of the economy. The growth of GDP in 1991-92 had come down to 0.9 per cent compared to 4.9 per cent during the crisis year of 1990-91 and 5.6 per cent during 1989-90. But the success in achieving one target led to more doses of reform. The foreign sector continued to be one of the main areas of reform. A new series of freely transferable five-year bonds, known as "India Development Bonds" were launched by the State Bank of India for NRIs, which were exempted from income and wealth taxes in India. It was followed by another scheme called "The Remittances in

Foreign Exchange (Immunities) Scheme 1991" that allowed NRIs and others to bring in foreign exchange without disclosing the sources—obviously aimed at bringing in funds stashed abroad by residents via the NRI contacts.

Foreign investment policies were also substantially revised in sharp contrast to the cautious and restrictive policies of the past. Foreign investment approvals upto 51 per cent of equity in a specified list of 34 priority industries was made automatic, subject only to registration with the Reserve Bank of India. Even investments above 51 per cent equity was permitted on a case-by-case basis subject to the approval of the newly-constituted Foreign Investment Promotion Board (FIPB). The Foreign Exchange Regulation Act (FERA) was amended to remove a number of constraints earlier applicable to firms with foreign equity operating in the country. The NRIs were permitted 100 per cent equity with full benefits of repatriation in industries such as hotels, tourism, hospitals, shipping, export-oriented deep sea fishing and oil exploration. In 1993, real estate transactions were also opened up under the same conditions. Foreign trade policies were also suitably modified, removing many of the direct administrative controls and licensing. Except for consumer goods which remained restricted, almost all items of capital goods, raw materials and intermediates were permitted to be freely imported subject only to appropriate customs duties. Import duties were reduced in stages. The imports of gold and silver were considerably liberalised.

Within the domestic economy, reforms were directed primarily in the industrial sector. The New Industrial Policy was announced by the Industrial Policy Statement of July 1991. It

demolished the industrial licensing system which had prevailed since 1956. Except for 18 industries (later brought down to 16) involving strategic or security concerns, environmental implications or health considerations, all others were delicensed, abolishing all requirements of registration. Entrepreneurs were thus required only to file information in the prescribed format for industrial approvals. The Monopolies and Restrictive Trade Practices (MRTP) Act of 1969 was radically amended permitting considerable freedom for large enterprises in terms of growth and diversification.

The list of industries reserved for the public sector was reduced from 17 to 6. Private sector participation was allowed in most industries even in the reserved list. The policies towards the public sector was also changed. While conceding that many public sector undertakings had performed well, it was noted that as a whole the public sector had not lived up to expectations in the matter of generating surpluses for reinvestment, but that many enterprises had to be supported by the Government. It was, therefore, decided that budgetary support in the form of non-Plan loans to loss-making PSEs would be phased out. Further, public sector equity in selected profit-making enterprises would be disinvested up to 49 per cent partly to mobilise resources for the Budget, but partly also to create a greater commercial orientation in the management of such enterprises.

The reforms were extended into the sphere of taxation also. A Tax Reforms Committee was set up in August 1991 under the chairmanship of Raja J. Chelliah. The committee stressed the importance of lower rates of taxation, a narrower spread between the entry rate and maximum marginal rate, and considerably

reduced special exemptions and deductions as far as direct taxes were concerned. In the case of indirect taxes, the committee recommended a reduction in the general level of tariffs and in the dispersion of tariff rates. Overall, the committee was of the view that moderate taxes combined with fewer deductions and exemptions and effective enforcement would encourage voluntary tax compliance and increase in revenue. Accepting the main thrust of these recommendations, the 1992-93 Budget brought down the maximum marginal rate of personal income tax to 40 per cent. The exemption limit for payment of income tax was raised from Rs. 22,000 to Rs. 40,000. No change was made in corporate taxes initially, but from 1994-95 they too have been reduced and simplified. In tune with the spirit of the reforms, wealth tax on financial assets was abolished. And as part of the process of opening up of the economy, customs duties were considerably lowered. A process of simplification of excise duties was started in 1993-94 and has continued since then.

The reforms in the financial sector, including the banking system, have also been quite striking. An efficient banking system and a well-functioning capital market capable of mobilising savings and channelling them to productive uses were seen as essential arrangements for the kind of structural change envisaged. Though the regulation and nationalisation of banks were considered necessary at one stage, there was a feeling that the banking system had turned out to be "over-regulated and under-governed". It was felt that the system of multiple regulated interest rates, with a large proportion of bank funds pre-empted by the Government through the Statutory Liquidity Ratio (SLR) requirement had weakened the financial health of the banking

system and forced banks to charge very high rates on their commercial lending.Lowering the SLR was, therefore, seen to be a matter of high priority. A decision was made to bring it down in a phased manner from 38.5 per cent in 1992 to 25 per cent during a period of five years. Along with it the Reserve Bank was to bring down the Cash Reserve Ratio (CRR) also. A guarded process of deregulation of interest rates was initiated. Selected nationalised banks were permitted to enlarge their capital base through public issues and private sector banks were assured that they could expand without any fear of nationalisation. Development finance institutions such as the Industrial Finance Corporation and the Industrial Development Bank of India were permitted to raise resources from the market for their expansion.

Stock market reforms were also taken up, especially after the scam of April 1992. The Securities and Exchange Board of India (SEBI) was strengthened and was granted statutory powers to regulate the activities of the players in the capital market. The Capital Issues (Control) Act of 1947 was repealed in May 1992 with the powers exercised by the Controller of Capital Issues transferred to SEBI. Under the supervision of SEBI the private sector was allowed to set up mutual funds, and a National Stock Exchange using modern information technology was set up in Bombay.

These were among the major structural adjustments that significantly changed the features and characteristics of the Indian economy in a short period starting in June 1991.

3

The External Sector

The reforms, it is claimed, have been most successful in re spect of the foreign sector. The unprecedented payments crisis of June 1991 was effectively dealt with, the underlying imbalances relating to foreign trade have been corrected, and above all, the foreign exchange reserves, which had gone down to about U.S. $1 billion in 1991 shot up to an all-time high of over $25 billion in April 1995 (though there has been a slight decline since then). Such are the claims.

The high foreign exchange reserves, it may be noted, do not reflect Indian *earnings* of foreign currencies through any surplus of our exports over our imports, but is more an indication of what has been raised through *loans* and what has come in as foreign investments. In other words, the high foreign reserves India claims to have are not ours, but have simply been parked here for a while, using an analogy from another sphere. What has been borrowed will have to be returned and what has come in as deposits or even as investments can be taken away, though as long as they are here, we may use them to *finance* our foreign transactions such as paying for imports, repayment of loans, and so on. The situation is somewhat similar to an individual who was under

pressure to repay his loans feeling temporarily relieved after he succeeded in raising a bigger loan!

The Finance Ministry's *Economic Survey* 1994-95 gave a detailed account of the roughly $9 billion worth of foreign exchange that became available in 1993-94. It consisted of $1.7 billion external assistance (that is, loans made available on concessional terms by foreign governments), $0.8 billion commercial borrowing, $0.2 billion from IMF, $0.9 billion NRI deposits, $4.1 billion foreign investments, and the rest, "other flows", such as delayed export receipts.

This form of building up of reserves has at least three problems. The first is fairly obvious. Most of these amounts and interest on them have to be repaid some time, perhaps not all at one time. But they do add to the stream of payments in the future. Foreign investments and even foreign loans can be used for productive purposes, thus augmenting the capacity for payments in the future, provided they also add to exports at a later stage. But here it is important to note that not all foreign investment will necessarily augment production and raise exports.

Foreign investment is of two kinds. The first is what is referred to as foreign direct investment (FDI), which is investment of foreign capital into new productive activity which may or may not lead to an increase in exports. (It will not, if production is directed towards the domestic market.) The second form of foreign investment is portfolio investment, that is, foreign capital purchasing the shares of existing Indian companies to claim a share of the profits and to exercise control in the sphere of production. Such investment makes hardly any contribution to production or exports.

Foreign direct investment may be thought of as "sunk" capital, and hence once it is brought in, it may not be easy to take it out immediately. On the other hand, portfolio investment is basically "floating" capital, always on the move in search of avenues of profit. It can go out almost as easily as it comes in. Which creates the second form of problem relating to foreign exchange reserves, an element of volatility in the foreign sector accounts that may not be related at all to exports and imports. It may be related to other conditions in the country, such as the level of the rate of interest in the economic sphere or threat of instability in the political sphere. It may not be related to anything that happens in the country and may be the result of events or situations in other parts of the world. Under such conditions, it will also be highly influenced by speculative activities in any part of the world. Hence, reserves built up on the basis of portfolio investments introduce a big component of not only volatility but also risk into the economy. These aspects may not be noticed when the flow of funds is into the economy as has so far been in the Indian case since the reforms were launched in June 1991. It may not be noticed also if the flow turns out to be in the opposite direction as long as the quantities involved are negligible. But what can happen is that a reverse flow can turn out suddenly from a small trickle into a big flood—a "capital flight" of the kind that took place from India from October 1990 to June 1991—or the more dramatic outflow from Mexico in 1994.

It turns out that the bulk of foreign capital that has come to India consequent to the opening up of the economy has been portfolio investment as can be seen from the *Table 1*.

Table 1

Foreign Investment Inflows *[$ millions]*	1994-95		1993-94		1992-93	
	Amount		Amount		Amount	
Direct Investment	1,314	[26.8]	620	[15.1]	341	[78.7]
Portfolio Investment	3,581	[73.2]	3,490	[84.9]	92	[21.3]
Total	**4,895**	**[100.0]**	**4,110**	**[100.0]**	**433**	**[100.0]**

Note : Percentage to total in Brackets.

Source : Reserve Bank of India, *Annual Report* 1994-95, based on Table 5.3.

Over the three years, almost 76 per cent of foreign capital that has come into the country has been portfolio investment to buy the shares of Indian companies or even to buy up Indian companies as Coca-Cola did with Parle's.

The third problem that movement of funds into and out of the country creates is related: it affects the value of its own currency. The recent (December 95 - January 96) fall in the value of the rupee suggests that India is entering a phase of that kind. Something of the background may be helpful. (For a more detailed discussion, see C. P. Chandrasekhar's column, "Managing a volatile rupee" *Frontline,* December 1, 1995). After the devaluation of the rupee in July 1991, the exchange rate was around Rs. 31.50 for a dollar. After greater convertibility was established, it remained for long relatively stable at Rs. 31.37. This stability was hailed as indicating both the correctness of the measures undertaken and the efficiency of the market mechanism. But the value of the

rupee was not left to the market forces; it was maintained, managed, by the Reserve Bank of India.

