The Indian Economic Liberalisation Story

An Audit from a Liberal Perspective

Discussion Papers

Project for
economic
education

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Preface

Ten years ago the Project for Economic Education organized a seminar on December 4 and 5, 2002 to examine the progress of economic reforms initiated 10 years earlier by a (marginally) minority Congress government led by the late prime minister Narasimha Rao.

The seminar concluded then, that the initial momentum egged on by a desperately critical balance of payment situation, was already faltering. It could be steadied only through aggressive changes on several fronts such as cutting red tape, phasing out subsidies, reviving the stalled disinvestment process, enacting legislation ensuring fiscal responsibility, amending the Companies Act, ensuring fair competition and amending the country's labour laws. Barring the last mentioned, the others were taken up and some legislation passed even if their implementation has left much to be desired.

The surprise win by the Congress-led coalition in 2009 general elections saw the sensex shooting up to a staggering 28 percent in a day. The country was so upbeat that when the global economic crisis broke out around that time, the crisis did not have a major impact on India. On the other hand the country actually saw a surge in overseas investments. India was no longer a 'developing country' but 'an emerging nation' and the hope was that it would be the third richest country in the world after China and the USA.

This is fast turning into a mirage

For a while it seemed so but what we had not reckoned with was that deadly concept called "Coalition Dharma" a euphemism for the survival in power of a coalition of disparate political parties.UPA1 blamed the 'left' parties for the near suspension of economic reforms. UPA2, though free of the 'left' now has to contend with state parties like the DMK in Tamil Nadu and the Trinamool Congress in West Bengal who really call the shots. To add to these, the Anna Hazare-led agitation against corruption and the constant downpour of scams, have not only halted economic reforms but paralysed governance itself.

The seminar on May 5, guided by eminent liberal economists has, on the other hand, drawn attention to the fact that it is not only "Coalition Dharma" but a number of other factors that are also responsible for the present situation. The country finds itself dangerously perched on a cliff and could well topple back to the bad old days.

July 2012 *SVR*

Session 1

Liberalisation – The Last Decade

This session was chaired by leading economic commentator, author and journalist, Niranjan Rajadhyaksha. The paper presented by Seetha continued the economic liberalisation story in the last decade, providing a backdrop and setting the tone for the two presentations and the discussions that followed.

Chairman's Remarks : Niranjan Rajadhyaksha

It has been more than 20 years since we set off on the path of economic liberalization. There have been significant successes during this phase:

The first is that the rate of economic growth has picked up and incomes have increased. Also recent data shows that growth acceleration has led to a significant decline in poverty. A recent paper by Dr. Sukhdeo Thorat showed that communities which usually have fewer chances of advancement – SC/STs and Muslims – have benefited a lot from economic growth. When we talk of inclusive growth, we must accept the fact that growth has indeed been inclusive.

One can argue that there should have been even greater inclusion, but the canard that is being spread that growth has been against the poor, that economic reforms have harmed the poor, just does not stand in the face of numbers.

That said, there have been significant problems as well. One knows that since 2004 there have not been significant reforms and the Indian economy is facing the brunt of policy inaction. What should have been done five or seven years ago when things were looking good, was postponed and we have been suffering because of that.

If you look back over the past 20 years, certain patterns can

be discerned. One is that some parts of the economy have progressed faster than others. For example, industrial reforms have moved at a faster pace than reforms in the services or reforms in agriculture.

Another way of looking at the progress of reforms is that India has had more success in liberalizing the product markets, while there has hardly been any progress in reforming the market for factors of production – the financial market, the market for capital, the market for labour, the market for land. These failures have led to immense structural problems. We have seen it in the land issue. Nobody talks about labour reforms these days, but employment growth has suffered; and because of very little financial sector liberalization, there is the entire issue of financial access, access to capital for the poor or for small enterprises.

Another emerging issue, obviously, is crony capitalism. Raghuram Rajan gave a very blunt talk recently in Delhi, when he was launching the second edition of a book of essays for Manmohan Singh, and basically what he said was that the licence raj has been replaced by the resource raj. There are many controversies over the allocation of natural resources. Liberals who believe that the market has a clear role in allocating resources have to ensure that we don't see the rise of oligopolies.

Finally, while we know that reforms have benefited the poor, data does show that inequality is increasing and we have to figure out what exactly the response should be. It is a fact that fast growing economies tend to see an increase in inequality, but should we wait for the poverty to completely decline and then attack it, or should there be a different sequencing.

Finally, over the past few years, there is the growth of entitlements. The government is promising right to education, right to work, right to food. So, as liberals, how do we see these emerging challenges even as the need for further reforms is recognized?

Mr. Niranjan Rajadhyaksha, a reputed economic journalist and Managing Editor, *Mint.*

Session 1

An Audit – From the Liberal Perspective

Seetha

This paper is an updated and modified version of Liberalisation: A Balance Sheet *that I authored and was published in 2002 by the Project for Economic Education and the Friedrich Naumann Foundation. That paper looked at the successes and failures on the economic and social front from 1991 to 2001. This paper is focussed more sharply on how much the state has moved away from micro-managing the economy and how far India has moved on the path of a deregulated, free-market oriented economy.*

Introduction

India's economic reforms process is now a major – twenty-one years old.

In June 1991, Indian economic policy embarked on a definite change in direction. Jettisoning the planned economic development model that had been followed since the 1950s – which was marked by the state micro-managing the economy, oppressive controls on the private sector and over-reliance on the public sector – the state decided to play a facilitating and regulatory role, giving more freedom to entrepreneurs and the private sector and opening up the economy.

The era of planned economic development had been based on the belief that it would lead the country out of poverty to prosperity. Unfortunately, the paraphernalia of a closed economy only stifled growth. The Indian economy grew at an annual average rate of 3.5 per cent in the first three decades.

The realisation of the need for easing the controls on the

economy came in the 1980s. However, this only resulted in some tinkering with the controls mechanism and there was no attempt at a fundamental restructuring of the economy. Though growth picked up, this was on the back of heavy public spending, which only led to huge fiscal deficits and increasing external debt. This finally culminated in a full-blown crisis in 1990-91 when the rise in oil prices due to the Gulf War put a tremendous strain on India's balance of payments position. Foreign exchange reserves plummeted to being enough for just two weeks of imports and India was in serious danger of defaulting on its external debts. The IMF came up with a bailout but there was no escaping the fact that the Indian economy needed drastic reforms. These were undertaken with a major delicensing exercise in 1991. Industrial licensing was scrapped, imports liberalised, foreign investment levels hiked. Over the years, sector after sector was slowly opened up to competition – domestic and foreign.

Twenty-one years later, can India take its place among the market economies of the world? And has the economic liberalisation process served its purpose – of a robust and freer economy that provides a range of opportunities to its people and allows them to take advantage of them?

To answer that, it is necessary to first understand what economic reforms and liberalisation actually mean. Simply put economic reforms or liberalisation involves the removal of distortions in the economy caused by too much state intervention, bordering on state control, in the free play of market forces and economic actions by individuals and groups.

Going by this, the liberalisation process has had its ups and downs. For the first four years, it proceeded well, but began faltering in the mid-1990s when a series of electoral setbacks suffered by the Congress Party was blamed on economic reforms. The pace picked up again from the late 1990s, with tax reforms being initiated, setting up of a Disinvestment Commission and later a Disinvestment Ministry, strategic sale of public sector undertakings (PSUs), repeal of the

Urban Land Ceiling and Regulation Act (ULCRA), among others. From 2004, however, the reforms pace has slowed down and even been reversed in some cases. Worse, India appears to be slipping back to a welfare state, with several legally enforceable entitlements – from work to education to food – being legislated or in the process of being legislated, with little concern for their fiscal or economic fallouts.

Liberalisation – the Ups and Downs

Industry

The industrial sector has been the focus of much of the economic reforms. In 1991, industrial licensing was abolished for all but 18 industries; the number of sectors reserved for the public sector was reduced from 12 to 8; imports were liberalised; the Monopolies and Restrictive Trade Practices (MRTP) Act relaxed. Besides, certain sectoral measures were also taken. The 1991 Automobile Policy opened up the auto sector to foreign manufacturers and the New Power Policy allowed private participation in power generation. Since then the process of delicensing continued. In 1993, the telecom sector was thrown open to the private sector. Even defence equipment has been opened up to the private sector. Small scale sector reservation, which had discouraged industrial units from achieving economies of scale and becoming efficient, remains, but for a very few industries.

All this (accompanied by a host of other reforms in the financial sector and the capital markets, deregulation of interest rates, easier access to external finance etc.) has given greater operational flexibility to industry. Companies were now free to decide which areas they should invest in, the location of their plants, how much to produce etc. This has led to the emergence of new players in established industries as well in sunrise industries like pharmaceuticals, biotechnology etc. Entrepreneurship has received a huge boost, especially in the service sector. The pressure of competition has increased but so has the ability of companies to face up to it. Indian

firms that once tried to stall the liberalisation process – under the garb of ‘level playing field’ – out of fear of being swamped by foreign competitors soon started out-performing these very competitors.

Going one step further, Indian companies are now challenging foreign firms on home turf. The second half of the 2000s has seen the proliferation of Indian multinationals as domestic firms have set up manufacturing centres and bought companies abroad, even acquiring iconic global brands like the Jaguar Land Rover. The flip side to this is the concern that one reason for Indian firms investing abroad could be the less-than-favourable domestic investment environment.

While delicensing did end the permit-quota raj, inspector raj, however, continues to thrive, especially at the state-level where there is a plethora of regulations that industrial units have to comply with. While some amount of regulation may be necessary, especially on matters concerning safety and the like, many of these regulations give too much discretionary power to the inspectors and this only increases the scope for corruption and hence transaction costs for business. Amendments to labour laws designed to give industrial units freedom to restructure operations as and when needed, have been bypassed by successive governments.

Agriculture

Agriculture has always remained a neglected sector, both during the era of planned development and the liberalisation period. The reforms period has not been very kind to agriculture. Agricultural growth declined to 2.29 per cent per annum during the 1990s (1989-90 to 1999-2000) from 3.72 per cent per annum during the 1980s. In the first decade of 2000, it went up marginally to 2.7 per cent per annum. Public sector investment has been crucial to the development of agriculture related infrastructure like irrigation, electricity, agriculture research, roads, markets etc. However, this has remained stagnant at 0.5 per cent of GDP. Much of the public resources being spent on agriculture are going towards subsidies

instead of the creation of productive assets. Subsidies on power and water are close to 40 per cent of the total subsidies being given to the agriculture sector. Free power and water or extremely low user charges only result in wasteful use of these resources and create collateral problems. At the same time, there has been little progress in protecting agriculture from the vagaries of rainfall. Besides, blanket subsidies often result in misuse. Subsidies are enjoyed not just by large farm owners but also by owners of urban 'farmhouses' where there is little agricultural activity. Such cases may be a very small percentage of the total spending on subsidies to agriculture but the problem needs to be addressed only to establish the principle that subsidies should go only to the deserving. Besides, given the burden on the exchequer, any saving on the subsidy bill that can be put to more productive use should be explored.

The poor performance of the agricultural sector, without a robust growth in the non-farm sector, has largely been responsible for continuing high levels of rural poverty. This needs to be addressed if the slogan of inclusive growth is to have any meaning.

