SPEECH

NEW ECONOMIC POLICY AND THE ROLE OF THE STATE*

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There is a high degree of consensus among economists, political scientists and others on what the goals of our economy are. All of us want an accelerated economic growth and, at the same time, we want to see that the benefits of growth are equitably shared. The expression 'growth with social justice' in a way summarises the objective. However, there is not that degree of unanimity on what road to take or what instruments to be used in order to achieve this objective. There are differing interpretations of historical experience.

One aspect of development economics relates to the role of the State. It has to be recognised that there has been a significant change in the climate of opinion regarding the respective roles of government and markets. In the fifties and sixties the dominant view in the literature on development economics was that government had an important role to play and that it should undertake activities that would compensate for "market failure." "Market failure" was perceived as the inability of markets to allocate optimally resources over time, that is, for investment because of the 'myopic' nature of markets. The literature also emphasised the importance of coordinated and consistent set of investment decisions. It is this line of reasoning that led most developing countries to formulate economy-wide plans. However, four decades of development experience have shown that there can be 'government failure' as well. The regulatory state in many countries has resulted not only in economic losses due to misallocation of resources arising from faulty investment decisions but also in diversion of resources to rent-seeking activities because of the very regulations themselves. In fact if there is a lesson to be drawn from the development record of the last four decades it is that there can be both "government failure" and "market failure" and that the critical issue is not so much the presence or absence of State intervention but the extent and quality of that intervention. The New Economic Policy builds on this experience.

The nature of State intervention as well as its impact has varied from country to country. While in the case of some countries as a consequence of intervention development got accelerated, in some others, intervention had resulted in the State becoming primarily a regulatory one with little impact on development. Much therefore depends upon the nature of the State and the forces operating behind it. It has also been argued that public intervention in the form of direct government investment and production becomes necessary only when there is "double market failure." This implies that besides market failure, it should also be established that a less interventionist policy cannot correct market failure. The nature of State intervention in any country has therefore to take into account not only the objective conditions but also the historical experiences relating to the effectiveness of State intervention.

The New Economic Policy comprises the various policy measures and changes introduced since July 1991. There is a common thread running through all these measures. The objective is simple and that is to improve the efficiency of the system. The regulatory mechanism involving multitudes of controls has fragmented capacity and reduced competition even in the private sector. The thrust of New Economic Policy is towards creating a more competitive environment in the economy as a means to improving the productivity and efficiency of the system. This is to be achieved by removing the barriers to entry

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and the restrictions on the growth of firms. While the industrial policy seeks to bring about a greater competitive environment domestically, the trade policy seeks to improve international competitiveness subject to the protection offered by tariffs. Private sector is being given a larger space to operate in as some of the areas reserved exclusively for the public sector are also now allowed to private sector. In these areas the public sector will have to compete with private sector even though the public sector may continue to play the dominant role. What is sought to be achieved is an improvement in the functioning of the various entities whether they be in the private or public sector by injecting an element of competition. There is, however, nothing in the New Economic Policy which takes away the role of the State or the public sector in the system. It is sometimes made out that the New Economic Policy makes a total shift towards reliance on market. Nothing can be farther from truth than this. The Eighth Plan envisages that of the total investment to be made during the Plan period, public seotor will account for 45.2 per cent. In fact, in the important infrastructure sectors of power, transport and communications, the share of public sector investment will be dominant. However, if the public sector is truly to play its role, it needs to improve its efficiency and productivity and generate the necessary surpluses as was originally envisaged. It is only an efficient public enterprise system that can enable the government to meet its social obligations.

The changing role of government is fully reflected in the Eighth Five-Year Plan, which mentions that planning in India will be increasingly 'indicative.' In fact, planning in our country in a large measure has been indicative. An outstanding example of indicative planning in this country is planning for agriculture. Agriculture is a sector where millions of farmers take their independent decisions. However, when self-sufficiency in food was set as a goal, Government went about creating conditions in which the farmers would take such decisions in their own interest which would help in achieving the targets. This is a successful example of policy influencing private behaviour to achieve public goals. The area of indicative planning will further enlarge in future. The "prescriptive" component will come down as the 'indicative' component rises.