Initially, when the foreign funds started flowing in, the demand for the rupee was increasing and there was a tendency for the value of the rupee to appreciate. An appreciation of the rupee would have had an adverse consequence on exports that had begun to pick up. Those who were managing the economy could not afford to let this happen. Hence, the Reserve Bank stepped in to buy dollars and to make rupees available. Through such operation, the value of the rupee was steadily maintained during that phase, till April 1995.

One of the consequences of this operation was increase in domestic price levels which reduced the competitiveness of Indian exports. A correction of this was considered necessary and it was felt that it was safe to leave the rupee to find its level through the market forces. The rupee started slowly depreciating which, however, did not receive much attention as the dollar itself was getting depreciated at this time. The value of the rupee in terms of the yen, the mark, the Swiss franc and the pound did come down. About this time, the gap between India's export earnings and import payments started widening, because, although the growth in exports was quite satisfactory, imports increased rapidly as a result of the industrial recovery. The inward flow of foreign investment also began to slow down. The purchase of dollars for interest payments on foreign loans and for debt repayments too came to be routed through the market.

Thus the demand for dollars increased and the dollar itself staged a recovery in the international currency market and so the fall in the value of the rupee in terms of the dollar became quite

visible. At one stage (the third week of October), it looked as though almost Rs. 36 would have to be paid for a dollar and the Reserve Bank once again decided to intervene, by selling dollars this time, to bring the value to Rs. 34.60.

But the volatility of the rupee has continued. One reaction, including the publicised official reaction, is that the economy overall has been doing well and hence the variations in the external value of the rupee are not a matter of concern, and that in any case, in a market economy all prices, including the price of the currency, will tend to fluctuate a little around the "equilibrium" levels. This view is not valid for a variety of reasons. There is no easy way of knowing, particularly in the case of the currency, what its equilibrium level is. Also, the value of a currency is no longer a reflection of the performance of the rest of the economy and is heavily influenced by many other factors, particularly external factors. And, the volatility of a currency is not a simple matter confined to the external sector.

A predictable consequence of the volatility of a currency is that it invites speculative activity by offering the possibility of making quick profits. Speculation is a major element in the currency markets even under normal circumstances, and where the future is not easily predictable, it assumes major proportions. Those who are eager to buy and sell currencies will be willing to take loans for short periods (sometimes for just a day or shorter) even at high rates of interest. When the "call money market" of this kind thus becomes lucrative, funds from other avenues will be diverted into it and, consequently, there will be squeeze on credits in those avenues. It is quite possible, though it requires more detailed study, that this is the explanation for the frequent

downward movements in the price of shares which is not justified in terms of the performance of the economy, especially the industrial sector.

The adjustment of the external value of the rupee was, in the first instance, meant to stimulate exports, partly for India to come to have a larger share in world trade and partly in the hope that export promotion would lead to higher growth performance. "Export-led" growth is what Singapore, Hong Kong, Taiwan and South Korea are said to have achieved and that is what is recommended for other countries aspiring for rapid growth. However, there is a big difference between these small economies—even South Korea, the largest among the four, has a population of only about 45 million—and India with its huge population and rich natural resources. Foreign trade will naturally tend to be a higher proportion of total production in small countries compared to big countries and so the efficacy of exports as an engine of growth will be limited in the case of the latter. But there is no doubt that India's share in world trade, just about 0.5 per cent, is indeed extremely low. A higher involvement with the rest of the world can certainly be beneficial to India and the opening up of the economy is a step in the right direction if its main purpose is to increase trade.

Exports have, in fact, picked up since 1991. Exports were valued at $18.5 billion in 1990-91, came down a little to $18.3 billion in 1991-92, moved to $18.9 billion in 1992-93 and to $22.7 billion in 1993-94. It is estimated that in 1994-95, the value of exports was $26.7 billion and for the first five months of 1995-96, $12.3 billion. If exports continue to be of that order during the rest of the year, the rate of growth in 1995-96 will be higher

than what was achieved in the preceding year. In terms of GDP, exports were 6.2 per cent in 1990-91, but steadily moved to 9.2 per cent in 1994-95.

The acceleration of exports was partly because during the past couple of years, world trade itself had recovered from the global recession of the late 1980s and early 1990s, but the devaluation of the rupee and other measures adopted for export promotion must have also helped. While the volume of exports has gone up, there is no perceptible difference in its composition since the reforms were initiated. Readymade garments, other textiles, handicrafts, and so on, still have a big lead over other items. In a basket of exports still dominated by traditional items, there has only been a marginal increase in goods from the engineering and chemical industries.

Imports had declined drastically following the devaluation of the rupee in 1991 and the recessionary conditions that followed it. Imports were of the order of $27.9 billion in 1990-91, but had fallen to $21.1 billion in 1991-92. The recovery during the next two years was slow, but in 1994-95 the estimated figure was $30.1 billion. This increase resulted both from the recovery of industrial production and the reduction in import duties. But to some extent it also reflects the increasing import intensity of Indian industrial output arising from the attempt of Indian industries to reduce the technological gap following liberalisation.

With sharp reduction in the import duty on capital goods, import intensity may go up in the future. If so, although exports are going up, the increase in imports may widen the gap between the two. Already some quasi-official projections indicate that the

deficit on trade accounts during 1995-96 may turn out of be of the order of $6.0 billion, far higher than $3.9 billion of 1994-95. The combination of these conditions—a huge deficit on trade account, the slowing down in capital inflows, and the volatility of the rupee—is a matter of concern.

The growth of foreign debt adds another disconcerting note. Heavy foreign indebtedness was something that the Indian economy got into during the liberalisation process of the 1980s, especially during Rajiv Gandhi's New Economic Policy of the second half of the decade. Rapid industrialisation depending on foreign resources through borrowing, especially short-term commercial borrowing, was something that not only India but many other Third World countries were encouraged to take up during that decade. Many of the Latin American countries, Mexico being the most glaring example, had got caught up in a "debt trap" early in the decade, but India's "new growth path" which appeared to avoid that sort of situation was highly commended by international agencies like the World Bank as late as 1989. Even when India's external debt shot up from less than $20 billion in 1980 to $82 billion in 1990 and India suddenly emerged as one of the top debtor nations of the world, there was no recognition that there was a crisis around the corner, which shows how unpredictable conditions in the global economic and financial arena had become. Many of those who took an active role in India's economic policies then admit now that serious errors were made.

Consequently, in the new wave of liberalisation and globalisation, two major differences have been consciously adopted. The first has been to open up the economy to *foreign investment* so that Indian authorities do not have direct

responsibility for repayment. Second, there has been an attempt to reduce the share of commercial borrowing and of short-term debt. But the total external indebtedness of the economy has been going up, though as a proportion of the GDP it has come down. The changing position can be seen from the *Table 2*.

Table 2

External Debt 1990-94 *[$ billion]*					
	1990-91	**91-92**	**92-93**	**93-94**	**94-95**
Total	**82.0**	**84.0**	**90.1**	**91.2**	**94.8**
Of which commercial borrowing	19.6	21.0	21.8	22.9	23.5
Short-term debt	8.5	7.1	6.3	3.6	4.0

Source: World Bank, *India: Country Economic Memorandum, 1995*, based on Table 1.16.

External debt as a percentage of GDP moved up from 28.5 in 1990 to 41.1 in 1992, but came down to 32.9 in the first quarter of 1995. But, the debt service ratio which came down from 31.7 per cent in 1990 to 25.3 in 1994, went up to 27.1 in 1995.

Making an assessment of India's external accounts since the reforms, the World Bank has expressed the view that while they have improved, they still remain vulnerable for a variety of reasons. First, domestic oil production (40 per cent of national consumption now) will level off towards 1998 and oil imports will therefore increase rapidly thereafter. Second, out of the $95 billion external debt, about $24 billion is due to be repaid in the

next four years with a peak of about $7 billion in 1996-97. This means that apart from financing the recurring current account deficit, it will be necessary to mobilise about $40 billion in the next four years. Third, the NRI foreign currency accounts and the high level of portfolio investments can be withdrawn without much difficulty, thus making the economy extremely vulnerable. These are not just "long-term" forebodings either. In view of the problems that the external sector is already facing, the possibility of serious trouble surfacing any time, without much notice, cannot be ruled out.

4

The Domestic Economy

Whatever may be the achievements of the reforms in terms of India's relationships with the global economy, in the final analysis the reforms will be judged, and should be judged, by their impact on the domestic economy and, of course, on how they influence the lives of the Indian people. It is widely recognised too that the opening up of the economy, the greater role envisaged for foreign capital, and the expectation that these, in turn, will bring in technology and usher in competition, are meant as means to stimulate the productive processes within the economy.

There are many standard indicators to evaluate the performance of the domestic economy. Of these, the most widely used is the growth of gross domestic product (GDP), which is the value of goods and services produced in the economy during any given year. The rate of growth of GDP is, thus, the standard indicator of economic performance. It is reasonable to think that growth in GDP will show some annual variation, especially in a country where agricultural output is still a major component of domestic product. But if a longer period than a year is taken into account, it will be possible to figure out the long-term trends from which the

annual changes can be thought of as variations. Hence, in considering the growth in GDP of an economy, both the long-term trend and the short-term variations around that trend must be taken into account.

It has been calculated that the trend rate of growth of the Indian economy was just a little over one per cent per annum during the four or five decades prior to Independence, but that for the first three decades or so after Independence, roughly till the end of the 1970s, the trend rate of growth had gone up to about 3.7 per cent per annum. It indicated an upward shift in the trend growth rate since Independence, reflecting the better performance of the economy. Another upward shift came in the decade of the 1980s when the trend growth rate exceeded 5 per cent per annum. There were variations around this trend. For instance, the growth rate of GDP in 1982-83 was 2.2 per cent, but in 1988-89 it was 10.7 per cent. It may be noted also that low growth rates in one year are usually followed by high rates immediately thereafter: the 1983-84 rate following the poor performance of 1982-83 was 8.1 per cent, and the second growth rate of 1988-89 followed a modest performance of 3.8 per cent during each of the preceding three years.