The reason for the sorry state of agriculture is the fact that the sector continues to be subject to a large number of government controls - on pricing and movement of agricultural goods, marketing and credit. There was some easing of licensing requirements and restrictions on storage and movement of wheat, rice, sugar, edible oilseeds and oils, decanalising of the export of agricultural commodities and easing of export controls in the first decade of liberalisation. But these have been reversed and then restored in an ad hoc manner. When there is a shortage of a commodity in the domestic market, the government immediately clamps down on exports, raises stocking limits and brings back the Essential Commodities Act, designed to check hoarding. But when there is a glut of a commodity, the lack of cold chains and storage infrastructure results in farmers having to sell their produce at distress prices.

The state-level Agricultural Produce Marketing Acts, which

require farmers to sell their produce only at designated *mandis*, remain on statute-books despite overwhelming evidence that these do not help farmers or consumers. The restrictions imposed by the APMC Act are a disincentive to private sector investment in cold storage facilities and other supply and transport infrastructure as well as for the food processing industry and organised retail industry which can give farmers better returns for their produce. Close to 40 per cent of India's fruit and vegetable production goes waste as a result. The ad-hocism that appears to be the hallmark of the policy on agricultural exports has given India the reputation of an unpredictable supplier, and prevented farmers from benefiting from the export market.

All this combines to prevent farmers from getting better returns for their produce, whether in times of shortage or plenty. Y. Sivaji has aptly captured this conundrum when he says "often the burden of falling international prices falls immediately on the farmers and the gains of increasing international prices are cornered by middlemen."[i] It is the inability to get a remunerative price for their produce that leads to farmers being unable to service their debts, one of the reasons for the large number of farmers' suicides.

Services

The services sector, which has largely escaped the government's heavy-handed regulation and micro-management, has flourished after liberalisation, benefiting from the freeing of controls on industry and the financial sector. With the liberalisation process throwing up new opportunities, a host of new services emerged offered by imaginative and resourceful entrepreneurs. India has also been a major exporter of services, especially in the information technology and information technology-enabled services. The Indian IT and ITES sectors are seen as a threat to companies in more advanced economies. India's share in world service exports has increased more than six times – from 0.5 per cent in 1990 to 3.3 per cent in 2010. India,

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[i] Pre-budget memorandum to Union finance minister reproduced in *Freedom First,* February 2012.

which plays the protectionist card at the World Trade Organisation (WTO) on industry and agriculture, is aggressive in demanding more openness by advanced economies in the service sector negotiations. At the same time, it continues to be protectionist and closed when it comes to opening up some sectors like law and education.

Financial Sector

Banking sector reforms were kicked off in 1992 and have been continuing since then. Private banks, including foreign banks, have been allowed to operate and their reach is now extensive. This has ushered in much-needed competition into the sector, improving services in public sector banks as well. Interest rates have been decontrolled. Both deposit rates and lending rates have been deregulated. Banks are being given greater operational freedom than before and mandatory requirements on investment in government securities, priority sector lending etc have been eased.

However, public sector banks are still not completely free of government control and political interference. A Bill on reducing government stake in public sector banks to 33 per cent was tabled in 1999 but nothing came of it.

The public sector monopoly in the insurance industry finally came to an end in 1999. Apart from the six public sector insurance companies that were the only insurers in 2000 when the sector was opened up, there are now close to 50 insurance firms and the stiff competition among them has been a boon for consumers. A strong regulator – the Insurance Regulatory and Development Authority – has set strict guidelines for insurance firms. However, there are still restrictions on the extent of foreign investment in insurance firms.

The Indian capital markets have seen far-reaching reforms, the biggest being the setting up of a statutory regulator, the Securities and Exchange Board of India in 1992. This has resulted in better governance of the stock markets and there is far more transparency than before.

One financial sector reform that is still pending is full capital account convertibility, though the capital account has been liberalised quite extensively in phases. But this is still an issue on which there is little consensus, even among economists who favour liberalisation.

Infrastructure

Realising that rapid economic growth is not possible without quality infrastructure, and that it is not possible for the government alone to provide for all the infrastructural needs of a growing economy, the sector has been opened up to private players gradually since 1991. Roads, electricity, ports, civil aviation, telecommunications are no longer state monopolies that they once were. In some areas like roads and highways where private sector interest is a bit subdued, the government is encouraging public-private partnerships. A new Electricity Act, which replaces the multifarious and outdated laws that governed the sector and which allowed private participation in generation and distribution of power, is now in place. But the overall infrastructure sector presents a mixed bag of achievements.

Electricity: Once a state monopoly, the sector has been opened to the private sector in both generation as well as transmission and distribution. There is an open access system in place at the inter-state transmission level, which gives freedom of choice to both buyers and sellers of power. Distribution too is no longer a public sector monopoly. It has been privatised in some cities like Delhi while franchising arrangements – where a private firm manages the distribution network and collects revenue – are in place in others. However, there is no competition in this area and public sector monopolies have only been replaced by private sector monopolies. The sector is regulated by an independent Central Electricity Regulatory Commission at the centre and state-level state regulatory commissions, which set tariffs. But there is still political interference in tariff setting and governments have been known to reverse tariff hikes recommended by state-level regulators. The whole idea of depoliticising tariffs does not seem to have worked.

***Roads*: **The poor state of Indian roads is a hindrance to industrial and agricultural development. The private sector has not responded too enthusiastically to attempts to attract private investment in the roads sector. The concept of toll roads has now been introduced in the roads sector. After some initial resistance, road users are now reconciling themselves to the idea of paying for road use.

Telecommunications: The telecom sector has been a success story of private sector involvement in infrastructure and testimony to how free competition ultimately benefits the consumer. Starting with opening up email, voice mail and cellular services to the private sector in 1991, competition has now been allowed in basic services and national and international long distance services as well. All this has led to a tremendous increase in connectivity. Tele-density, which was less than 1 per cent in March 1991, is now over 70 per cent. Cellular phones, once considered a luxury, are now a lifeline for service providers like electricians, plumbers, food hawkers, roadside tailors – the very section the market was not expected to cater to. There are over 650 million mobile phone connections across the country now.

Unfortunately, telecom is also one sector that has been beset by scams. But this again relates to the granting of licences and sale of spectrum, which are in the domain of the state. This, however, is not to argue that the state not have a role at all in this.

External Sector

Since 1991, the Indian economy's exposure to the world economy has increased tremendously.

The phased reduction of tariffs and removal of quantitative restrictions (QRs) on imports has meant more competition for domestic industry (though the government does tend to intervene from time to time to protect different industry segments). The use of tariff walls has become limited because of obligations to reduce rates under the World Trade Organisation obligations. But the use of non-tariff barriers

is still quite common. While this may help the producing industry, this often works to the detriment of the user industries which are denied the benefit of cost-competitive inputs and consumers in general.

A stronger domestic industry has also been able to take advantage of opportunities in the export markets. India's share in global merchandise exports has increased from 0.5 per cent in 1990 to 1.5 per cent in 2010.

India is also more receptive to foreign investment than it was in the pre-reforms era. The first steps towards a more open foreign investment regime were taken in 1991, when the Industrial Policy of that year allowed foreign direct investment (FDI) up to 51 per cent in high-priority industries. Foreign portfolio investments were first allowed a year later, in September 1992.

Since then, the FDI regime has been progressively liberalised, with only nine sectors barred from receiving foreign investment. Even the defence industry is allowed FDI up to 26 per cent. FDI up to 100 per cent on the automatic route is allowed for most sectors. Approvals from the Foreign Investment Promotion Board is required for some; investment ceilings exist for others like telecom, civil aviation and insurance; certain requirements for investors have been stipulated in yet others. But there is still stiff resistance to FDI in certain sectors like retail. The resistance is mainly from domestic business lobbies and other sections whose rent-seeking actions will lose their rationale. No government has been able – or indeed appears willing – to manage this opposition politically.

Privatisation of the Public Sector

This has been one of the most disappointing aspects of liberalisation, one in which there has even been a reversal. The public sector undertakings, often referred to as India's crown jewels are little more than bleeding ulcers (barring a few well-performing ones). The public sector initially came into areas where the private sector could not or did not want to invest large sums of money (though

this is the subject of debate). But over the years, the areas of operation increased to cover hotels and manufacturing of bread.

Realising the drain on the country's resources, disinvestment of government stake in PSUs was first proposed in 1991. Initially only piecemeal sale of government equity was done. The strategy changed in 1998, when the government went in for sale of majority stake to strategic partners along with transfer of management control. The National Democratic Alliance government took the boldest steps in this respect, with then finance minister Yashwant Sinha mentioning the word privatisation in a budget speech. Fifteen PSUs were privatised, ranging from bread manufacturer Modern Bakeries to telecom major VSNL to mining companies like Balco and Hindustan Zinc and petrochemicals company IPCL.

But privatisation has come to a halt since 2004, when the United Progressive Alliance came to power. One of the first actions the government did was to remove a section on the disinvestment ministry website that listed out the rationale for privatisation. The government has said it will not let its stake go down below 51 per cent in PSUs, ruling out strategic sales altogether. As a result, disinvestment is once more about offloading bits of government stake in PSUs.

Even this process has become a farce – and a method of plugging the fiscal deficit - with cash-rich PSUs being made to buy back their shares or other PSUs like the Life Insurance Corporation of India buying shares of PSUs when investor interest has been low. This amounts to the government taking money out of one pocket and putting it in the other. The logic of privatisation/disinvestment should be to end/reduce government control of PSUs, not generating revenues for government coffers.

Not just is the government going back on privatisation, it is also going out on a limb to protect non-performing PSUs – Air India being the most telling and shocking example. The government has

cleared a Rs 30,000 crore financial package, but there is no mention of professionalising the board or top management. Air India has run into problems only because of excessive government control and lack of professional management.

Independent Regulators

Independent regulators are necessary in a free market to check market distortions and safeguard the interests of the consumers. To this end, several independent sectoral regulators have been set up since 1991. These are the Securities and Exchange Board of India (SEBI) to govern the stock markets; the Telecom Regulatory Authority of India (TRAI) for the telecom sector; the Central and State Electricity Regulatory Authorities (CERC and SERCs); the Insurance Regulatory and Development Authority (IRDA); the Petroleum and Natural Gas Regulatory Board; the Competition Commission of India to check anti-competitive practices; and the Pension Fund Regulatory and Development Authority to regulate the pension sector.

However, the functioning of some of these regulators has not been satisfactory. The government has been reluctant to give up control over the various sectors these regulators oversee and has failed to give them genuine independence, as they are dependent on the government for finances and basic infrastructure. The regulators are mostly headed and staffed by retired and serving bureaucrats, often from ministries overseeing the sectors they regulate. The government has a tendency to ignore the advice of the regulators when it suits it. Where the regulators set tariffs, as in the case of the electricity sector, tariff hike orders tend to get overruled.

Tax Rationalisation

Tax rationalisation has undoubtedly been one of the success stories of the reforms process. However, there are a large number of exceptions and concessions on various grounds in both direct and indirect taxes. Such tax sops are estimated to have touched Rs 529,000 crore in 2011-12. While some concessions are necessary to encourage

savings or give a fillip to some sectors of the economy, as a broad principle, exemptions increase the complexity of the tax structure, reduce government revenues, shift the burden of taxation to other non-exempt groups and encourage lobbying by vested interests.

Direct taxes

The maximum rate of personal income tax was brought down from 56 per cent at the onset of reforms to 30 per cent now. Corporation tax, which ranged between 51.75 per cent and 57.5 per cent in 1991-92, is now a uniform 30 per cent. There are now only three slabs for personal income tax (10-20-30 per cent) and one for corporate income tax (30 per cent).