What has been the experience since the reforms were started? On a year-to-year basis, the growth rates have been 0.9 per cent in 1991-92, 4.1 per cent in 1992-93, 4.4 per cent in 1993-94 and about 5.3 per cent in 1994-95, according to the preliminary estimates. For 1995-96, an advance estimate of 6.0 per cent has recently been made available by the Central Statistical Organisation (CSO), which is responsible for making these calculations. There is no doubt that since the reforms, the Indian

economy has been staging a steady recovery. But the higher rates of growth of the past two or three years, including the 6.0 per cent projected for the current year, are recovery rates which means the economy is still recovering from the downswing that had set in in the pre-reform period since 1988-89. The first impact of the reforms was to depress the economy reflected in the very poor performance of 1991-92. What is significant, however, is that even with the optimistic projections for 1995-96, GDP will still be below the long-term trend. There is a long way to go before it can be stated that the reforms have made any significant difference to the growth of the economy or put it on a high growth rate of the kind that some of the East Asian countries have been showing. Any attempt to compare the four-year period prior to the reforms and the four years since the reforms in terms of the growth performance will not also be particularly meaningful because the former showed a downswing and the latter an upswing. An important question, therefore, is whether the 6 per cent growth expected in 1995-96 can be sustained over a period of at least a few years. From this perspective a testing time for the reforms will be the next five years.

The first four years of the reforms had a fortuitous circumstantial factor—continuously good monsoons which, of course, had its impact on agricultural production in general and foodgrains production in particular. During the decade of the 1980s, agricultural output grew at the average rate of 3.4 per cent with considerable annual variations. The growth of agricultural production in 1991-92 was 2.0 per cent and of foodgrains production 4.5 per cent. Thereafter, both recovered and have been showing steady growth rates. Foodgrains production, particularly, has

been moving from peak to peak. Even so, the performance of the 1990s has not risen above the trend growth rate of the 1980s. And if the monsoons fail in the coming years, as they tend to do from time to time, the performance of the agricultural sector may be adversely affected which, in turn, will have a bearing on overall growth rate too. The estimates given by CSO show that for total agricultural production, there has been a slight decline between 1994-95 and 1995-96.

The reforms have been directed primarily to the industrial sector and hence what has been happening in that sector is a better indicator of their impact. As was only to be expected, during the first years of the reforms with the heavy squeeze on imports, the performance of the industrial sector was seriously affected. In 1991-92 industrial production increased only by 0.6 per cent compared to the preceding year. The performance in 1992-93 was also poor, an increase of just 2.3 per cent. With a little over 4.0 per cent growth in 1993-94, recovery began to become visible and became firm in 1994-95 with a growth of 8.0 per cent. But in the 1980s the trend growth of industrial production was 7.6 per cent per annum and the figures for the 1990s are well below that level. In the 1980s, industrial production picked up very quickly till 1988-89 and then suddenly collapsed. Commenting on the performance of the 1980s, an official assessment said: "The pattern of industrial growth during 1989-90 was significantly different from that in the previous year, or generally, from the previous eight years (1980-81 to 1988-89) when the tempo of industrial growth witnessed a distinct acceleration over the growth rate in the decade of the 1970s.... First, the consumer durable industries... faced a precipitate fall in their growth rate to

1.9 per cent during 1989-90 due to constraints in the consumer demand... Secondly, substantial deceleration occurred... in basic industries and intermediate goods industries." (Reserve Bank of India, *Annual Report,* 1989-90). Can this happen in the 1990s also?

There are two things in common between the two decades, the reliance on foreign resources on the supply side and on the purchasing power of the top income groups on the demand side. Not that the conditions are exactly similar. In the 1980s the foreign resources were accessed almost entirely through borrowing, whereas in the 1990s there is a clear shift favouring foreign direct investment. And yet, there are problems ahead. The first, of course, is that the flow of foreign capital into the economy since it was thrown open has not been much into productive activities (as already discussed in Chapter 3). Second, and more important, the rapid expansion of industrial production in the 1980s has already imposed a severe strain on the infrastructural facilities—transport, communications and power. These are sectors where there is a long lag between the beginning of investment and the actual expansion of capacity. Since the decade started with major bottlenecks in practically all of the infrastructural sectors, they may turn out to be insurmountable constraints in the coming years and the restricting factor on the supply side. On the demand side, the strategy for industrial growth in the 1990s is the same as it was in the 1980s, namely, to rely on the purchasing power of the top income groups.

One of the calculations in this area is that even the top 10 per cent of the Indian population is some 90 million people, a very large market indeed in absolute terms. That big market may sustain industrial production of certain kind for a while, but its

sustainability over time is doubtful. Consequently, a greater spread of purchasing power is a vital requirement for the sustainability of industrial production. Even if it is granted that through the trickle-down effect, purchasing power will percolate to lower levels in the long run, it cannot prevent a forced pace of industrialisation running into demand constraints till that long run is reached.

What has been happening in the agricultural sector, especially in terms of foodgrains production, may illustrate this problem. During the past few years, foodgrains production has been moving up steadily since the end of the 1980s with the exception of 1991-92 when there was a fall in production. From 171 million tonnes in 1989-90, it reached 182.1 million tonnes in 1993-94, and, according to estimates available, was 183 million in 1994-95. But the stocks held by the Government have also been rising correspondingly, reaching embarrassingly high levels—over 30 million tonnes, twice as much as is considered necessary.

How is this to be explained ? As noted already, the increase in production has been owing mainly to favourable weather conditions, and not any supporting policy measures. But as production increases, the "surplus" also appears to be increasing in the form of additional stocks with the Government. To say that a country with a population of over 900 million people is getting satiated with less than 200 million tonnes of foodgrains appears to be rather strange! That because of inadequate purchasing power, the rising foodgrains production cannot be fully absorbed—or that the demand for foodgrains is not keeping up with the production of foodgrains—is a more satisfactory explanation of this otherwise paradoxical phenomenon. It may be noted too that the

stocks with the Government do not automatically increase when production goes up. The Government *purchases* the grain from the large producers and at steadily rising prices so as to avoid a crisis in the foodgrains sector. That is, the deficiency in demand is made good by the Government. The Government undertakes these operations of purchasing from the producers at "remunerative prices" and selling it to the consumers at "affordable prices" through the public distribution system because it is clear that at least the foodgrains sector cannot be left entirely to the "forces of the market". Free market pricing of foodgrains is not a politically feasible proposition.

In the industrial sector, the Government does not usually intervene in the manner it does in relation to foodgrains. But if the deficiency of demand is a problem in the industrial sector also, it will manifest itself in some other form. The pattern is quite familiar. When restrictions are removed or relaxed in what was a controlled economy, the pent-up demand initially provides a stimulus for the production (or import) of certain kinds of goods which were, till then, not available. This will be particularly so where purchasing power is concentrated in the hands of a few and where the products concerned are some high-priced consumer durables. What was so far a "seller's market" where, because of limited supply, the sellers had the upper hand so far (for example, the power to determine the conditions under which the goods will be supplied, including possibly a period of waiting after the order is placed), will begin to ease and the goods concerned will become readily available. After a while, it may turn out to be a "buyer's market" where the producers and suppliers may have to persuade potential buyers by offering them various

forms of concessions and incentives to buy. When markets for several goods are affected in this manner, industry may initially go into a recession as has been happening frequently followed by a collapse in at least some of its segments.

This is what happened in the 1980s, a precipitous fall after a successful crash programme. What is being attempted in the 1990s in the name of reforms is yet another crash programme of industrial growth which is beginning to show the initial spurt. However, since the basic features of the economy, especially in terms of a broader distribution of purchasing power, have not been altered, it is unlikely that this spurt will turn out to be more sustainable than that of the past decade.

Conditions this time are not exactly the same as in the 1980s. The expectation is that because of the availability of foreign capital a more broad-based industrial development programme would be possible, involving even capital goods industries and infrastructural requirements. But, as noted already, foreign capital has not been moving into productive investment to the extent that was anticipated. Also, the latest figures available on industrial production are not very reassuring. According to the CSO, though overall industrial growth during April-June 1995 was considerably higher than what it was during the corresponding period in 1994 (13.3 per cent and 7.3 per cent respectively), there has been a decline as well. Industrial growth, which was 14.9 per cent in April 1995, came down to 10.9 per cent in June. Within the industrial sector, the deceleration has been even more pronounced in manufacturing, from 15.9 per cent in April to 9.8 per cent in June (*The Hindu*, December 2, 1995). Whether these are normal variations or early indications of a downswing cannot be

stated categorically. However, it may be noted that other factors are also beginning to be unfavourable to sustain industrial production. The recent depreciation in the value of the rupee would make imports more costly: the increase in interest rates is also not helpful to industrial growth. We cannot predict what will happen in the next few months or in the coming years, but even on the industrial front, the situation is not as rosy as the defenders of the reforms have been making it out to be.

A major factor affecting the growth of the economy is capital formation. For reasons which have not been adequately explained, gross domestic capital formation, which was 22.2 per cent of GDP in 1985-86, had moved up to a record figure of 27.1 per cent in 1990-91. From then, that is during the reform period, it has been falling steeply, 23.6 in 1991-92, 22.0 per cent in 1992-93 and 20.4 per cent in 1993-94, the latest figure available. Thus, in terms of capital formation, between 1991-92 and 1993-94, the economy has been taken back to a level that it had in the early 1980s.

The same can be said also about gross domestic savings where the level moved up from 19.8 per cent of GDP in 1985-86 to 23.7 per cent in 1990-91 and then declined to 20.2 per cent in 1993-94. In terms of savings, the private corporate sector's performance has considerably improved during this period, from 2.7 per cent of GDP in 1990-91 to 4.0 per cent in 1993-94. But both the public sector and the household sector have performed poorly, the former coming down from 1.0 per cent to 0.2 per cent and the latter from 20.0 per cent to 15.9 per cent. These changes have not been sufficiently studied to provide any satisfactory explanation. But, at least in the case of the household sector, a connection

can be established between the consumerist thrust of the reforms and the fall in the rate of savings.

This account of the performance of the domestic sector of the Indian economy may now be summarised. After an initial fall, the growth rate of the economy as a whole and of the industrial sector has started picking up. But these are in the nature of recovery rates and the performances since the reforms are still below the trend rates of the 1980s. In the industrial sector, there are alreay some signals of a slow down. The agricultural sector did not come much under the impact of the reforms but its performance was maintained mainly because of an unusually long stretch of favourable weather conditions. Domestic capital formation and savings rate have noticeably declined which raises serious doubts about the sustainability of long-term growth unless foreign capital and technology bring about substantial changes in productive processes for which, however, there are no hopeful signs so far.

5

The Role of the State

The role of the state in the functioning of the economy has been one of the most contested issues in the course of the economic reforms. The immediate background to the somewhat negative view about the role of the state in economic affairs was the collapse of the state-dominated economic systems of the erstwhile socialist regimes in Eastern European countries in the late 1980s and the breakup of what was the Union of Soviet Socialist Republics (USSR) during the early years of the present decade. It may be recalled that in the years immediately following the Second World War, it was recognised that under the direction of the state, the economies in these countries succeeded in achieving a high and steady rate of growth on the one hand and in establishing a fairly egalitarian social order on the other.

In some quarters there was the feeling that these achievements had a high cost in terms of suppression of individual liberties and political democracy. But the positive gains on the economic front were seldom in question. Former colonies that emerged as independent countries during the post-War years, including India, therefore, assigned a key role to the state in the

economic transformation they were deliberately striving for. In our Constitution the state has been assigned the responsibility "to promote the welfare of the people by securing and protecting, as effectively as it may, a social order in which justice, social, economic and political, shall inform all the institutions of the national life". The decision to take up planned economic development under the overall direction of the state was the operational part in the economic sphere of that declaration. In a practical sense there has been no country in the world, especially in the second half of the 20th century, where the state did not play a prominent role in economic affairs. Even in leading capitalist countries, such as the United States, the state had emerged as a prominent entity in economic matters either to counteract the periodic cyclical fluctuations or to attend to a wide range of welfare measures, such as doles for the unemployed or security provisions for the aged. However, in the second half of the 19th century a rather abstract model of the economy, efficiently coordinated by the forces of the market alone, had been developed in Europe which was soon picked up in the U.S. During the early years of the Cold War between the two super powers, this model was revived and was projected as the theoretical basis of capitalism governed by competitive markets and resulting in efficiency in economic operations.

Thus, the economies of the world came to be arbitrarily classified into two pure types, capitalist economies following market principles and socialist economies under the domination of the state. Soon, emotive terminologies, such as "free markets" and "free enterprise", seeped into public discourse as scientific expressions of what was basically hidden ideological propaganda. State and market, both of which have their role in any functioning

economy, came to be depicted as antithetical entities, the former identified with socialism and the latter with capitalism. International agencies, such as the World Bank and the International Monetary Fund, not only joined this subtle ideological campaigns, but at one time became the chief propagators of the market ideology. When the collapse of socialist regimes took place, it was interpreted as the vindication of market ideology and the rejection of the role of the state in the economic sphere. Hence, economic reforms under the sponsorship of the Fund-Bank combine insist that a drastic reduction in the presence of the state in the economy is a must. Operationally, the principle is applied in the area of public finance and of the public sector enterprises, with special emphasis on the infrastructural sector. The implication of the current economic reforms in these areas is examined in what follows. In relation to public finance, it has been noted already (*Chapter 2*) that reduction in the deficit of the Government (the Central Government, specifically) was one of the conditions agreed upon as part of the Indian structural adjustments. It has also been noted that the sharp increase in the deficit of the Central Government in the 1980s was one of the underlying causes of the crisis of 1991.

In order to understand the impact of the Government's deficit on the economy, it may be useful to take a look at the Government's accounts that the budgets summarise. There are two major components to the Government's accounts, current or revenue account, and long-term or capital account. The former deals with the day-to-day operations of the Government, primarily administration, and the latter with longer term commitments, especially development. Fiscal prudence would suggest that the

current expenses of the Government should be met out of tax revenues and that the revenue account should show a surplus which can be transferred to the capital account to finance long-term development enterprises. Some borrowing to finance capital expenditure may also be quite legitimate. An important issue to be considered is where pruning should be done if the involvement of the Government in the economy is to be reduced. It is reasonable to suggest that the reduction should come basically on the revenue account and that the revenue account should at least balance with the expenditure being met out of tax revenues. If the revenue account is in deficit, and borrowing becomes necessary, even to meet the routine expenses of the Government, it may be taken as an unhealthy sign.

Apart from this *revenue deficit,* deficits can be calculated in other ways as well. The deficit that figures in the Fund-Bank reckoning is *fiscal deficit,* that is, the excess of the total expenditure of the Government (the expenditure on current items plus capital expenditure) over its non-borrowed revenue. The principle underlying this calculation is that the Government must "live within its means" or that its capital expenditure should be substantially confined to the surplus it can generate in the revenue account. When individuals and private concerns consider it prudent to borrow to finance capital expenditure, why the Government should not resort to the same procedure is worth examining. But there is a more immediate issue that deserves attention. If it is insisted, as the Fund-Bank adjustment calls for, that the fiscal deficit should be brought down, it makes it possible for the Government to achieve the objective by reducing capital expenditure, instead of current expenditure. In other words, it provides the option to the

Government to satisfy its commitment to the external agencies by sacrificing long-term requirements for the development of the economy.

It can be seen what a dangerous option it is. But it is precisely this kind of adjustment that has been attempted by the Indian Government under the reforms. In the very first attempt, the fiscal deficit was brought down from Rs. 44,600 crore in 1990-91 to Rs. 36,300 crore in 1991-92 and the revenue deficit from Rs. 18,500 crore to Rs. 16,200 crore. But in 1992-93 the fiscal deficit moved up to Rs. 40,200 crore and the revenue deficit was back at Rs. 18,500 crore. By 1994-95 they were Rs. 61,000 crore and Rs.34,000 crore respectively.

But, of course, these figures in absolute terms can be misleading. In any case, the commitment has been to bring down the deficits as a percentage of GDP. Hence, it is necessary to see what has been happening over time to fiscal deficit and revenue deficit in relation to the rising GDP. The information is given in Table 3.

Table 3
Deficit of the Central Government

Year	Fiscal deficit	Revenue deficit
	[as percentage of GDP]	
1987-88	8.1	2.7
1988-89	7.8	2.7
1989-90	7.8	2.6
1990-91	8.4	3.5
1991-92	5.9	2.6
1992-93	5.7	2.6
1993-94	7.7	4.2
1994-95	6.7	3.8

Source :Budget papers of the Central Government

It can be seen from the Table 3 that only in the first year of reforms (1991-92) was it possible to bring about a steep fall in the fiscal deficit (column 2). Between 1992-93 and 1993-94, there was a rise of not negligible magnitude. The budget for 1995-96 promised to bring down the fiscal deficit from 6.7 per cent in 1994-95 to 5.5 in 1995-96, but all indications at present are that this is unlikely to happen. More revealing are the figures relating to the revenue deficit (column 3) which remained at 2.7 per cent of GDP in the final years of the 1980s, but went up to 3.5 per cent in 1990-91. Along with the fiscal deficit, it was brought down during the first two years of reform, but shot up to 4.2 per cent of GDP, the highest ever in 1993-94.

Even in 1994-95 it was higher than it was in 1990-91. It must, therefore, be concluded that in terms of one of the major planks of the reforms, the performance has not only been below the commitments made, but the emerging pattern has been far from satisfactory. It has been indicated that if the reduction in the fiscal deficit is taken as the binding commitment, there is the dangerous possibility that targets can be achieved, or at least approached, by reducing capital expenditure. *Table 4* shows variations in the capital expenditure of the Central Government over time, expressed as percentage of GDP. This Table provides information about a

Table 4

Capital Expenditure of the Central Government

Year	CECG as percentage of GDP
1980-81	5.6
1989-90	6.3
1990-91	5.9
1991-92	4.7
1992-93	4.7
1993-94	4.3
1994-95	3.6

Source : Economic Survey 1994-95.

process of adjustment the steady withdrawal of the Government from long-term development activity that publicity brochures choose to ignore!

Year after year, especially when the Central budgets are presented and discussed, the Finance Ministry has been making self-congratulatory claims about how the reforms have been implemented and how smooth the adjustment has been. Hence, it is important to take note of some of the implications of the fiscal adjustments of the years of reform. First, the inability to curb revenue expenditure and the commitment to liberalise taxes have led to increased market borrowings even to finance the regular administrative, defence and social service expenditures of the Government. In turn, it generates a vicious circle of a very high proportion of current revenues having to be spent as interest payments alone. Interest payment as a share of the tax revenue of the Government went up from 50 per cent in 1990-91 to 70 per cent in the 1995-96 budget. And, while great publicity is given to the absolute increase in tax revenue (to establish that lowering of tax rates has resulted in greater tax compliance), it is not mentioned that gross tax revenue of the Central Government came down from 10.8 per cent of GDP in 1990-91 to 9.5 per cent in 1994-95, and that, therefore, there is little chance of reducing the interest burden in the coming years either. Second, the substantial reduction of capital expenditure by the Central Government has already begun to tell on capital formation in the economy as a whole (as was shown in the comments on the Domestic Sector in *Chapter 4*).

Third, reduction in the Central Government's deficits has been achieved, partly at least, at the expense of net transfers to the

States which showed absolute increase from 1990-91 to 1994-95, but declined considerably as a percentage of GDP from 6.1 to 4.6 during that period.

Fourth, this reduction of transfers to the States has posed serious problems for fiscal management at that level, particularly in relation to those subjects which are primarily the responsibility of the States in our federal structure, namely, agriculture, education, health, and so on, which are the ones closest to the lives of the ordinary citizens. The Government has recognised the implications of this situation for the people, and more so to itself, and hence in the pre-election budget for 1995-96 outlays on the social service sectors, poverty alleviation and employment generation programmes were raised so as to show that the reforms have a "human face". But it is doubtful whether they can bring about more than cosmetic changes. Even the staunchest supporters of the market ideology will, in a pragmatic sense, concede some role for the state in real-life economies, but would like to see it confined to fiscal operations.

On the question of the direct presence of the state in the functioning of the economy, those committed to the market ideology have very clear views: the state should keep away, leaving the entire space to private enterprise. The direct involvement of the state in the economy by the ownership and management of public sector enterprises is considered to be a clear indication of socialist inclinations which, of course, is not acceptable to those who take the position that capitalism is not only part of the natural order, but also the guarantor of economic efficiency.