Far from leading to lower collections, tax revenues have been buoyant and actually increased, proving the point that lower tax rates actually increase compliance. Of course the lower tax rates were accompanied by measures to widen the tax net, but it is a moot point if this would have been successful without a lowering of tax rates and simplifying the tax structure. The share of direct taxes in total tax revenues increased from 19.1 per cent in 1990-91 to 56.6 per cent in 2010-11. The share in GDP has also increased, from 1.9 per cent to 5.4 per cent in the same period.

The government has now tabled a Direct Taxes Code Bill in Parliament which will replace the Income Tax Act, 1961. The purpose of the Direct Taxes Code is to widen the tax base, moderate tax rates and cut down exemptions, thus increasing tax collections.

But the government's latest move to retrospectively amend the Income Tax Act, 1962, to tax certain capital gains in corporate acquisitions, after it lost a case against telecom company Vodafone is a worrying development. Amending tax laws with retrospective effect creates uncertainty and unpredictability of tax laws.

Indirect taxes

The simplification and rationalisation of the complex system

of indirect taxes, especially excise duty, has been a major achievement of the reforms process. In the 2000-01 budget, the excise duty structure was rationalised to a single rate of 16 per cent Central VAT (Cenvat). The 2001-02 budget replaced the three special rates of 8 per cent, 16 per cent and 24 per cent with a single rate of 16 per cent. Currently, there are three rates – the highest rate of 12 per cent, a merit rate of 6 per cent and a minimum rate of 2 per cent. But there is still some tinkering with rates that finance ministers do, depending on requests from industry.

Importantly the country has moved towards a nation-wide single value-added tax (VAT) system. The next step, a single Goods and Service Tax has got delayed because of concerns over revenue loss on the part of state governments.

In line with the policy of import substitution, India's customs duties were among the highest in the world. Tariffs in India once were as high as 300 per cent. Peak customs duties on non-agricultural goods are now down to 10 per cent. However, the doubling of the import duty on gold to 4 per cent in the 2012-13 budget is a regressive step. The increase was explained as a step to discourage Indians from parking their money in gold, an unproductive but safe and guaranteed returns investment, instead of financial markets. Though the government has argued that the 4 per cent duty was not high enough to encourage gold smuggling (quite common in the pre-reforms era when the Gold Control Act, 1962, placed a number of restrictions on gold holdings), such measures only show the government's inclination to meddle in economic decisions of individuals and perhaps later companies.

One large segment of the economy, agriculture, continues to be outside the tax structure. The subject of agricultural income tax is a political minefield which no party is willing to negotiate.

Legally Enforceable Entitlements

Since 2004, there has been a growing clamour in favour of

rights-based entitlements and some entitlement programmes have already been legislated or are in the process.

The ***Mahatma Gandhi National Rural Employment Guarantee Act*** guarantees 100 days of wage employment in unskilled work to adults in rural households. Those who do not get work after applying are entitled to an unemployment allowance. The scheme, launched in a phased manner in 2006 and which now covers the entire country, has been lauded as a success – as of 2010-11, it has provided 5.49 crore households with employment.

But what is worrying is that a scheme that was supposed to provide succour in distress is becoming a permanent job generator. Wages under NREGA were set at Rs 65 initially but are now linked to statutory minimum wages in each state. As a result, people from the poorer states who migrated to the richer states to work on farms and factories now prefer to stay in their villages. This has pushed up the cost of labour for more productive sectors like industry and agriculture. Indeed, the cost of farm labour is reported to have increased almost 40 per cent. While it is good that people are now finding jobs closer to their native places and that unskilled workers are now in a position to bargain for better wages, one question that needs to be asked is if they are also being encouraged to move up the skill ladder? Or is NREGA willy-nilly encouraging people to remain satisfied with low-skill jobs, which is not beneficial either to them or the national economy in the long run. Apart from this, there is also the problem of large-scale corruption in the implementation of the scheme.

The ***Right of Children to Free and Compulsory Education (RTE) Act*** was enacted in 2009 to give effect to the Right to Education that became a fundamental right in 2002. The Act stipulates that all children between the ages of 6 and 14 shall have the right to free and compulsory elementary education at a neighborhood school. To this end, even private unaided schools have to reserve 25 per cent of their seats for students from economically weaker sections. The

government will compensate these schools in line with the cost of providing education in government schools. The Act stipulates minimum standards on infrastructure and teacher-student ratio, among other things, and warns defaulting schools of de-recognition.

While the intent is laudable, whether this is the right way to achieve this is open to question. One, this will prove a huge burden on the exchequer, with the initiative expected to cost Rs 2.3 lakh crore. This does not include the subsidy that the government has to provide to private schools. Two, the implementation may have unintended consequences in the form of closure of low-cost private schools catering to low-income students. These schools may not be able to meet the strict norms that the RTE Act sets out, but they were still serving a need. With their closure, it is doubtful if other schools have the wherewithal to step in and fill the gap.

The intent of the RTE initiative may perhaps have been better served by exploring other alternatives – vouchers, easing infrastructure norms for schools catering to the poor and the like.

Even as the NREGA and RTE Acts pose implementation challenges, the government has tabled a ***National Food Security Bill***, which entitles 75 percent of the rural population and 50 percent of the urban population to a specified quantity of foodgrains a month. Anyone not getting this specified quantity can claim a food security allowance from the state government. This imposes a huge burden on the exchequer. Though the food minister has pegged the annual cost of the project at between Rs 80,000 crore and Rs 1 lakh crore, a Working Group on Centre's Financial Resources for the Twelfth Plan estimates it to be closer to Rs 5.5 lakh crore.

While there is no denying that a large section of India's population does go hungry – India ranks 67 among 122 countries in the Global Hunger Index rankings – it is also a fact that the problem is the result of the government not being able to manage foodstocks efficiently. Government-determined procurement prices that are higher than what the market offers forces the government to purchase large

quantities from farmers. Inefficiencies in the public distribution system result in the poor not getting the subsidised foodgrains meant for them. The lack of investment in storage capacities results in surplus foodgrains rotting even as people starve. In such a scenario, a guaranteed food security legislation is hardly likely to help.

The problem that each of these legally enforceable entitlements is addressing is not the result of liberalisation but a lack of it. Freeing up agriculture and the rural economy and the unorganised sector can result in more employment opportunities. Easing the stifling regulations on private schools can help more schools to come up and provide competition to poorly run government schools and thus increase options for those wanting to educate their children. Removing the distortions in the food economy can help address the problem of hunger.

There will still be people who will be left out of such market-based approaches and it is nobody's case that they be abandoned. Alternative methods to provide for them can be considered – direct cash transfers, education vouchers, food coupons. A legally enforceable rights approach will only perpetuate for eternity a system that will create an expansionary state, which could well end up becoming an interventionist state in order to fund its ever-increasing role.

Impact of Liberalisation

Has the economic reforms process had the effect it was supposed to – a more robust economy, increased prosperity and a reduction in poverty?

Macro Economic Stability

The reforms that were kicked off in 1991 did have an impact on the economy. Growth of gross domestic product (GDP) spurted from 0.8 per cent in 1991-92 to 5.3 per cent in 1992-93.[ii] GDP

[ii] At 1980-81 prices.

growth kept up this upward spiral and averaged 5.5 per cent in the 1990s. Inflation, which had soared to 13.7 per cent prior soon came down to single digits and has remained at that level since then, even going down to 2 per cent at several points of time. The reforms also strengthened India's external sector substantially. The share of both exports and imports in GDP rose. This was prompted by liberalisation and decline in real exchange rate in the case of exports and strong domestic demand and lowering of tariff and non tariff barriers in the case of imports. From a current account deficit of 3.1 per cent of GDP in 1990-91, India had a current account surplus of 0.8 per cent of GDP in 2001-02, for the first time in 23 years, though current account deficit levels are now at worrying levels.

India is now the world's fourth largest economy in PPP terms and is also among the fastest growing economies. Its share in world GDP is 5.5 per cent, against 3.2 per cent in 1990.

The economy did go through its ups and downs. There was a slowing down of growth in the late 1990s following the East Asian financial crisis and again in the early 2000s in the wake of a slowing down of the world economy. But the economy bounced back and growth crossed the 9 per cent mark for three years in a row in the mid-2000s. Another, more serious, economic crisis in the western economies once again saw growth slowing first to 8 per cent and then to 6.9 per cent between 2010 and 2012. This, of course, is an indication that the Indian economy is now more integrated with the global economy than it was before.

Public Finances

Public finances continue to be a major source of worry. The fiscal crisis of 1991 was in no small measure due to the high fiscal deficits of the 1980s, caused by huge public spending. The combined fiscal deficit of the Centre and the states touched 10 per cent in the crisis year. Fiscal consolidation, therefore, became a crucial element of the reforms process.

Initially, the fiscal deficit at the Centre did fall from 8.3 per cent of GDP in 1990-91 to 5.9 per cent in 1991-92 but increased to 7.4 per cent in 1993-94. Since then it hovered around the 5 per cent mark for several years but started going up again since 2008-09.

A major step in the direction of fiscal reform was taken when the National Democratic Alliance government tabled the Fiscal Responsibility and Budget Management Bill in 2000. It was enacted in 2003 and the FRBM Rules notified in 2004. Under the Act, the central government was to reduce its revenue deficit by 0.5 per cent of GDP every year from 2003 and eliminate it entirely by 31 March 2008. The fiscal deficit was to be reduced to 3 per cent of GDP by 31 March 2008, with an annual reduction of 0.3 per cent of GDP from 2003.

Yashwant Sinha, the finance minister who introduced the FRBM Bill in 2000, started working towards meeting these targets even before it became an Act. Initially, the United Progressive Alliance government worked at keeping to the targets of the Act. Fiscal deficit came down to 2.5 per cent of GDP and revenue deficit to 1.1 per cent of GDP in 2007-08 – the deadline year. This was because then finance minister P Chidambaram decided to push back the FRBM targets by one year in 2005-06 because of the changed pattern of devolution of finances from the Centre to the states. There were hopes that with some fiscal discipline, the government would be able to meet the FRBM targets in 2008-09 and that future governments would stick to the path of fiscal rectitude.

However, fiscal slippage set in the very next year, with the fiscal deficit soaring to 6 per cent in 2008-09. This was attributed to the fiscal stimulus packages in the form of tax sops and stepped up spending on infrastructure given to industry to help it tide over the global economic crisis. In addition to this, there was stepped up spending on welfare projects like the National Rural Employment Guarantee Scheme, which saw a 144 per cent increase in outlay. The

revenue deficit also soared to 4.5 per cent of GDP. Though the finance minister said this was a matter of concern and that the government would "address this issue in right earnest to come back to the path of fiscal consolidation at the earliest" this did not happen. The states have been doing better in this respect but the combined deficit of the Centre and the states is close to 7 per cent in 2011-12.

There is a point of view – much debated, however – that a high fiscal deficit can be condoned if it results in the creation of physical assets and infrastructure. Unfortunately in India, the high fiscal deficits are often because of unproductive expenditure like subsidies or welfare schemes which create a dependence on government doles.

It is perhaps too much to expect subsidies to be eliminated entirely. The poor perhaps need a measure of government support, though the extent of such assistance is debatable. The welfarist view is that the poor need to be given most things free of cost or that the government has to step in to cater to them since the market does not. But there is enough anecdotal evidence that the poor are willing to pay for goods and services and that the market does cater to them. In any case the extent of subsidies in India – they accounted for 28 per cent of the government's revenues as of 2011-12 – shows that these are going even to the better off and even affluent sections of society.