During the early stages of planned economic development in our country, the then policymakers had taken a rather pragmatic

view about the role of the state in the long-term development of the economy. The leaders of industry and business in the country who were responsible for drafting what came to be known as the "Bombay Plan" (1944) themselves had recognised that the state had to play a positive role in economic development. The substantial investment required for infrastructural development transport, communications, irrigation, power, and so on was admitted to be beyond the capabilities of private enterprise and hence investment in infrastructure was accepted as not only the legitimate, but also the necessary, role of the state. Thus, the public and private sectors were considered to have a complementary role in the economy, the former concentrating on infrastructure and the latter on the rest.

This view was reflected in the Industrial Policy Resolution of 1948. When the ruling party accepted "socialistic pattern of society" as its long-term objective and the industrial policy was amended in 1956 along those lines, apart from infrastructure, some "strategic" sectors such as defence, atomic energy and civil aviation, were also brought into the public sector, in order to give the public sector effective control over "the commanding heights" of the economy. The nationalisation of banks in 1969 was meant to supplement that control. It was felt that since the state was to direct the pattern of economic growth to conform to certain broader social objectives, such as prevention of concentration of economic power, ensuring balanced regional development and protection to "the small man," crucial segments of the economy had to be under state control.A further role was assigned to the public sector to generate the surplus required to undertake investment. However, public sector enterprises were not meant to be run as

private enterprises with the sole objective of making profits and generating surpluses. They were to have a pricing policy in tune with the broader development objectives. Subsidised supply of electricity to farmers to augment food production was an illustrative instance of this kind. However, as in most other cases, here too the gap between intentions and performance emerged over time and soon became very glaring. Public sector enterprises (PSEs), which were mostly monopolies, soon got trapped in the lethargies so common to monopolistic concerns. They also became victims of bureaucratic delays and, worse still, political interferences and manipulations. In India's democratic polity they came under various popular pressures as well. The combined effect of all this, in an economic sense, was that many PSEs, instead of contributing to the public exchequer, came to depend on budgetary supports from the Government, a possibility which can turn out to be conducive to further poor performance. There is no doubt at all that the policy towards PSEs required review and revamping. But what is to be the new approach? To join the chorus "privatise, privatise" is too naive, although there are vested interests of many shades who shout that chorus. First, there is the matter of magnitudes. In a study done just before the reforms were launched, one of our top administrators, who as Finance Secretary to the Government of India for a while had intimate knowledge of the PSEs, stated, using data for 1989-90, that the total capital raised in the capital market in the country (inclusive of debentures) was only 1.1 per cent of the book value of the assets of the PSEs. There may have been some change in the situation since then, but not enough to invalidate his inference that "except at the margin, the sale of these assets through capital

markets is simply not a feasible or practical proposition" and that, therefore, solutions to the problems besetting the public sector in India will have to be found primarily within the framework of public ownership (Bimal Jalan, *India's Economic Crisis The Way Ahead,* 1991, p. 77).

Second, PSEs are not all alike. According to *Economic Survey* 1994-95, the overall rate of return on capital employed in Central PSEs was less than 3 per cent, which certainly calls for corrective action. However, of the 240 central PSEs as on March 31, 1994, 120 were profitable in 1993-94 and their profits went up from Rs. 7,384 crore in 1992-93 to Rs. 9,722 crore in 1993-94. But the losses of the loss-making units also increased during this period from Rs. 4,113 crore to Rs. 5,287 crore. Hence, the handling of the PSEs requires a differential approach. In particular, where losses are being made, a careful study of the reasons is necessary.But the reformers have not shown the inclination and the sagacity for such an approach. What has been decided upon is a policy of disinvestment of the shares of the PSEs, not to solve their problems, but to solve the fiscal problems of the Government, by using the amounts thus realised to add to the Government's capital receipts. Since revenue-raising became the matter of top priority, it is hardly surprising that the Comptroller and Auditor General of India was led to observe that the first two rounds of disinvestment were carried out without any preparatory study and without any effort to generate widespread investor enthusiasm. Reserve prices were not properly determined and the shares were sold in bundles so that the prices of "very good" and "good" shares were affected by the presence of "poor" ones in the bundle.

More recent attempts at disinvestment have not fared better. For the financial year 1995-96, the Finance Minister in his budget speech had set a target of Rs. 7,000 crore to be raised as capital receipts by the disinvestment ofPSEs. The first round for the current year with a target of Rs. 2,000 crore ended on a dismal note with only less than Rs. 170 crore having been mopped up, though the shares that were offered were of such prestigious concerns as the Oil and Natural Gas Corporation (ONGC), the Steel Authority of India Limited (SAIL) and the Mahanagar Telephone Nigam Limited (MTNL). In fact, in order to raise resources, the Government even went to the extent of fixing minimum reserve prices of some of these companies below the market rates and yet the response was poor. Knowing that the Government is committed to disinvestment, potential buyers are probably making an attempt to get more favourable terms from the seller.

The policy towards the infrastructural sector cannot be claimed to have been more enlightened or even more successful. In view of the loud noises made on behalf of privatisation in this country and perhaps more so by ideologues all over the world, it was assumed that if only the Government would give up its monopoly in this area, private concerns would rush into it. The Government has formally given up its monopoly in practically all infrastructural areas except the railways. Energy, telecommunications and civil aviation have been thrown widely open to the private sector, Indian and foreign. And because of reduction of investment in these areas, particularly in power and transport, the post-reform growth rates have already been adversely affected. However, the compensating involvement of the private sector has been minimal.

The entry of foreign capital into the infrastructural realm has

been much in the news. This is not because anything much has happened, but because of the amazingly generous guarantees given by the Government, a 16 per cent assured return on equity in the power sector exclusively to foreign investors, for instance and more so because of the controversies generated arising from absence of transparent procedures for their inductions as witnessed by the Enron deal and the telecommunication tenders. As for the actual situation, an informed commentator has recently observed: "India's recent foray into private sector participation in power is quite pathetic. Nearly four years after the initiative, the country has not seen a single kwh come through or a single MW set up. Shrouded in mystery and pushed through with contemptuous disregard of critics (many of whom are experts, senior planners and bureaucrats), the power policy and its implementation has polarised the country into proponents and opponents of private investment into power" (S.P. Gupta, *Mid Year Review of the Economy* 1995-96, 1995, pp. 45-46). In the eagerness to join the global bandwagon of liberalisation and privatisation, the P. V. Narasimha Rao Government has abandoned responsibilities and vacated space; but that hardly amounts to a process of economic reforms.

6

The Real Impact

The audit of the performance of the Indian economy since the "U-turn" reforms were initiated in July 1991 does not bring out any spectacular achievements contrary to the claims frequently made by the Prime Minister, the Finance Minister, the Commerce Minister, their many foreign admirers and, of course, the publicity wing of the Government.

The payments crisis of June 1991 was averted, but elaborate reforms of the kind being pushed were hardly necessary to achieve that objective. The opening up of the economy to foreign capital has not succeeded in attracting a flow of capital or technology into the country, especially into the productive sector. Over 75 per cent of capital that has come has been into portfolio investment and its role there has been to claim a share of the profit already being made by Indian enterprises. Exports have picked up, partly as a result of the devaluation of the rupee, and partly because of the general improvement of world trade. But, after an initial slump, imports have been growing more rapidly, and the present indications are that on trade account there is likely to be a huge deficit by the end of the present financial year. Foreign debt

has increased significantly and the World Bank has cautioned that the servicing of the debt and repayment obligations may begin to exert pressure on balance of payments in 1996-97 and beyond. A major achievement has been to make the foreign exchange reserves position comfortable, but that has created its own problems and has not prevented the rupee from depreciating in terms of the major currencies of the world.

Within the economy, though growth rates have started moving up, the performance is still below what was achieved in the 1980s in spite of unprecedentally good weather conditions that have sustained the growth of the agricultural sector. Industrial growth has recovered after the very poor performance of the first two years of reforms. But, its sustainability is a matter of doubt because of the sharp fall in savings and capital formation which is likely to make the already pronounced infrastructural bottlenecks more constricting in the next few years. A major failure of the reforms has been that foreign capital has failed to move into the infrastructural sector. The prolonged depressed condition in the stock market is a sad commentary on the effectiveness of reforms as one of their main objectives has been to give capital, Indian and foreign, greater freedom in the operation of the economy. The rate of inflation has come down, but prices have soared alarmingly high and continue to rise, especially of essential commodities. In terms of fiscal adjustment, another major thrust of the reforms, the performance has been way below expectations and hardly any long-term correctives have been made. The state has abandoned its responsibilities in some crucial areas such as capital formation and though a "middle path" is sometimes referred to, little has been done to redefine the role of the

state and of the public sector in a new economic set-up.

Urged by the Fund-Bank combine, foreign capitalists and their Indian supporters, and enthusiastically supported by those who claim to be experts in some abstract economic theories, the reforms were launched with a big bang in July 1991. Four-and-a-half years later, the slips are beginning to show with those who were former cheerleaders suggesting that what has gone wrong is that the reforms have not been pushed enough. Those who have been directly responsible for initiating and implementing the reforms try to defend the situation by pointing out that things here are not as bad as in some other countries, including Russia where the same reform measures have been taken up.

But if these are the realities, how does one explain the seemingly flourishing performance of the economy, the abundance and variety of goods that have suddenly become available during the past years? As against the one and only Indian Airlines, there are now half a dozen to choose from. The roads are crowded with automobiles, of different global manufacturers, and more will be seen in the next few months. Cellular telephones and pagers can be seen everywhere. Designer shirts and exotic perfumes do not have to be brought from outside, they are here in great abundance. Kelloggs and Kentucky Fried Chicken are no longer to be seen only in foreign magazines. They are here.

These are facts, but facts that need some interpretation. According to figures relating to 1994, in this country of some 900 million people, there were only less than 3 million passenger cars, not more than 2.5 million in private possession. That is, only a little more than 1 per cent of households own cars. Almost half of these are located in just 23 cities, possibly a third in the four

metropolitan cities (Delhi, Calcutta, Bombay and Madras) plus Bangalore. Only less than 4 per cent of households have telephones. The number of households owning a refrigerator is only a little more than 6 per cent of the total. (These statistics are from Praful Bidwai's column in *Frontline,* February 10, 1995.) It is, therefore, clear what kinds of goods are becoming available and for whom.