Subsidies usually take the form of government control on prices, so that a good costs the same for persons at two entirely different points on the income scale. If the government compensates the producer of the good, it is a drain on the exchequer and a waste of tax payer's money. If the producer is not compensated for selling the good at a loss, then there is no incentive for him to produce more, leading to scarcities which, in turn, lead to the development of a black market. If there is dual pricing of a good – one for the poor (through fair price shops) and one for the non-poor – this leads to diversion and black marketing.

In 2002, an ambitious programme of phased dismantling the administered pricing mechanism (APM) in the case of petroleum products was kicked off. Public sector oil marketing companies were to be free to sell some petroleum products at market-determined prices. This worked well for two years but since 2004, the government has deprived the oil companies of this freedom and has not been allowing price increases when and to the extent they are needed. This is really reversing a much-needed reform measure, both from the point of public finances (the government subsidises part of the losses the oil companies suffer) and the financial health of the public sector oil companies (they have to suffer losses for a part of the under-recoveries).

This is also proving to be a disincentive for private players, since they are not in a position to offer the highly subsidised rates of the public sector oil companies and lose custom to the latter. Reliance Petroleum, which had entered the retail petroleum product market, had to close these operations precisely for this reason. So the retail sector continues to be a public sector monopoly.

A better way of delivering subsidies – one that eliminates leakages and diversion and ensures that only the poor get it – is to shift to direct cash transfers. For a long time, this remained only a topic of academic-ideological debate in India. However, since the 2010-11 budget it has moved into the realm of policy. Some pilot programmes are under way to see how direct cash transfers work at the ground level.

Poverty

The structural adjustment programme has often been criticised for being anti-poor. But there is enough statistical evidence that poverty has been declining steadily, and since 1991 at a faster pace than before. The latest figures put out by the Planning Commission shows that the percentage of people below the poverty line has fallen to 29.8 per cent in 2009-10 from 37.2 per cent in 2004-05 (Table 1).

Table 1
Population below poverty line (percentage)

Year/Category	Rural	Urban	Total
1993-94	50.1	31.8	45.3
2004-05	41.8	25.7	37.2
2009-10	33.8	20.9	29.8
Rate of reduction (percentage)*			
1993-94 – 2004-05	0.8	0.6	0.7
2004-05 – 2009-10	1.6	1.0	1.5

** simple annual arithmetical average*

Source: Planning Commission Press Release dated 20 March 2012

There has been criticism over the methodology (based on the Tendulkar Committee recommendations) of arriving at these figures, which are said to underestimate poverty. The percentage of poor in the rural areas (and hence at the national level) increased after the Tendulkar formula was accepted in 2010 (Table 2). However, the fact of the decline cannot be denied, regardless of the formula followed.

Table 2
Difference in poverty ratios based on different formulas

	Estimates based on Lakdawala formula		Estimates based on Tendulkar formula	
	1993-94	***2004-05***	***1993-94***	***2004-05***
Rural	37.3	28.3	50.1	41.8
Urban	32.4	25.7	31.8	25.7
Total	36	27.5	45.3	37.2

Source: Economic Survey, 2011-12

While the overall picture is encouraging, there are wide inter-state variations, with poverty ratios being well above the national average in nearly ten states. Bihar has the highest poverty ratio of 53.5 per cent, followed closely by Chhattisgarh with 48.7 per cent. Within states, too, there are huge disparities.

Employment

The other criticism levelled against the reforms process is that it has led to jobless growth. Indeed, employment seems to be a mixed bag of achievements. At 2.62 per cent in 2004-05, growth in employment has been less than the growth in the labour force (2.84 per cent), which has been the general trend in employment in India. The unemployment rate has also increased – from 6.06 in 1993-94 to 6.6 per cent in 2009-10, spiking to 7.3 per cent and 8.2 per cent in 1999-2000 and 2004-05 respectively.

Non-agricultural employment grew faster than agricultural sector employment between 1993-94 and 2004-05 (3.49 per cent and 0.40 per cent respectively).

In the organised sector, which employs 287 lakh persons as of 2010, employment growth has been largely stagnant since 2001, barring a few years when it exhibited a 1 per cent or 2 per cent growth. Within the organised sector, however, it is the private sector that is contributing to employment growth at an average annual rate of around 2 per cent since 2001. After negative growth between 2002 and 2004, the annual growth has ranged between 2.4 per cent and 6.4 per cent. Growth in public sector employment has been stagnant.

These figures are an indication also of a structural shift in employment – from the organised to the unorganised sector, as new forms of work relationships in the form of contract labour, temporary labour evolve in a more flexible labour market scenario. Employment in the unorganised sector is more uncertain than in the organised sector but more flexible labour arrangements are needed by industry to cope with competition and seasonality of demand.

The less than satisfactory performance on the employment front is as much the result of lack of employment opportunities as lack of employability of those entering the labour force. Less than 5 per cent of those entering the labour force in rural areas are skilled. Only 5 per cent of young workers had post-secondary education. This, in turn, is the result of a shortage of education opportunities as well as a centralised, over-regulated and restrictive education sector, which does not cater to the needs of the job market. Participation by specific industries or sectors in vocational training or technical education is low as attempts to revamp the syllabus or curricula to meet market requirements is resisted. Education reforms have been initiated but these do not appear to be addressing the problem of over-centralisation.

Corruption

One of the reasons for getting the state out of the economy is to reduce the scope for corruption. Chances of corruption increase when demand for a good or service is more than the supply and/or if someone has the sole discretionary power to allot a good or service. When the supply is increased or the discretionary power is removed, corruption does decline. A case in point is telephone connections. Before the telecom sector was thrown open to the private sector, the waiting list for connections was huge and bribing to jump the queue was common. Greasing the palms of linesmen for repairs was also common. All this became a thing of the past once private players were allowed in and supply of telecom services increased exponentially. This became true for a host of other goods and services.

Unfortunately, while petty level corruption seems to have disappeared, high-level corruption has not. In fact, it appears to have increased. A recent book, *Corruption in India: The DNA and the RNA* by Bibek Debroy and Laveesh Bhandari, makes the same point. The authors call the petty corruption DNA and the mega scams RNA. The DNA or small-ticket corruption, they have found, has declined with economic reforms. But this has not been the case with the RNA or big-ticket corruption. “.. .the RNA kind of corruption doesn’t ease

with economic reforms. If anything, the evidence is to the contrary. Reforms seem to throw up opportunities for big-ticket corruption." The authors point out that since 1991, not only has the monetary value of scams increased, but so has the frequency.

A related issue is that the economic reforms process does not seem to have ended the phenomenon of crony capitalism that was the hallmark of the pre-reforms era. Powerful industrial sectors as well as companies are able to tweak policy to suit their interests or get fiscal concessions. Incumbents in a particular sector often succeed in influencing policy to prevent new entrants coming in and giving them competition. the opposition to FDI in the retail sector, for example, has as much to do with opposition from domestic organised retail as from unorganised retail and political ideology. The murky deals that characterised the pre-reforms era are still very much a part of the government-business relationship landscape.

Conclusion

Liberalisation, thus, has been a mixed bag of achievements and failures. The failures have led to a lot of scepticism with liberalisation and globalisation. This has become more marked with the economic crisis in the western economies and the very logic of free markets has come to be questioned. What is lost sight of is the fact that the failures can largely be attributed to either the lack of genuine reforms, half-hearted reforms or the wrong kind of reforms which benefit only certain groups. Reforms have been carried out only in areas which benefit large industry and vocal groups, while those affecting the less articulate sections – small farmers, small and medium industry, unorganised sector – have been delayed, often because these hurt more influential groups.

It has become fashionable to blame the slow pace of reforms after 2004 on coalition politics. But recent Indian history shows coalitions do not stand in the way of tough economic measures. P. Chidambaram earned the reputation of a liberaliser during the tenure of the United Front coalition government, which was not only a shaky coalition but also had the Communist Party of India (CPI) participating

in it. The National Democratic Alliance (NDA) government also took several bold steps, especially on privatisation and dismantling the administered price mechanism for petroleum products.

Indian industry must also take some blame for stalling reforms, though it is the one that complains the loudest about the lack of it. Industrialists and businessmen who benefited the most from liberalisation and competition have no compunction in lobbying against policies and measures that will make them face a more competitive market place.

Political groups and others who oppose the move to a more open economy often claim to speak on behalf of the ordinary people who, they insist, will be hurt by steps to reduce or withdraw subsidies, open up sectors to foreign investment and the like. It is this mindset that sees any reform or tough economic decision being put off whenever elections are round the corner. What this points to is the need for political management of reforms – going out and explaining to people why certain steps are necessary, how the short term pain will be offset by long term benefits and how current economically-unsound policies are unsustainable. The political class cannot be expected to undertake this. It benefits from the lack of awareness in the public, which allows it to continue with its sweetheart deals. Unfortunately, even economists and other intellectuals who support a more open polity and economy have not addressed themselves to the larger body of people in whose name reforms are opposed. This needs to change. A broad-based support for reforms needs to be built up.

There is no doubt that liberalisation is not just inevitable, but also desirable and needs to be taken forward. What the country needs are reforms to ensure genuine competition.

Seetha is a journalist and author. She is the author of *The Backroom Brigade: How a few intrepid entrepreneurs brought the world to India* and co-author of *The Maruti Story: How a public sector company put India on wheels.* She had also authored the earlier Liberalisation: *A Balance Sheet*, published in 2002.

Session 2

Getting On With the Reforms Process

Chairing the second session, eminent economist, Corporate Executive, President of the Forum of Free Enterprise Minoo R. Shroff asked: "Are economic reforms inevitable? If the answer is yes why are we stuck – what is putting us back?" The paper presented by Sunil Bhandare, leading economic consultant and Chairman of the drafting group of the Liberal Budgets produced between 2004 and 2008, dealt with the issues raised by the chair – and more.

Chairman's Remarks : Minoo R. Shroff

We have an excellent background paper and we could start with the assumption that there is no doubt that liberalization is not just inevitable, but it is also desirable. It needs to be taken forward. When we all seem to be convinced, then where is the rub? This is what Mr. Bhandare is going to tell us.

I have great regard for his erudition and for his balanced views. We have participated in many programmes together. He is my colleague on the Council of the Forum of Free Enterprise. And with his rich experience, he has been at the top of the economic think tank of Tatas for so many years. We can look forward to a stimulating presentation.

The main question I would like to pose is: Are reforms inevitable? If the answer is yes why are we stuck - what is putting us back? Is it only the trumped up excuse of coalition compulsions? But as rightly pointed out by Seetha, did we not have coalitions during the last 30 years. In Europe coalitions have worked successfully for decades. Even in Britain, after a hundred years, they have a coalition government now.

During my meetings with some Union Ministers and Senior Officials, I have gathered the distinct impression that that the freeze

in Government's decision-making is predicated on electoral compulsions.

What Kaushik Basu, the Prime Minister's Economic Advisor, observed in USA, that no major reforms can be expected till 2014 is a reality. Look at Air-India. Several Ministers in private have admitted that it is a bottomless pit and it can never be made viable under state management. However, the political class will not consider privatization purely because they do not want to let go the privileges and patronage enjoyed under State ownership. The only excuse trotted out is that it is a national career and we must retain it as a matter of national pride. But at what cost ?

The other impression which one strongly gathers during discussions is that the majority of leaders in the present Government are against reforms. It is a well-known fact that Sonia Gandhi herself is allergic to reforms and strongly committed to promoting populist welfare schemes. While many of these schemes are well conceived and are certainly required to improve the living conditions of a vast majority of our population, the economic implications of these are not seriously weighed. More importantly when the schemes are announced and made public the overall costs are not carefully computed and its benefits to the targeted audience evaluated. The real malady is our total incapacity to efficiently deliver public services.

Now let me comment on some of the salient issues raised by the participants. The oft repeated one is lack of governance. This arises mainly because we have a plethora of politicians and hardly any statesmen. As aptly observed by an astute commentator "politicians only care for the next elections while statesmen are concerned with the next generation." Electoral considerations invariably trump good economics. The tragedy with the ruling political dispensation is their sense of over-confidence and smugness. They have ridden roughshod over the serious shortcomings pointed out by the media, the opposition and the public. Consequently we have been landed with so many huge scams which in turn has resulted in

inaction and virtual atrophy. This roadblock has become so obvious in government's dealings not only with the Opposition parties but even with its allies and more importantly forward looking members of its own party. This has resulted in the log-jam on critical reforms such as GST, banking, insurance and other reforms.

On the point of why forward looking businessmen and intellectuals have not formed Think Tanks as in USA, UK and other developed countries which can help mould public opinion and government policies in the right direction. Such efforts were made years back. Highly reputed Think Tanks were approached by certain business groups. These efforts did not fructify as the potential foreign collaborators were allergic to these being promoted by one or two business groups who were most likely to promote their own agenda and would not be considered independent.

There is a raging public debate about subsidies. The public know little about the total national impact of subsidies, explicit and implicit, at the Central and state levels. My discussions with a former Finance Minister way back in 1995 shocked me. I was told that a White Paper prepared by him for the Cabinet listed the total gamut of subsidies which worked out to 11% of the GDP. You know what happened – the Paper was never discussed. The present FM disclosed on the side to some pressmen recently that if a factual evaluation were to be made the total impact of subsidies would work out to an incredible 15% of the GDP. Yet the response of the government to reduce subsidies has been pathetic. The consequence has been swelling of fiscal deficits and slowing down of public investments.

Another important issue was the fast deteriorating Current Account Deficit situation. Last year the CAD exceeded 4% i.e. around $. 75 billion. During the last several years as a result of the spurt in invisible earnings, mainly through exports of IT and remittances by Indians abroad, we were able to meet it comfortably. This combined with comparatively large inflows of FDI, FIIs and commercial borrowings we experienced an increase in our forex reserves.

Unfortunately as a result of our 80% dependence on oil imports, combined with the sharp rise in oil prices and the huge spurt in gold imports (over $ 60 billion), we had a balance payment deficit last year. It is reckoned that only 20% of gold imports are used for jewellery exports whereas the balance goes into personal hoardings as investments. With the current critical situation we certainly cannot afford this drain. A faint effort was made to discourage gold imports by levying a small import duty in the Budget. The bullion traders went on strike and the government buckled in.

It is a sad commentary that with so much going for India in the last decade, we have a sense of gloom around us today. There is, of course, no need for despair as the country has enough material, financial and intellectual resources to put the economy back on the fast track given resolute determination and action.

Time is not on India's side particularly with the global situation being in disarray. We need not wait till 2014 as suggested by some informed commentators for the turnaround. The current sense of complacency that the present situation will get better by itself over time given the country's many inherent basic strengths is totally misplaced. The solution lies in strong political will and assertive public opinion compelling government to act decisively.

Mr. Minoo R. Shroff, President Forum of Free Enterprise, Chairman A. D. Shroff Memorial Trust and Chairman Leslie Sawhny Endowment.

Session 2

Getting the Reforms Process Moving Again

If one were to evaluate the net worth of our country from a balance sheet of the Indian economy covering the entire post liberalisation period, it would show that as compared to the crisis year 1991, there were multifold gains, be it in terms of overall growth performance, structural shifts or qualitative changes. Yet despite these changes, as the Chairman observed, the Reforms have got stuck. How do we get the process moving again?

Presentation : Sunil S. Bhandare

Seetha has presented a comprehensive balance sheet of the Indian economy covering the entire post-liberalisation period. It unfolds distinctive changes in the Indian economy made possible by the process of economic reforms. If one were to evaluate the net worth of our country from such a balance sheet, it would show that as compared to the crisis year 1991, there were multi-fold gains, be it in terms of overall growth performance, structural shifts or qualitative changes.

It was evident from the subsequent lively discussions that there was virtual agreement amongst us that the "reluctant reformers" of yesteryears were eventually convinced about the imperatives of economic reforms for India. Thus, after initial resistance, the constituency of reforms started expanding gradually. The resistance to reforms in the early years was both from the political domain as well as from business and industry. While many amongst the political class were overwhelmed either by the Nehruvian strategy or the call of "Swadeshi", even at that time a substantial section of business and industry clamoured for a level playing – under the banner of what was known as the Bombay Club!

Major Concerns of Policy Paralysis

Seetha has done extremely well in assessing the progress of reforms and their outcomes – how and where we started off in 1991, and where are we at present. She has also highlighted numerous inadequacies and policy faultlines, keeping in view the liberal perspective. Against this backdrop, I would like to focus on some of the following crucial issues:

First, what has happened to the India growth story? Has it been suddenly stunted? Second, are we in the midst of what is generally perceived as policy paralysis? Also, there are growing concerns about whether we are deviating from the path of economic reforms that was started two decades ago; and where are we heading? Will the policy-makers, and the UPA government in particular, be able to steer the reforms process towards the long-pending next phase?

Before turning to these issues, let me highlight some of the striking features of India's economic performance in the post-liberalisation era.

- Evidently, there were two distinctive phases – the first during 1993-94 to 1996-97, when average annual real GDP growth worked out to about 7.5 percent; and the second during 2003-04 to 2007-08 recording average annual real GDP growth of about 9 percent. There was, thus, a remarkable scaling up of the growth trajectory. These phases of high growth also came to be popularly branded as "India Growth Story", "India Shining", "Incredible India" and so on.

  Many experts and several important futuristic studies started projecting that if such high growth rates were to persist for the next 20 years or so, India would probably catch up with China, as the growth rate of the latter would inevitablyslow down, having been around 9 to 10% for the past more than 25 years. Incidentally, in terms of purchasing power parity (PPP), thanks to a spate of high growth phases, India is expected to (would

probably even) overtake Japan very soon.

- Second, the Indian economy had also shown remarkable resilience by withstanding not only the Asian meltdown of 1998, but the global economic crisis of 2008, which led to Great Recession.

- Third, India's globalisation process gathered momentum with a rising share of the external trade of both goods and services as well as of capital inflows and outflows. The external trade represents almost 50% of our GDP; and gross capital inflows and outflows taken together account for about 54% of GDP. Surely, there are inevitable "coupling" (some) implications – either positive or negative – of major global events due to such rapid process of globalization.

- Fourth, India received recognition in the global community for its significant performance in the above parameters as well as its economic resilience and efficient management of the financial system even in the midst of global economic crisis. Thus, though real GDP growth rate slackened to about 7% in 2008-09, it quickly bounced back to an average of about 8.4% in the subsequent two years. India gained recognition as a member of G 20 and as a prominent constituent of BRICS. It has also become an influential player in conceptualizing global policy architecture through international institutions like IMF, World Bank and WTO.

  Seetha has also mentioned the emergence of Indian multinationals, and Indian corporates making their footprints abroad not only in terms of exploring markets for their diversified products, but also in terms of their investment abroad - the outbound FDI.

- Last, but not the least is the fact that high growth was transmitted in the pace of poverty reduction and prompting the political class to become aggressively "populist" or "welfarist" in policy strategy. However, there is a growing feeling that the gains of high growth and associated powerful assets in the balance sheet

of the Indian economy did not trickle down in adequate measure. Consequently, the belief that we have not combined growth with equity and social justice sufficiently and therefore it is time to think more aggressively in terms of a 'welfarist' approach. We strongly feel that there is a premature conglomeration or clustering of various welfare programmes that are currently taking place (currently).

Over the last 18 to 20 months, much has been said about policy paralysis. The first major salvo was fired by a group of fourteen prominent persons (G 14) many of whom were from Delhi and Mumbai. In their open letter written to our political leaders, the G14 brought to the public attention what was really going astray in our progress with policy reforms. It cautioned of the adverse consequences that could befall India's growth story if the government failed to initiate any substantive policy action at this stage. Their focus was primarily on governance and regulatory issues. Before turning our discussion on this vital issue of policy paralysis, let me highlight several likely long-term adverse consequences of deceleration in economic growth.

Implications of a Falling Growth Trajectory

Taking a cue from the current policy predicament, the point which I want to highlight is that we have already retreated from a 9% growth trajectory to less than 7% real GDP growth now. Also, a widely held expert opinion, clearly suggests that achieving even 7% real GDP growth rate in 2012-13 would be extremely tough. If 7% annual growth becomes a new performance norm, then what would be its implications? In substance, it would imply a climb down of at least 2 percentage points from our aspirational level of annual 9 to 9.5% real GDP growth, as envisaged just about a year ago in the Approach Paper of the Twelfth Plan. This would mean that

(a) The pace of prosperity or the rate of per capita income growth would slow down sharply. Thus, doubling of per capita income growth, instead of taking ten years, would require a waiting

period of thirteen or more years.

(b) About 0.5 percentage point less employment growth annually, using the prevailing norm of coefficient of employment growth, which is hovering around 0.25. Every percentage point growth in real GDP leads to about 0.25% growth in employment. If there is 2 percentage point less real GDP growth, the economy would experience about 0.5% less employment growth or a loss of as many as about 2.5 million additional jobs annually. In the context of annual addition to India's labour force of about 10 to 12 million, this would be a huge setback, leading to incremental unemployment rate.

(c) The pace of reduction in the poverty ratio would also be severely impaired. According to one expert calculation (Minaz Merchant, *Economic Times*, May 5, 2012), if India were to grow at 9% per annum probably 75 million people will be lifted above the poverty line, but if the growth rate remains only at 7% annually, only 50 million people could be lifted above the poverty line. According to my own calculation, there would be 1.4 million less people being lifted annually above the poverty line due to 2 percentage point loss in the annual growth momentum.

(d) There would be a loss of tax buoyancy to the extent of about 0.35% to 0.40% of GDP because of fall in the growth rate. In the process, it would erode the government's capacity to undertake social sector welfare schemes. Thus, slowing down of the growth momentum and on the other would cause erosion of capacity to implement social welfare schemes.

(e) There are consequential problems of fiscal management, and among other things, capital formation in the economy will get substantially reduced.

(f) If economic growth continues to slow down, the attractiveness of India in terms of an expanding market size of the economy would tend to decline automatically. Admittedly, with Europe

on the stagnation mode, and the USA finding it difficult to manage even a 2% growth rate, India would still have a relative advantage. But its earlier powerful positioning as attractive estination for the foreign investment in the country amongst various countries when the annual real GDP growth rate happened to be 9% would have been of a different dimension.

So there are huge costs involved in the loss of economic growth associated with the policy paralysis in this country. That is why many people have expressed their concern and we as liberals need to think about how to take forward the reforms agenda within the present political milieu.

In substance, the cost of policy paralysis would essentially be in four or five major areas: First, there is a crisis of credibility and confidence about the ability of the current political leadership to take forward the reforms process; second, a loss of economic growth momentum *per se;* third, a setback to overall investment outlook affecting domestic capital formation; fourth, the loss of growth momentum (*per se)* impacting adversely on employment generation and poverty ratio; and finally, the consequential rapid erosion in India's status as a high growth economy in the global context. Witness also, the recent downgrading by Standard and Poor's (S & P's) of India's outlook from stable to negative; and also put India in its current BBB- investment-grade rating on watch. There was a clear warning signal of India moving into non-investment grade status – a notch lower from its current position to BB+ or what is popularly described as "junk".