Since these are also facts, more than the usual performance audit of the economy in terms of national aggregates or averages is necessary to evaluate the impact of the reforms. A more penetrating social audit is called for, taking into account the vast economic differences of the people of the country. Such social audits of the reforms also exist. G. V. Ramakrishna, member of the Central Planning Commission, in the Garg Memorial Lecture at the Institute of Naval Architects, New Delhi, in April 1995 asked: "Where are we now and how far have we come in the reform process?" and went on to say: "After three years, different people are looking at the reforms from their own perspectives. We have the upper-class, very happy with the ongoing reform process. They have more CTVs, more channels on cables, more imported goods and so on. Nobody is any longer ashamed of conspicuous consumption. Then we have the middle-class which is seeing this as an opportunity of its advancement to the upper class. Many feel making money one way or the other will get them into the high consumption category. Then we have the lower classes. They are worried as they ask: "What is there in this for us? We don't know what liberalisation is, what capital market is. What is our net gain in this package? We want jobs, less inflation, and they ask, have we got any of these? "

In fact, even Prime Minister P. V. Narasimha Rao, speaking

to his party workers in July 1995, attempted a similar social audit of the reforms. According to a report: "He began by delineating the social structure's three segments. The crust, according to him, consists of about six crore people, who do not need to be canvassed about the economic reforms. The next layer, he believes, contains about 25 to 30 crore people, belonging to the middle-classes, who are beginning to appreciate the benefits of liberalisation... It is the next segment, of 55 to 65 crore of lower income and poor people who remain unappreciative of the changes in the economy" (*The Hindu,* July 25, 1995).

The Prime Minister, apparently, did not bother to examine why 55 to 65 crore people out of a total of 90 crore do not appreciate the heroic reforms of his Government, though in a democratic country that would have been the most natural question to consider in view of the numbers involved. Those whom the Prime Minister described as lower income and poor people, who constitute a clear majority of the people of the land, are drawn from different walks of life. By far the largest segment among them consists of the agricultural labourers who constitute 26 per cent of the labour force in the country. They and their families, therefore, may account for a fifth to a fourth of the total population.

Most of those who are usually designated marginal and small farmers who manage to eke out a precarious living from the tiny plots of land that they cultivate will also form part of this group. So are the rural artisans, the millions of men and women engaged in a wide variety of household industries, the traditional fisherfolk, the many in petty trades and repair works in the urban areas. They have low incomes and the majority of them come under our rather low-level poverty line; but they are the ones who really

toil. It is a sad commentary on the economic and political policies of the past that almost half a century after Independence about half of the people of our land are in that kind of plight.

If this reality is taken seriously, one would imagine that the real thrust of any economic reform in this country would be to tackle their problems. And so it is claimed by those who have been pushing the post-1991 reforms. The Government of India's Discussion Paper of 1993, *"Economic Reforms : Two Years After and the Task Ahead,"* stated: "The fundamental objective of economic reforms is to bring about rapid and sustained improvement in the quality of life of the people of India. Central to this goal is the rapid growth in incomes and productive employment. Hundreds of millions of our people are still trapped in abject poverty. The only durable solution to the cure of poverty is sustained growth of incomes and employment: in agriculture, in industry and in services." This is certainly a noble statement and since a major aspect of poverty is the inadequate access to goods necessary for living, increase in productivity leading to increase in output is a necessary condition for the eradication of poverty.But to say that sustained growth is required for the abolition of poverty and that therefore stepping up of growth of GDP to 6 or 7 per cent per annum must become the focus of reforms, may not result in the eradication or even reduction of poverty, even if the growth target were to be achieved. This is because growth by itself is not a sufficient condition for the removal of poverty. At least two other conditions are required: the increase in output must be of the goods that the poor need, and when such goods become available, the poor must have access to them. How crucial these two conditions are and how easy it is for them to be not

satisfied even when growth is taking place can be readily seen, especially in a situation where the market forces are assuming greater significance in the decisions about what goods will be produced and who will have access to them. For, the power that propels the market is economic power which finds expression as purchasing power.

Consequently, the goods the production of which increases when the forces of the market come into play are likely to be the ones that those who have purchasing power in abundance wish to buy. It is for this reason that the high growth rate of the 1980s, led by demand resulted in and from the increase in output of a variety of high-priced consumer durables. The stimulus for the recovery of industrial production during the past couple of years has also come from the demand of those whom the Prime Minister described as belonging to the "crust". And the goods that are becoming available, not surprisingly, are meant for them—automobiles, telephones, refrigerators, air-conditioners, kitchen gadgets, processed food and the like. Secondly, while these goods are visible to everybody, they can be availed of only by the few; they are beyond the means of the bulk of the population. It is the same principle that leads to the stock of foodgrains to increase when production goes up: those who need food cannot afford to buy it because their incomes are low and the price is going up.

The social audit can now continue. The account that follows draws on an article by S. P. Gupta, "Economic Reform and its Impact on Poor" (*Economic and Political Weekly*, June 3, 1995), based on analysis of available official statistics, primarily from the National Sample Survey Organisation (NSSO). The NSSO divides the total population into ten groups (deciles) from the poorest to

the richest and gives information on the consumption expenditure of each group. Taking into account the period from 1987-88 to end of 1992 (data on these aspects come with a lag of two to three years), it is seen that both in the rural and urban areas the distribution of consumption has deteriorated since the reforms were initiated, the shares of individuals in the lowest three groups, as also of the middle four groups, deteriorating at the expense of the gain of the top three groups. In the absence of data on income distribution, it is not possible to say whether this reflects any significant income shift in favour of the richer sections or simply an increase in consumerism among the rich. But it is clear that the disparities in consumption between the upper crust and the lower levels have become greater and, certainly, more visible.Since levels of poverty in the country are indicated in relation to consumption, the percentage and numbers below the accepted poverty line also can be calculated from the same NSSO data. However, as the calculations involve decisions regarding the choice of prices, there is some difference of opinion about the final verdict. Estimates made by the Planning Commission show that the percentage of population below the poverty line came down from 51.2 per cent and 38.2 per cent in the rural and urban areas in 1977-78 to 20.6 per cent and 11.5 per cent in 1990-91. But subsequently, in 1992, they went up to 22.4 per cent in the rural areas and 12.7 per cent in the urban areas, rather marginal increases.

On the other hand, on the basis of a procedure suggested by a group of experts appointed by the Planning Commission, another estimate shows that the percentage of population below the poverty line in the rural and urban sectors respectively had dropped from 57 per cent to 35 per cent and from 45.9 per cent to 37 per

cent between 1970-71 and 1990-91, but moved up to 41.7 per cent in the rural areas and 37.8 per cent in the urban areas by the end of 1992, indicating a fairly substantial increase in the rural areas. The Planning Commission has now made available its estimates of poverty for 1993-94 (*The Hindu,* January 6). The percentage of population below the poverty line in rural areas was 21.68 and in the urban areas 11.55, both still higher than in 1990-91, but lower than in 1992 according to the Commission's method of calculating these figures.It is not wise to rely too heavily on these fine-tuned calculations, but the directional change they indicate is significant.

However, the period for which the data are available is the very first stage of the reforms and hence it will not be fair to arrive at definitive conclusions solely on the basis of such evidence. But it is possible to examine the impact of the reforms on the lives and livelihood of the people, particularly the low income groups who constitute the majority, using other indicators. The performance of prices during the reform period offers a way of looking at the consequences of the reforms on the people.

It is a well-known fact, of much concern and complaint, that the 1990s have been a period of high and rising prices. The first half of the decade, in fact, has witnessed the highest price increase during any five-year period since the 1950s with a double digit or near double digit rise in prices, every year cumulatively. If the price level is taken as the most obvious index affecting the economic welfare of a population, the impact of this unprecedented increase in prices on different sections can be used as a major factor in the social audit of the reforms, provided it can be shown also that the reforms are directly responsible for the rise in prices.

Understanding the nature of the price increase of the 1990s is, therefore, necessary. Since the 1950s there have been four five-year stretches of high prices, 1964-65 to 1968-69, 1972-73 to 1976-77, 1979-80 to 1983-84 and the latest. The earlier three were closely associated with droughts and the consequent fall in agricultural production, supplemented in the second and third cases by factors external to the Indian economy, namely, sharp increases in the international prices of petroleum. Neither of these conditions was responsible for the current phase of inflation. On the contrary, the ongoing increase in prices can be related to different policy measures associated with the reforms.

First, there was the devaluation which affected the internal prices by raising the level of exports, and making imports more costly. Second, after depressing the economy through fiscal operations, there has been a desperate attempt to revive it through monetary expansion. The period since the start of the reforms has witnessed an unprecedented increase in money supply. Part of this expansion was the result of the attempt in 1992-93, 1993-94 and 1994-95 to prevent the appreciation of the value of the rupee (which would have adversely affected export performance) as the inflow of foreign capital led to an increase in the demand for the rupee. Third, there has been a deliberate attempt to raise prices, especially in the case of goods whose prices have been administratively determined in the past, to bring them in line with international prices. One of the most glaring price revisions of this kind has been that of foodgrains where not only the support price to the producers, but the issue price through the public distribution system, has been sharply raised more than once since 1991 leading to increase in open market prices also. That is the main

explanation for the shooting up of the prices of foodgrains when production has been increasing and stocks with the government have been bulging. In the light of these considerations, the price rise of the 1990s can, without any hesitation, be viewed as a policy induced one. The *rise* in prices is still continuing although the *rate* at which it is rising came down in November and December 1995. But some decline in prices during the last months of the calendar year has been quite common. One has to watch out for a possible flare-up in the early months of the new year as it happened in February 1995. On the other hand, if fighting inflation, through a tight money policy continues, it may further slow down industrial production. The weekly reporting of the rate of inflation, above 10 per cent most of 1994-95 and less than 7 per cent during the past few weeks, however, hides what has been happening during the past five years. The general price level, represented by the wholesale price index was 185 (1981-82=100) in 1990-91 and was hovering around 300 at the end of 1995, an increase of over 60 per cent. During the same period, the price index of food articles overall increased from 201 to 340, that is, by almost 70 per cent.