The Constituency of Reforms

India is at the cross-roads: the government can either allow the downward drift to continue or recharge the agenda of economic reforms with a view to reversing the on-going economic slowing down. In the morning session, a pertinent question was raised about the constituency of reforms. This issue should invite some more focused discussion. Indeed, two major challenges are: First, how to

expand the constituency of reforms, keeping in view the liberal perspective? Second, what would be a well-defined typical reforms agenda that the liberals ought to aspire for?

To begin with, I have made a very crude attempt to assess the constituency of liberal economic reforms. I have tried to divide the structure of Indian society into five separate categories – (i) a political class; (ii) businessmen class; (iii) policymakers (including bureaucrats, Planning Commission, etc); (iv) common man; and (v) civil society. I have given for each one of them a distinctive weight to represent its respective importance/role in influencing economic policy formulation of our country. Needless to say, the political class is a domineering class and therefore has at least 50% weight in overall policy making; this is followed by the business class (15%), policy makers (15%); common man (8%) and civil society (12%). The relative importance of different categories of our society is based on some realistic assumptions and judgmental values. Further, each of these categories are segmented into (a) anti-reformists ; (b) "statusquoists ; (c) normative reformists ; and (d) realistic reformists

By using the weights of the five respective decision-making classes of our society and their distribution among four distinctive approaches to reforms, assessment has been made of likely overall anti or pro-reformist outlook in the country. What turns out is that with anti-reformists representing roughly about 28% of the overall constituency, and statusquoists accounting for about 33%, the climate for vigorous pursuit of reforms is far from conducive. This is not surprising in the present context, given the powerful vested interest of the political class to either take a populist stance or just muddle through. Illustratively, take the case of subsidies. Even, the current compulsions for upward revision of petrol prices , the government has prevented any such action by the oil marketing companies. Take another example wherein the huge vested interest of so many among the political class could thwart effective implementation of education reforms. Why would they not want educational reforms, especially in higher or even vocational educational system? Obviously, many politicians have their own educational institutions and/or private

coaching classes. This area of education is a hugely exploitative commercial business; it perpetuates artificial sortages of competitive quality institutions serves their personal/family businesses.

In contrast, only about 16% of the constituency would really belong to what liberals would consider as "normative" reformists, meaning wanting to push (for) vigorous liberal economic reforms. This is an enlightened class consisting of microscopic minority in terms of political category, and made up largely of businessmen and professionals. And if we were to add the remaining "realistic" reformist category, namely, those who would be supportive of more gradualistic approach to liberalization, based on the logic of current compulsions of coalition and fragmented politics, the aggregate constituency for reforms would at best be just about 48 per cent. In this exercise of determining the overall constituency of reforms, I have sought to provide a quantitative dimension based on my own qualitative/personal judgment.

The point which comes out loud and clear is that we as liberals are in a minority. Several other keen observers of the current economic predicament have already commented that economic reforms have no takers; "reforms can't sell, reforms don't generate votes". I vaguely recall what T. N. Nainan observed in one of his recent articles: "Look what BJP did in the 2004 elections. It played the card of reforms in'India Shining', they collapsed on their face. The Congress Party said, '*hamara hath, Aam admi ke sath",* and they won. In 2009 again, it was a similar kind of situation".

Clearly, the major challenge before liberals or those who are reformists is: how to sell reforms? If reforms don't get votes, the political constituency for reforms cannot expand. Unless this happens, in the "normal" economic situation, the agenda of economic reforms cannot be pushed. Thus, the only desperate hope is one wherein reforms are inevitably forced by a crisis situation – something similar to the 1991 scenario and all that is associated with it! As one of the participants observed "let there be another two years of waiting

and we will have one more crisis, and then we will have more reforms coming up". For the sake of breaking the prevailing growth logjam and policy paralysis, one may wish that the crisis situation befalls us sooner than later!

What Liberals Aspire For? The Reforms Agenda

Let us now turn to the crucial issue: what economic reforms we as liberals do want? What those at the helm of power need do to recover lost ground and stimulate economic growth momentum on a sustainable basis? While reflecting on these issues, I believe that there is no need to reinvent the wheel, as so much has already been said and written about the whole gamut of pending reforms agenda. Also, as mentioned earlier, the two letters written to our political leaders by G14 have set out eloquently several policy prescriptions, and with special emphasis on improving and strengthening the governance system. Indeed, if we persistently fail to overcome the governance deficit issue, then much of what liberals prescribe by way of reforms would never lead to their implementation.

Incidentally, what response did these letters receive? Almost nothing, except a few positive media commentaries! Thus, efforts of G14, comprising of respected and influential personalities in our public life – businessmen, professionals, economists and other experts – to focus on governance deficit and pursue crucial reforms did not make any impact; it did not create the required groundswell to force the government into positive action. Apart from governance issues, G14 emphasised on improving regulatory systems, effective implementation of institutions like Lok Ayuktas and appointing independent investigative agencies and law enforcing bodies for fighting corruption. It also talked about adopting something similar to the Bribery Act of UK, which is a recent piece of valuable legislation, aimed at covering all the nuances of the current dimension of corruption/bribery cases.

Thus, various facets of improving governance have been restated, reiterated and refocused. Therefore, liberal position needs

to strengthen this crucial constituency of governance reforms.

There are many other areas of reforms for recharging the growth momentum. For example, environmental issues are posing a major stumbling block. Likewise, the urgency of creating transparency in the pricing and allocation of natural resources, which Seetha also touched upon. Also, the urgency of electoral, police and judicial reforms given the fact there is a huge backlog of pending cases in the judicial system and unless something is done in these areas, confidence and credibility in our institutional system would be lost.

Given the huge backlog of pending reforms, the question that also assumes importance is: what should be the starting point for sequencing of reforms? It may be recalled that the 1991 reforms process started due mainly to external or foreign exchange shock, fiscal crisis and high inflation. But there were other long-term adverse features in our economic system, namely, the high cost economy, lack of productivity and competitiveness, inward-looking economy, structural rigidities and so on. The pattern of reforms then was substantially different; first to restore economic stability and external viability and thereafter to move forward with restructuring the economy. Thanks to the crisis situation and compulsions of IMF conditionalities, the adoption and implementation of certain package of reforms was relatively easy.

I also believe that economic reforms follow some sort of pyramidal structure; certain reforms like industrial delicensing and deregulation and external sector liberalization, for instance, are at the apex of the pyramid and these were well-conceptualized even before the 1991 crisis; and these were hugely impact making and growth promoting. These reforms were relatively easy to implement then. The next tier of the pyramid is a set of intermediate reforms; most of them are in the nature of transformation of regulatory and institutional systems; these have much less impact in terms of visible contribution to growth promotion, but are important to improve the

quality of growth and governance. These are not so easy to conceptualize and implement, as many of these have to encounter resistance from various vested interest groups. The bottom tier of reforms are essentially those wherein the efforts are essentially focused on sharing the gains of reforms/economic growth; these represent a typical "social welfarist" approach, and should normally come after successful implementation of stabilisation and structural reforms. I believe that the contribution of the social sector reforms to economic growth momentum will normally be very low, but these are legitimately required for sharing the gains of economic development and making growth more inclusive.

In the nineties, the Indian economy did well in progressing with the top pyramidal end of reforms. But now the urgency of real top end of reforms has shifted to overcoming the governance deficit. Having so said, let us turn our attention to specific policy reforms:

First, improving fiscal governance is an integral part of this process and there are multiple dimensions of this issue. It needs to be stressed that our current economic problems are largely to be attributed to fiscal mismanagement of the last two or three years. Apart from external factors decelerating performance of the industrial sector, especially during the last year has also been an important causative factor, since this sector contributes to almost 80 to 85% of government's tax revenues. The loss of tax buoyancy is a matter of great concern, especially when expansionary "welfarist" measures are superimposed on the fiscal system.

Our four separate sequential Liberal Budgets between 2004 and 2008 have consistently propounded that the fiscal responsibility should be treated as sacrosanct, and prudent norms of revenue and fiscal deficit ratios, namely, zero and 3% of GDP, respectively, should not be violated. Admittedly, the inspiration for this proposition was taken from the earlier Kelkar Committee report.

Second, as part of this effort, rationalization and reduction of subsidies burden, which Seetha also talked about, assumes

considerable significance. The Finance Minister has also been eloquent on this issue in his latest budget speech, pointing out the government's intention to bring various subsidy schemes under direct cash transfers to improve the delivery to deserving beneficiaries and prevent leakages in the system. The proposition of using UID through adoption of appropriate communication technology and banking network is expected to bring about transformational change in effective implementation of several social sector schemes. Needless to say, the liberal position fully endorses fuller and faster implementation of all such subsidy reforms.

Third, at the same time, the time is most opportune to evaluate a whole set of centrally sponsored schemes, many of which were started some 25-30 years ago. Several of them are found to have become obsolete. Yet, substantial budgetary allocations are being made as a matter of routine thanks to strong vested interests associated with them. Many of these schemes are required to be reformed/reviewed/phased out so that valuable financial resources are saved and redeployed more productively and effectively on the other innovative schemes. The Finance Minister, the Planning Commission, the state governments together with respective ministries must undertake such evaluation and agree to either withdrawal or reforming such schemes for realizing better and better outcomes from outlays.

Fourth, the Liberal Budgets have invariably called for expenditure reforms and we need to reiterate its urgency in the current context. We have a fiscal situation wherein over 85% of the total expenditure is revenue expenditure, and thus only 15% of public spending is available for capital formation in the economy. Likewise, almost two-thirds of total expenditure is pre-empted by non-plan expenditure, and thus, leaving little over one third for the discretionary plan expenditure. Expenditure reforms are inevitable to change the budgetary dynamics and progressively enhance public spending on capital formation and productive plan programs.

Fifth, Indian policy makers seem to be sanguine about our current position of public indebtedness. No doubt, we have done

well in reducing the overall indebtedness to GDP ratio (Centre and states together) over the last decade or so; the ratio has dropped from 88% in 2005-06 to about 70% now – the Centre's ratio declining from 61% to about 50%; and states from 27% to 21%. This is a welcome achievement. But there are perhaps several of those off budget liabilities (including those of departmental undertakings and loss-making PSUs) of the governments, which are not fully reflected in this ratio. We believe that all-inclusive indebtedness of the governments (Centre and states) needs to be looked at afresh and the prudent limit needs to be around 65% of the GDP.

Sixth, in the area of tax reforms, the liberal position fully endorses the expeditious implementation of GST, which we believe would be a powerful game changer for promotion of economic growth of the country. For the past about three years, we have been only proclaiming the importance of this reform. Very recently, the finance minister of Bihar, Sushil Modi, who heads the State Finance Ministers Committee desperately pointed out "look, we are trying to do our bit but the Central Government is not coming forth in terms of providing a compensation package". We strongly suggest that if the state governments have to be brought on board, it is necessary to reach out to them to the maximum extent possible, and for which the Centre must be willing to provide/ sacrifice some Rs.20,000 to Rs.25,000 crores by way of a compensation package to the States.

This is indeed a small price to be paid for such powerful reform of our complex indirect tax structure. Sooner the Centre becomes somewhat more generous and forthcoming in its approach and reflects the concerns of the states, the better it would be for quicker implementation of GST in the country. In the long-run, it is going to be a positive sum game, as it will stimulate investment and growth in the economy and make India more competitive.