Though the reforms were started in 1991, the price indices of 1990-91 are considered here because one of the major commitments in the election manifesto of the Congress(I) was to roll back prices of essential goods to the 1990-91 level within 100 days of forming a new government. On this basis, it can be stated that no one whose earnings during the past five years did not go up by 60 to 75 per cent could have benefited by the reforms. It is not easy to say what percentage of the total population can be said to have been the beneficiaries, in this sense, but perhaps

5 per cent, or 10 per cent at the most. In view of this sharp increase in prices of daily necessities, especially food items, it is not surprising that during the elections to the State legislatures late in 1994 and early in 1995, those parties that promised foodgrains at reasonable prices were able to carry the electorate with them. And the Prime Minister should have no difficulty in figuring out, if he cares to know, why the lower income and poor people remain "unappreciative of the changes in the economy."

Specific changes brought about by the reforms would have affected different segments of the people in different ways. A study on the impact of the reforms on employment and equity concedes the possibility that expenditure switching from the organised industrial sector to more labour-intensive traditional export sectors (for example, gems and jewellery, garments, leather) may improve employment, but points out that it may, at the same time, result in greater casualisation, feminisation and deskilling of the work-force (S. Guhan and K. Nagaraj, *"Adjustment, employment and equity in India,"* 1995). On employment as such, another study, on the basis of available evidence, has come to the conclusion that "the first three years of reform have seen some deterioration or, at best, a sluggishness in the quantity and quality of employment generation" (S.P. Gupta, *Mid-Year Review of the Economy* 1995-96).

Yet another study has looked into the impact of the reforms on small producers and notes : "The small-scale sector which accounts for a substantial quantity of goods and provides employment has been uniformly affected by the new economic policies on one count or the other. The present policies are also oblivious to the problems of small farmers and other primary

sector producers, especially in the semi-arid regions" (Sarthi Acharya and Niru Acharya, "Structural Adjustment and Small Producers", *Economic and Political Weekly,* January 7, 1995). The study draws attention to a type of problem which has been becoming increasingly common. In the coastal regions of Andhra Pradesh and Tamil Nadu, small-scale paddy farmers are being displaced from their land to give way to prawn farming by large companies for export. Similar is the problem faced by small fishermen who operate with traditional craft when they are displaced by big companies operating with mechanised trawlers in an attempt to increase in output (or certainly the value of output) and in export earnings, but the damage these processes cause to vulnerable sections of the population and ecological conditions may be overlooked.

That many such instances have been taking place is now a matter of common knowledge. That the people who become victims—small farmers, artisans, handloom weavers, fisherfolk—have been offering stiff resistance is also coming to be known. The Delhi-based Public Interest Research Group in a publication with the title *Against Consensus* has documented instances of resistance and mass action against specific measures of reform affecting the day-to-day lives of the people.

At the factual level, even those who have been enthusiastic supporters of the globalisation, liberalisation and marketisation thrusts of the reforms are likely to agree that very little benefits have accrued to the "common man" and that the poor may have been adversely affected. But then it will be pointed out that any process of adjustment will have some " social costs" and that the Indian reforms are no exception. That, however, is a way of

dodging the issue, for there is no such thing as social benefits and social costs in the abstract. Since it is evident that the reforms have indeed gone in favour of a small segment in society and that the majority of the people have been adversely affected, the real question is whether benefits should go to the former and the costs should be borne by the latter. By confining the analysis at the level of society or economy in the aggregate—the growth of GDP, foreign exchange reserves and stocks of foodgrains, for instance—this crucial and embarrassing question is cleverly ignored. But to the people at large, it is the most important question and they have been giving convincing responses to it whenever they had an opportunity to do so. A great advantage of the democratic process that we have adopted is that once in five years at least the mass of the people have an opportunity to assert themselves over the craftiness of the learned and machinations of the powerful.

7

What Next ?

On the question of the future of the reforms, there are, not surprisingly, divergent views. Prime Minister P. V. Narasimha Rao, Finance Minister Manmohan Singh and others in Government have been asserting at home and assuring those concerned abroad that the reforms are irreversible and will go on. Others do not agree. They promise to revise the reforms, if not to jettison them completely. It should be clear that these views about the reforms, for and against, are indirect pronouncements about the prospects of the groups concerned in the coming general election. And there should be no doubt that the outcome of the election will have a decisive bearing on the future of the reforms, for, as has already been pointed out, bringing about major changes—structural alterations, for instance—in the economy is essentially a political programme, reflecting the conflicting interests of different sections of the population.Hence, in commenting on the future of the reforms, more than an articulation of what is good for the country or the nation is called for. The beneficiaries of the reforms so far have been clearly the industrial and commercial classes who were able to take advantage of the opening

up of the economy, the liberalisation and the productive and, more so, speculative activities that they have given rise to. In a different sense, those who have had the means to purchase the wide variety of goods that have dramatically become available during the past four years—those who triumphantly say that now you get in the country everything you want—have also benefited by the reforms. On the other hand, as even the Prime Minister was led to admit, the vast majority of the people in the country can think of the reforms only in terms of the burden inflicted on them, especially the sharp and unprecedented rise in prices. In a democratic polity, the welfare of the nation must be judged by what happens to the majority of the population. That the benefits of the reforms have gone only to a few and that the vast majority of the people have been left out need not be thought of as a matter of deliberate design. It is not entirely accidental either.

Not only in India, and others that are usually designated as developing countries, but all over the world, including the affluent nations, the bulk of the people are engaged in making a livelihood for themselves and their families. Such activities may be in the form of efforts to prqduce one's basic requirements (as farmers do), or to work for others for a wage with which to buy the necessities of life, or to produce some goods to exchange for other goods to meet one's needs. These activities need not be confined to the level of meeting the basic needs although for many even that will be quite a task, not always successful. But with the availability of more physical resources, improvements in technology and more purposively directed personal efforts, it is possible to generate more by way of a surplus which can be utilised in many ways, the most important the being to produce or

generate more goods. In the economic system there may be a few who can take their living for granted and can concentrate on generating more surplus either directly through productive activity or through various forms of appropriating, usually via rents and profits, the surplus that others generate. Where those who specialise in dealings in surplus arise, they will come to have the upper hand in economic activities because the surplus over which they have control can be used to control other forms of economic activities. The surplus which initially emerges in the form of goods can, through the medium of money and the activity of trading, be converted into abstract monetary values which, in turn, can be used to exercise command over resources and people. Surplus in this form is what the term 'capital' usually designates. And 'capitalism' as an economic order is one where capital and its activities get priority over everything else, including the activities of the majority of the people to make a living.

Whatever be the activities capital may enter into, it is always guided by one basic principle: generate more capital. In this quest it becomes exceptionally mobile, across national boundaries and into economic activities in general. Capital, therefore, has a high built-in propensity to become transnational, multinational and 'global'. The globalisation of capital, in this sense, has been a rapidly emerging phenomenon during the second half of the present century. The global penetration of capital was, for a while, kept under check by the political power of countries that were attempting an economic order other than capitalism. But with the collapse of these experiments in the East European countries and the former Soviet Union late in the 1980s and early in the 1990s, and the opening up of the Chinese economy to capital from other

parts of the world during the past two decades or so, the global movement of capital has come to have a new thrust and triumph.

Part of this globalisation of capital finds expression in the form of what has come to be known as "the new international division of labour". The production of an automobile, for instance, is now done on the basis of parts manufactured in ten or more locations in the world, brought together and assembled as the final product. Such decentralised production processes, made possible by technological changes in production and communication, calls for centralised decision-making and control. The multinational or transnational corporations (MNCs or TNCs) are the organisational arrangements that combine decentralised production and centralised control.

The presence of these corporations—some of them with much more resource power than that many nation states—is a new phenomenon in the global economic scene of the past two decades or so. A great deal of international trade today is the movement of goods from one country to another, but on behalf and under the auspices of these corporations. In the case of several commodities involved in international trade, they not only influence the prices, but also determine them. Global trade in foodgrains, for instance, is very much under the domination of a handful of transnational corporations (TNCs). The MNCs or TNCs are, therefore, a major factor to be reckoned with in today's global economy, the sphere of production, trade and prices. In the 1980s they made their presence felt in another sphere of the global economy, namely, finance. In a sense, finance is closely associated with production, but it can also become a profitable enterprise in itself. The profitability of financial operations per se is what is reflected through

the hectic buying and selling in the stock market. Soon after their involvement with productive activities in different countries, many of the TNCs naturally turned to financial activities of that kind. Capital invested in productive activities take time, sometimes several years, to yield profits. Financial activities, on the other hand, can yield profits in a matter of minutes or even seconds. Hence, not surprisingly, capital under the control of global corporations started moving in a big way into the realm of finance in different parts of the world, facilitated by the high liquidity of capital in that sphere and the enormous advances in communication technology.

The rapid and voluminous movement of capital from one country to another in search of quick profits started affecting the value of national currencies also, especially after the U.S. dollar which had played the role of the lead currency since the end of the Second World War, lost that position towards the end of the 1970s. The volatility of the value of national currencies offered another avenue for capital to make quick profits.The shift of capital from productive activities into transactions and speculation in the 1980s can be seen from the fact that between 1982 and 1988 the annual increment in the stock of world financial assets was, on average, about $3,800 billions, whereas the annual average level of world fixed capital formation was only $2,300 billions. Similarly, by the end of the 1980s, the *daily* volume of trading in national currencies almost reached the average *monthly* volume of world trade. So dramatic and decisive were these changes that *The Economist* (of London) in a special survey of the global economy early this decade observed: "Twenty years from now economists will think of the 1980s not as the decade of the

international debt crisis, nor of the dollar's boom and bust, still less of Reaganomics and monetarism. All this mattered, but none of them marked decisive change in the forces that drive the world economy. Yet, the 1980s did witness such a change. During these years many of the boundaries between national financial markets dissolved, and a truly global capital market began to emerge. It is for this that the past decade will be remembered." (Those interested in details of this latest manifestation of global capitalism may wish to look up C.T. Kurien, *Global Capitalism and the Indian Economy,* Orient Longman, 1994, Chapter 4).