Seventh, the Direct Tax Code is yet another significant aspect of tax reforms in the country, though not necessarily a game changer. But even in this area, the GAAR provisions have created some serious

concerns, and therefore, needs to be looked at afresh. The essential point is that the integrated Indian tax system must progressively become simple, transparent, stable, competitive, globally compatible, investment and assessee-friendly.

Eighth, except for a brief period during the NDA regime, practically all the governments have been found to be wavering on privatization and disinvestment policy ever since 1991. Seetha has talked about government still insisting on 51% ownership of the public sector enterprises (PSEs); and the Finance Minster in his recent budget speech reiterated that there would be no change in this strategy. So the government is willing to be profligate with budgetary support for loss-making and non-viable PSEs that can continue to cause substantial drain on fiscal resources. Thus, it would infuse Rs.30,000 crores in Air India, but without any promise that this giant PSE can turn around and able to repay its obligations to the government. A huge lot of tax payers' money can go down the drain and such profligacy undermines the fiscal health of the country.

The Liberal Position is quite clear and consistent "the business of the government is to govern and not to be in business". Therefore, it is imperative that the government moves forward with disinvestment and privatization program and, to begin with, it gives up its rigid stand on having 51% ownership of PSEs.

Ninth, there are huge issues in the area of infrastructure development. If one looks at the future growth scenario for this country in the next 15 to 20 years, the manufacturing sector must emerge as a powerful growth driver and for which solid infrastructure support is imperative. In this context, several major policy initiatives are currently being talked about. Witness, the New Manufacturing Policy (NMP); it has very ambitious goal of raising the ratio of Manufacturing GDP in the overall GDP of this country from 15% at present to 25% by 2022. But in terms of action plan, nothing seems to be happening. Apparently, not many states have even been brought into the discussion process of the NMP. Thus, the Government of Maharashtra is

proposing its own separate industrial policy.

While there may be no harm in having a separate industrial policy, the crucial issue is to what extent such separate industrial policies of the states would synchronize with the aims, objectives and strategies of what has been stated in the NMP. In the ultimate analysis, the entire responsibility for industrial development rests with the states in terms of providing land, environmental clearances, roads and electricity connectivity and other infrastructure support. In many of these areas the Centre-states coordination is found wanting. It is in this context that the liberal position while supporting the basic strategic framework of the NMP, strongly suggests a valid action plan for strategizing its implementation.

Tenth, there is undue procrastination on crucial issues of land acquisition. No one is certain about the current status of the Land Acquisition Bill, which is supposed to be with the Standing Committee of Parliament. This Bill in its current format provides for a certain method for calculation of compensation to the existing land owner. Without going into technicalities and legitimacy about the method of calculation of compensation, it needs to be mentioned that serious concerns are being expressed about its implications on the economic viability of industrial and/or infrastructure projects in the country. It is being argued that typically the valuations for the purpose of land acquisition will increase by 6 to 7 times of the present market value. Surely, many infrastructure/industrial projects would suffer because of the likely huge escalation in the cost of land. The liberal position believes in resolving the conflicting demands of farmers – the protection of their economic security and means of livelihood in view of their dependence on their land on the one hand – and the future demands of infrastructure and manufacturing development on the other.

Eleventh, there are several other contentious issues infrastructure development as well as of major industrial projects, be it relating to coordination among multiple ministries handling

different responsibility centres, multiple permissions that are required for allocation of natural resources. Specifically, on the question of allocation of natural resources, the liberal position believes in a calibrated approach of having a mix of allocation based on fixed pricing or auction pricing .

Incidentally, the Planning Commission is envisaging the need to invest one trillion dollars on infrastructure development during the Twelfth Plan period. Doubtless, India has done increasingly well in terms of expanding the ratio of infrastructure spending to GDP in the previous five years; this has already risen to 6% of the GDP. But raising it further to 9% of GDP in the Twelfth Plan would be a major challenge unless various policy and regulatory issues outlined earlier are adequately dealt with. We are aware that many infrastructure (including urban infrastructure) projects have been blocked for environmental clearances. There are issues on which the Centre and the states are seen to be in conflicting position.

There is a whole set of other pending reforms, especially those concerning the agricultural sector – be it pricing policy, procurement policy, food distribution through Food Corporation of India or drastic changes/abolition of APMC. In most of these areas, the liberal position has to confront with powerful political and bureaucratic vested interests. But unless the governments (both at the Centre and the states) take bold and decisive action in these areas, the required investment in the agricultural sector is highly unlikely in the near future. It is a well-known fact that agriculture’s share in the GDP is rapidly declining; it is currently less than 15% of GDP. No doubt, a secular decline in agriculture’s GDP in the economy is an inevitable part of development dynamics. And in the next 10 years, the share of agriculture sector’s GDP would drop down further to around 7 or 8% of aggregate GDP.

In the prevailing scenario when over 50% of the people are engaged in agricultural occupations, what would happen to the excess labour force in this sector by then? A huge army of agricultural labour

would either have to find more productive employment in non-farm activities in the rural areas (agricultural sector) or some better means of redeployment would have to be strategized. We would have to take into consideration increased pressures of such excess labour on urbanization. NREGA and similar other rural employment schemes could probably hold back the excess labour, but these would have serious budgetary implications.

The liberal recipe is to anticipate such challenges in the agricultural sector by working on various options such as an aggressive building up of rural infrastructure (roads, electricity, affordable rural housing, telecom, banking, micro-financing, etc.) and capacity building of rural manpower (through primary and secondary education, vocational education and training in modern farming and off-farming operations.)

Last, but not the least, let me also flag off the issue of reforms required in the area of urban infrastructure development. India is becoming increasingly urbanized – the ratio of urban population to total population would be closing towards 50% over the next 20 or 25 years; there are already 65 cities with a million plus population; a few states have reached 50% urbanization level. Given the limitations on the rural sector providing gainful and more productive employment, the pressures of urbanization would obviously rise.

Watch out, External Sector Concerns

Before concluding my observations, let me also briefly touch upon one more dimension of the current economic situation – the external sector. For recovering lost ground in our growth momentum, the stability of the external sector is of vital importance. A careful evaluation of key macro parameters of the current external scenario gives ground for suspicion that India may be gradually heading towards external economic crisis, if corrective steps are not taken up urgently. The current account deficit to GDP ratio has risen to an unsustainable level of over 4% of GDP. Further, there has also been a substantial drop in foreign exchange reserves of the country

over the last year; and their current level (US$290 bn.) is capable of supporting just about six months of projected imports during 2012-13.

Thus the supply-demand position of foreign exchange (essentially, the US$) in the market would be very delicately poised. The prevailing turmoil in the exchange rate of the rupee – its depreciation by over 20% (exchange rate hovering over US$=Rs.55.50) – is already a matter of grave concern. By implication, the economy has to attract a huge quantum of net capital inflows. In turn, either the external indebtedness (both of government and private sectors) would rise or the country has to attract increased net FII and FDI inflows. At present, there is increasing dependence on commercial borrowings and NRI deposits. There are inevitable risks associated with the changing quality of capital inflows.

Concluding Observations

In summing up, let me confess that I have sought to portray (put across) virtually the entire canvas of pending economic reforms in its various dimensions with a broad brush. The tasks are huge and highly complex in the prevailing environment of coalition and fragmented politics. There is also a virtual (the) absence of a non-partisan approach, which is so essential in times such as these. Perhaps, it is too much to expect from the treasury and opposition to tread common ground even in the national interest.

The second issue relates to recovering quickly the lost ground of economic growth momentum. The short-term policy options are limited given the problem of stubbornly high inflation. The policy of monetary easing is circumscribed by considerations of lack of fiscal consolidation. At the same time, even within the limited fiscal space, the government is aggressively pushing social sector spending initiatives. This is certainly not going to be sustainable.

The third issue concerns the government putting in place some kind of time-bound approach for implementation, given so many

infrastructure and manufacturing policy initiatives.

Fourth, so much has been said about what the central government needs to do. Not much is being said about what the states have to do, and much less is being said of the third tier of the government – the local governments, municipal bodies and the panchayati raj institutions. I believe the groundswell for the liberal economic reforms must start from the lower levels of the governments and at the grassroots level. The lower segments of the federal structure need to be convinced about the positive outcome or benefits of reforms.

Last, from the liberal perspective one of the toughest challenges is: how to expand the constituency of reforms.

Mr. Sunil Bhandare is a leading Economic Consultant.

Session 3

Taking Forward the Liberal Agenda

In the third and concluding session the Chairman Mr. V. S. Palekar, well known Corporate Executive and Social Activist observed "It is very likely that the Liberal Agenda wil go forward whether we take it forward or don't make any effort. Why? Because I think we have reached a level of understanding and maturity in th country. He was of the view that in addition to the growth in GDP, an equally important criterion was our performance in the "happiness index".

Chairman's Remarks : V. S. Palekar

I am not a professional economist but I have been a practising economist, a sufferer of economists' decisions for a long time. I thought that although I might not be able to contribute much to the deliberations, listening to the deliberations would improve my knowledge and help me in my other activities.

We all listened to the learned speeches this morning from two of my very good friends, Sunil Bhandare and Chandrahas Deshpande. Incidentally, these two and Mr. D. R. Pendse, who is with us today have helped me a great deal in understanding economic problems better and through me some other institutions such as the Bombay Chamber of Commerce and Industry.

The topic for the discussion is 'Taking Forward the Liberal Agenda'. It is very likely that the Liberal Agenda will go forward whether we take it forward or don't make any effort. Why? Because I think we have reached a level of understanding and maturity in the country where the Society will take some things forward purely by the motion in which it has been put. Mr. Bhandare told us that in 1993-94 the growth of GDP was 7.2% and in 2007-08 it was 9%. The question is – is growth of GDP the only criterion of how we

are performing. Or, is there a ‘happiness index’ by which we should judge our performance.

I have raised this question at other fora and Dr. Deshpande might recall that at some fora we got the answer that that one of the better ways of judging the situation was to ask the people ‘Are you better off now than what you were five years ago?’ My guess is that most people would say ‘yes’. For a ten year term the answer may well be ‘maybe or perhaps’. Therein lies the key.

To this baffling question of how we are doing, one suggestion is to judge numerically on the basis of the Human Development Index. GDP will be the dominant factor, as indeed it should be, but the addition of infant mortality (means healthcare) and literacy (means education) would probably give us a better idea of how we are doing.

Talking, therefore, about the ‘Way Forward’, Dr. Deshpande will no doubt make a very learned presentation. Therefore, I am not going to talk about economics. I am going to talk (or listen) as a business executive or as a common citizen. Before I hand over the mike to him let me mention how Society will judge us – both parameters start with G. The first is Growth and we have talked enough about it. ‘Go for Growth’ is a *mantra*, no one can forget. Without Growth, there will be stagnation and with stagnation will come extinction (misery). The other G is Governance. Inadequate Governance is a real ‘problem of the day’. You might even call it ‘lack of Governance’ but I am told that it is politically incorrect language. It is semantics. The fact is that we need to do a lot on that front. I do sincerely hope that that the powers that be take it seriously and do something about it. Incidentally both Gs are interdependent. Good Governance will bring bigger and better growth leading to a much happier Society.

With these few words I would now like to handover the mike to Dr. Deshpande to make his presentation.

Mr. V. S. Palekar is a Corporate Executive and social activist; formerly President of the Bombay Chamber of Commerce.

Session 3

The Role of Liberals in a Liberalising Economy

What I really want to do is concentrate not on what government, RBI, SEBI, or WTO for that matter, should do, but as to what we, should, as proponents of a liberal economic policy, do.