It is to this rapidly evolving global circuit of capital that the Indian economy was opened up from July 1991 onwards. The traditional view of the flow of foreign capital into a country was that it would bring in additional resources and latest technology and thus raise the level of investment, productivity, output and employment. The decision at the early stages of the reforms to attract foreign capital was based on the premise that "foreign direct investment is... an important source of non-debt inflows and... a vehicle for technology flows and a means of building inter-firm linkages in a world in which transnational corporations are increasingly operating on the basis of a network of global interconnections" (Government of India, *Economic Reforms: Two Years After and the Task Ahead,* 1993). The assumption, obviously, was that if the Indian economy were opened up the flow of foreign capital into the country would be productive capital that would come in on a long-term basis, to transform and uplift the economy. But it has been noted already that only less than 25 per cent of the foreign capital that has come in since 1991 has been foreign direct investment, the rest being finance capital in various forms

seeking quick profits. Such capital, instead of augmenting investment and productive activity in the country, would skim off profits that are already being generated. It would come in and go out as it pleases, introducing a new element of volatility into the economy. Instead of increasing competition, it could, in fact, reduce it through the processes of buying up and mergers. It could generate speculative booms, in stocks, in real estate and even in commodity markets and then could drag the economy into fits of recession and depression. Above all, it is a game that few can play though it can affect the lives and livelihoods of millions of people. The liberalisation of the economy that has been brought about by way of the reforms has been to some extent in terms of increased international trade and the movement of commodities. But its main thrust has been to give roving capital the freedom to come in and go out. In opening up the economy to foreign capital, India, since the reforms, has gone way beyond what was necessary and prudent.

The World Bank in its 1995 Economic Memorandum on India stated: "The surge of capital inflows over the last two years was unexpectedly large. It led to the realisation that India's capital account, while still more closed than Chile's, Mexico's or Indonesia's, is already more open than Korea's and China's... At present, India's foreign direct investment regime is comparable to those in most open economies... This means that once established in India, a foreign investor can invest in all areas of the economy under the same terms and conditions as a national investor. In addition, unlike a practice prevailing in a number of developing countries, there are no limits or restrictions on profit remittances. Conditions on portfolio investment by foreign

institutional investors (FIIs) are much more liberal in India than in Korea (where there is a limit of 10 per cent, recently increased to 15 per cent, on the cumulative amount of equity that foreign institutional investors can hold in any given firm), and Taiwan and China, where the limit is 10 per cent and where, in addition, there is a global ceiling on the aggregate amount of annual portfolio inflows allowed into the country." (pp 24-25).

Of the special concessions given to foreign capital, two are particularly significant. The opening up of the economy in 1991, it may be recalled, was against the background of a balance of payments crisis. Hence it was important to ensure that the entry of foreign capital would not immediately have an adverse impact on the payments position. This is usually achieved by insisting that repatriation of profits is related to export performance. Indeed in the initial stage such conditions did exist. But when the Prime Minister visited Japan in June 1992 to extend an invitation to Japanese capitalists, they "requested" that the linking of repatriation of profits with export performance should be removed and it was promptly done. This has made it possible for foreign capital to move in to capture the domestic market if the entry is into productive activities. Indirectly, it has also helped capital that flows in for portfolio investment inasmuch as it gave a fairly free hand to foreign capital to choose the manner of its operation within the country.Added to it has been the fact that while the capital gains tax on Indian citizens is 20 per cent, for foreigners it is only 10 per cent, a stimulus given to foreign capital to enter into speculative activities. Many foreign investors succeeded in avoiding even this low rate of taxation via what is known as the Mauritius route. India has a double-tax avoidance agreement with Mauritius

and hence foreign investors have the possibility of setting up subsidiaries in Mauritius through which they can operate in India. Apart from these concessions of a general nature, the Government has been generous in dealing with specific foreign investors providing a wide range of incentives such as assured returns on equity, counter guarantees, and so on. Hence the noise that a section of Indian capitalists has been making about a "level playing field" is not unreasonable. What has happened is that after a long period of protection, the economy has been thrown widely open and favours are being shown to foreign groups and their Indian collaborators. If this is what has been achieved, intentionally or otherwise, the real issue is not whether the reforms are reversible, but how the reforms are to be reformed.

There is strength in the argument that the Indian economy should have greater links with the inter-national economy, certainly in terms of trade, and for that purpose some openness to foreign capital may be necessary. It can be granted also that capital from other parts of the world can bring with it technical know-how, advanced technology and newer forms of organisational patterns. But several steps are necessary and possible to see that foreign capital goes into productive activity, brings in technology that is appropriate for our needs, augments competition and export earnings, and that its propensity to enter into speculative activities is kept under control.From this perspective it may be noted that there is a qualitative difference between the approach to foreign capital of the Central Government and the State Governments. Chief Ministers have also been going after foreign capital. But invariably such capital is directed into productive activities, mainly into infrastructure. This is not to give a blanket

approval for what the State Governments do in this regard, but to point out that conditions can be imposed on the entry and role of foreign capital as against the wide open door (and red carpet) policy being pursued by the Central Government. It may be noted too that countries like China, and to some extent even South Korea, have been opening up their economies to foreign capital largely on their own terms.

Other aspects of the reforms should also be subjected to similar scrutiny. Granted that budgetary deficits should be reduced, it should not be achieved by scaling down investment and capital formation, but by controlling wasteful public expenditure. If subsidies have to be brought down, it should begin not with the support given to the weaker sections, but by eliminating the variety of hidden subsidies that the better-off sections enjoy. The way to reform public sector enterprises is certainly not to ask the Oil and Natural Gas Corporation to hand over the most profitable discoveries and proven blocks of oil fields to foreign private enterprises. The best way to increase employment is not to invite a Rs. 650 crore investment that assures work for some 600 people!

What, then? What should be the basic considerations to revamp economic policies in the days ahead? Often it is presented as though the crucial choices are between planning and the market, between the public and private sectors, between protection and liberalisation, between import substitution and export orientation. But these are just matters of modalities, not the central issues in reshaping economic policies. The basis of economic policy in the country since the 1980s Indira Gandhi's hesistant liberalisation, Rajiv Gandhi's new economic policy and Narasimha Rao's reforms has been the reliance on those with

resource power to determine the pattern of production. The first two relied on those who are within the country. Narasimha Rao's reforms, pin hopes primarily on those outside the country; that is the difference.

The underlying principle of the strategy is that when the rich become richer, the condition of the others will become "incrementally less intolerable". That is what the accent on "growth" implies with the expectation of the trickle-down effect added to it or perhaps growth accompanied by some deliberate, but token, redistributive measures for poverty eradication, employment generation and so on.

The question for the future is whether that approach can be reversed and whether drawing the mass of the people into productive activity can become the main thrust of economic policy. The material conditions are quite favourable for that kind of U-turn. The first step should be to utilise the excess stock of foodgrains to organise a massive work programme in rural areas directed towards improving irrigation and other infrastructural facilities in agriculture. In turn it will lead to further increase in the production of foodgrains, the diversification of agriculture and an overall economic revival in the rural areas. The opportunity must be utilised to stimulate technological upgradation in non-agricultural activities depending on local conditions and needs.

If economic policy is effectively reoriented in this manner, it will not be necessary to have blanket restrictions on commercialisation of agriculture, whether it takes the form of orchard or prawn cultivation and whether the goods thus produced are meant for domestic or foreign markets. The only

condition required for protecting social interest in these cases will be to give the local representative bodies, the panchayati raj institutions, a decisive say in the matter of the utilisation of land and other natural resources.

Another area where concerted action is urgently called for is infrastructural development. The issue here is often wrongly posed as to whether the responsibility should be that of the public sector or whether private sector also may be permitted. The basic problem is that in many specific spheres of infrastructural development huge investments are called for and for that reason and on the basis of technological considerations there will be a natural tendency for monopolies to emerge. How to ensure that in such instances developments do take place without the monopoly situation being utilised to make excessive private profits is the real issue. In the initial stages, as it happened in the case of power generation and the communication networks in our country, only the state could enter into them because of the large quantum of investments and the long gestation periods. It may be recalled that private airlines were willing to enter into air services only after airport facilities were provided by the efforts of the state; and even then they confined themselves to the profitable trunk routes till it was made obligatory for them to take on some of the less paying routes also. It should be possible too to separate functions within a public utility concern and to have different agencies attending to them. Thus, even if it is desirable to keep the railways in the public sector, there is no reason why catering in trains should not be handled by an agency, possibly a private one, with special competence to do so. More examples of this kind where the public/private rigidity can be given up in the interests

of adequate and efficient public services can be thought of. However, it must be emphasised that in the sphere of infrastructure and public utilities there is an unavoidable and indivisible "public" interest which should not be permitted to be exploited for private gain. That does not mean that they should remain under government and bureaucratic control. Public interest can be safeguarded by independent agencies with specific functions designated to them. The judiciary within our polity is the best example of this kind, the Election Commission being another.

Such independent bodies to exercise overall supervision and jurisdiction on matters relating to public utilities are quite common in other countries. In the United States, for instance, there is the Public Utilities Commission which has jurisdiction over pricing, service conditions and all other aspects of public utilities. In the United Kingdom, the Office of Electricity Regulation deals with the economic regulation of matters relating to that sector. Before this body takes important decisions, it makes available consultation documents to interested parties and elicits their comments. Through such procedures independent public bodies ensure transparency of operations, efficiency in functioning and the protection of common interests irrespective of whether the operating agencies are public, private or a combination of both.

These instances will show how futile it is to have abstract discussions of whether the economy should be under the control of the state or be left to the forces of the market. The central issue to recognise that economic activities of the nation must have the common good and the welfare of the majority of the people as objectives, that private interest of profitability mediated through the functioning of the market can be used for that purpose, but

under the overall guidance of the state. The state, in this context, is not merely bureaucracy, though the latter is a necessary part of it it is not even the government though it is crucial, but an ensemble of agencies and institutions in different spheres and at different levels responsible for defining the common good and ensuring that it is realised. Within the framework of such bodies entrusted with the task of guarding the public interest, private agencies, including those from outside the country, can be provided legitimate and important roles.

What is, therefore, needed is a social policy that will, in today's context, reorient the economy and the polity to protect and promote the common good with an accent on the basic needs of the majority of the people. The Structural Adjustment Programme, sponsored by the Fund-Bank combine in the interest of global capital, and presented by the Narasimha Rao administration as the answer to India's complex economic problems certainly is not a policy of that kind. A workable alternative is necessary and possible. The forthcoming general election is an excellent opportunity to mobilise public opinion in favour of such an alternative and to opt for political forces that will put it into action.