Presentation : C. S. Deshpande

Thank you for those very perceptive and important opening remarks, My task, in the next few minutes will be, as a liberal, to concentrate on the liberal economic policy. When I say a 'liberal economy', I mean basically four things: Open, deregulated that is liberal, market driven and private sector led. So I am using the word liberal basically to include these four facets.

A lot of ground has been very comprehensively covered by previous group presentations and so the ground for me to really cover is very little. I was going through Mr. Bhandare's presentation again and I find that there are really three or four things in his presentation which, I am going to build on. One: What is the constituency of reforms? Two: How liberals propose to expand this constituency. Three: Anticipating inevitable performance shortfalls and the imperatives for liberals to preparing annual rolling national liberal policy agenda. Actually these three things have, in a way, captured the essence what I am going to say.

Coming back to the main agenda, we have had more than two decades of reforms and the assessment has been discussed and debated very intensely today here and generally in the media and elsewhere. I feel, that by and large, India has gained significantly on many parameters. Equally I do believe that many challenges, if

not addressed urgently, holistically and adequately, will threaten the very gains which have accrued so far. However being an incurable optimist I always take the positive side into account and in that sense I agree with the remarks of the Chairman Mr. Palekar that over two decades, we have built up sufficient maturity and resilience with all its faults and with all associated shortcomings. As a result the Indian economy and, to some extent Indian society, if I might say so, have been placed on a different platform than what it was twenty years back. To that extent, I agree with the remarks of the Chairman that the two Gs (Growth and Governance) are really going to be the drivers of India's journey into future growth plus governance. This has been very well summed up by the Chairman.

My agenda today is to emphasise that, while we have been rightfully vocal as regards what governments either at the Centre or the states should or should not do in a liberalizing economy, it is time for us as well to reform, change or adapt ourselves to fast changing realities without diluting the core principles of a liberal market-oriented and open economic system. In other words, what I want to really do is concentrate not on what government, RBI, SEBI or WTO for that matter, should do but as to what we, should, as proponents of a liberal economic policy, do.

My basic premise is that henceforth our view point has to be far more nuanced, subtle and more micro designed rather than engage in broad generalizations. I know and feel very strongly that even on macro parameters, we need many more reforms; this point has been adequately covered by Mr. Bhandare and also partly by Seetha. I want FDI, for multi-brand retail and many bills passed yesterday; I want the or privatization of Air India. The point is, going forward henceforth, we have to take views far more in the micro sense, sector specific, possibly region specific, without, as I said, diluting the core principles. For example, state level reforms - Mr. Bhandare also mentioned in his presentation that most of the energy and time of the Indian Liberal Group has been of course correctly spent on what the central government or related agencies should do,

but it is high time that we talk to state governments particularly the more populous states, and give them some kind of an agenda within a liberal framework which they ought to pursue. For example, agriculture clearly is a state subject and there are so many things which state governments ought to be doing and which they are not. We need to redefine our own position on employment and unemployment, and what kind of solutions are possible within the liberal framework which we ought to, suggest.

I am not going into the details of any issues, but just flagging some of them. Also we have to be, very forthcoming on issues of inequalities and disparities and how to address them. I know that liberals and many eminent economists, including some people who are present here, have taken a view that as long as poverty gets reduced and gets reduced faster, for which we have evidence now, we should not be concerned about inequalities whether it is rural, urban, inter-state, be it concernng men, women, poor, rich etc. I differ from that view. I think that in our kind of democracy and society and the polity which we are in, major inequalities and disparities will eventually hurt growth and adversely affect poverty reduction itself. So this is the time when twenty years have passed, to address this issue. Of course we do not have any readymade solutions but in my view this cannot go unaddressed any further in our kind of forum.

Then there is the question of natural resources. What is our position regarding their exploitation; land acquisition; issues relating to the environment or matters relating to the infrastructure or the concept of public-private partnerships. We need to take positions on these, whether the kind of PPPs that we are having in infrastructure development are producing the desired results? Is it that in the case of all PPPs only government is at fault and not the private sector? We need to study and introspect on all these issues and go beyond our traditional views on urbanization. We need also as liberals to take a view on urban housing, urban transport and urban governance.

In other words, we now need to come out with Discussion/ Position Papers, in the next few months but definitely in the the next

year or two. I would like to submit that we need to create this kind of position papers because the days of broad generalizations are over. We have said twenty years back that we want FDI; that we do not want much of public sector but much has happened or not happened in the last twenty years. So beyond reiterating our own position, we are not going to get anything as far as the macro things are concerned. Hence we need to take micros views.

Also, simultaneously, should we also not urge for reform by the industry and by the corporate sector? Otherwise we will be rightly or wrongly perceived to be pro-industry or pro-business which in a way we are legitimately insofar as decontrol and deregulation are concerned.

We need to stand for ethnical governance and more importantly against land grabbing, unscrupulous real estate developers, natural resource exploiters whoever they are. We need to be as firmly against these people as we are against any government, Centre or state inaction or improper action or policy. Maybe it is agreed in principle but I think we should be far more forthcoming in terms of creating a constituency for the liberal economy as Mr. Pendse observed during the discussion on Seetha's paper. While political party formation based on our principles may perhaps be a little farfetched though not out of context in my view, why not at least start talking to all non-left parties including regional parties and try to convince them on some basic principles. I think this should logically be our next step so that whether they are in power or opposition they need to be told that certain things need to be recognized. A typical case is petroleum prices where a hue and cry is always made by everyone, knowing the fact there is very little we can do when international prices really go up. The whole question is whether you do tax adjustments, duty adjustments, *by how much*, *and when* you increase are important and crucial but the ground realities, the economic realities need to be explained properly to political parties, particularly to those who do not swear by left of centre policies. In other words we need to talk to them not ignore them. More strategic thinking

on our part is necessary to redefine what is the micro or specific role of the government and also what is the agenda for the corporate sector.

Now about the phrase ‘inclusive growth’ – whether you call it thus or you call it ‘widespread economic growth’ or ‘participatory economic growth’ what is it that we really recommend? Do we recommend greater and greater government intervention in times of crisis? If so, in what form? What is our considered view on NREGA or food security, or rural health mission or *Sarvasiksha Abhiyan* or national rural livelihood mission. Sitting here we might as well say, ‘*Is mein kutch matlab nahin, kisi ko paisa milta nahin’* (this is useless, no one will get any money) and that kind of cynical talk, but I am afraid the facts are not exactly as we urban elitists suspect because there is enough evidence that some of these missions and some of these programmes are generating a lot, though not necessarily productive, employment, with some kind of social security, or what in Marathi we call *Adhar* in times of crises which we cannot simply wish away. So, as liberals, we have to take cognizance of such welfare measures. We do not necessarily have to support it but let’s not oppose it because in our cynical view these are just welfare schemes and nothing is going to happen.

My last theme is that we liberals have to contribute to making this liberalizing process people-friendly. For example, one question which I had raised at the outset that if growth, especially in the last even or eight years, had been accompanied by faster poverty reduction but without commensurate increase in employment generation or productive employment, can it be enduring? We have to address this issue. Let us also understand areas where we tend to take a contrary view. With most of our high growth generated by the services sector in the last seven to eight years, which has low employment elasticity, how does it augur for the medium term especially when the services sector as a whole would be employing about twenty seven or twenty eight percent. So almost half the labour employed in agriculture is in the services sector and the question that labour has to be shifted

to other modes of employment as manufacturing cannot absorb it leads to a paradoxical answer.

Also, on inflation, how do we convince people about the benefits of deregulation of energy prices, electricity, fuel etc. when they are perceived to be inflationary. To elaborate a little further, urban middle class families, which you may perhaps agree, have been the biggest beneficiaries of these reforms over the last twenty years, are unfortunately protesting the loudest against price rise. It is the same class of people who have different models of cell phones and cars. They spend a lot time in malls, watch movies and suddenly realize that sugar prices have gone up. This is a paradox to my mind. The real vulnerable people are the senior citizens who live only on interest income. True, they are the ones who are hit the most. But unfortunately it is the middle class which is so vocal on this without realizing the gains which they have made in terms of their own salaries especially in the private sector over the last twenty years or so. My point is, everybody as an individual has a right to protest. Even I am hurt when prices of sugar or onions or milk go up; I am not questioning that.

My point is, should we not also try to somehow educate this ‘educated middle class” that this is a part of the growth process and our disproportionate complaints about price rise will in fact turn back the whole tide against liberalization, because if for the last twenty or twenty five years we have had some kind of liberalization internally, it is also thanks to the middle class which has by and large supported it, naturally because it has benefitted this class the most.

Look at our tax rates twenty years back and now. I am not saying, let the middle class surrender itself to whatever price rise takes place, but my point is, it has also to be understood in a different context and this is because moderate inflation and steady pace of employment generation are the two keys to the success of any long term economic reform programme alongside rapid economic growth.

Economic growth is taken for granted if you take three

macroeconomic indicators. Lets us for a minute forget the external sector. Is it that the economy is going to be judged by goods and services produced? Is it adequate? is it generating adequate employment and are the prices under control control ? Let us try to understand that nobody, least of all the man on the street, has anything to do with foreign exchange reserves or current account deficit. What is going to affect him and his family or his next generation is prices and employment. By all means rapid economic growth, yes, private sector led, yes, market driven, yes, an open economy, yes by all means but the next stage is some kind of a considered attention and a specific agenda on employment generation and inflation as a means to extend or expand our reach to the common people because if we are not perceived to be thought leaders addressing the issues of common persons like employment and price rise, (talking only in terms of growth, fiscal balance, are of paramount importance unquestionably), we wil find it difficult to expand our constituency. We have therefore to address these issues in a more dedicated manner and there is enough capability and competence among all of us and also some of the outside experts to deal with this.

Unfortunately it is just that we have been rightfully obsessed with growth, fiscal governance of course and unfortunately these questions are still not being addressed. In fact some of them have been deteriorating. In terms of expansion of our constituency, in terms of addressing various other stake holders, two things are necessary: One - addressing issues of critical importance to society. In my view these are employment and price rise; they could be different; and two, it is also high time we start preparing Position Papers on some of these sectors and also more importantly start talking to the political class, to create some kind of public opinion in terms of basic core principles.

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The Indian Economic Liberalisation Story

An Audit from a Liberal Perspective

Rough measurement of Index of Constituency of Reforms

	Nature of Liberalization	*Weightage*	*Anti-Reformists*	*Status-quoists*	*Normative Refor mists*	*Realistic Reformists*
1.	Political Class	50	15 (7.50)	18 (9.00)	7 (3.50)	10 (5.00)
2.	Businessmen Class	15	1 (0.15)	2 (0.30)	7 (1.05)	5 (0.75)
3.	Policy Makers	15 (0.45)	3 (0.60)	4 (0.45)	3 (0.75)	5
4.	Common Man	8 (0.24)	3 (0.16)	2 (0.08)	1 (0.16)	2
5.	Civil Society	12 (0.60)	5 (0.48)	4 (0.12)	1 (0.24)	2
Total		100 (31.58)	27 (8.94)	30 (10.54)	19 (5.20)	24 (6.90)
(Weighted % of aggregate constituencies)		100	28.3	33.4	16.5	21.8

Political Class = Govt. in power and all political parties at all levels of Indian federation; Business Class = industrialists, traders, bankers, professionals, etc.; Policy Makers = Planning Commission, bureaucrats, regulators, etc.; Common Man = ordinary citizens without much voice, trade unions, etc.; Civil Society = the whole gamut of non-govt. organizations.

(From the paper by Sunil S. Bhandare)

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