In order to give some concreteness to the changing role of public sector, the Eighth Plan has identified the principles governing public sector investments. These are :—

(a) The public sector should make investment only in those areas where investment is of main infrastructural in nature and where private sector participants are not likely to come forth to an adequate extent within a reasonable time perspective;

(b) The public sector must withdraw from the areas where no public purpose is served by its presence; and

(c) The principle of market economy should be accepted as the main operative principle by all public sector enterprises unless the commodities and services produced and distributed are specifically for protecting the poorest in the society.

To go to the genesis of the New Economic Policy, the situation that the nation and the economy had to face in mid-1991 was a grim one. The balance of payments situation had deteriorated so sharply and the foreign exchange reserves had fallen so low that the possibility of default in payment was imminent. Orthodox and unorthodox measures had to be taken urgently to restore credibility. On the domestic side while the Indian economy had done extremely well in terms of real growth between 1985 and 1990, the fiscal situation had also deteriorated sharply. The budget deficit as well as the overall fiscal deficit had sharply increased contributing, on the one hand, to large increases in money supply and, on the other, to sharp increases in interest payments. Fiscal deficit of the Centre and the States taken together which was about 7.5 per cent of the GDP in the late 70s had increased to about 11 per cent by 1991. The fiscal deficit of the Central Government alone which was below 6.0 per cent in the late 70s had increased to 8.5 per cent during the same period. Consequently, interest payments in the Central Government's budget had become the single largest expenditure item rising from two per cent of GDP in 1980-81 to near four per cent of GDP in 1990-91. The country thus entered the 90s with a fiscal deficit that was simply not sustainable.

The policy measures that were introduced to contain the balance of payments deficit were basically orthodox. Apart from the exchange rate adjustment which became necessary because of the rise in the real effective rate between 1990 and 1991, the measures taken were aimed at directly containing import growth. Most of these measures were draconian in character. In fact, it is worth noting that the international financial institutions which would normally favour import liberalisation had to acquiesce in a series of measures which by their very nature went against their normal thinking. As a consequence of the various measures taken, we had the lowest trade deficit in 1991-92 in more than a decade. On the domestic side the commitment to contain fiscal deficit to almost 6.5 per cent of GDP in 1991-92, to a further reduction to three to four per cent of GDP over the next three years was made as early as February, 1991. Such a commitment was necessary not only to ensure international credibility but basically to put the fiscal system in proper order also. It is sometimes argued whether there was an over emphasis on the reduction in fiscal deficit. During the 80s quite clearly the fiscal imbalance was excessive whether it is measured in terms of budgetary deficit which has an impact on money supply and therefore on prices, or revenue deficit which has implications for the resources available for capital expenditure or fiscal deficit which has a bearing on the overall interest payments as well as the extent of the resources that the Government can draw from the rest of the economy. There was, in fact, the need to contain all these forms of deficits.

The policy changes brought into force since July 1991 fall broadly into two categories. The first set of measures is part of what is normally known as stabilisation policy. The second set of measures come under the category of structural reform policies. While the stabilisation policies are intended to correct the lapses and put the house in order in the short term, the structural reform policies were intended to accelerate economic growth over the medium term. Structural reform policies cannot succeed unless a degree of stabilisation has been brought about. But stabilisation by itself will not be adequate unless structural reforms are undertaken to avoid the recurrence of the problems faced in the recent period. Structural reforms were broadly in the area of industrial licensing and regulation, foreign trade and investment and financial sector. There is considerable unanimity among the economists about the need to reduce and as far as possible eliminate barriers to entry and expansion of firms. The policy of licensing as has been practised in the past has had no particular merit and, in fact, the Approach Document of the Eighth Plan submitted in May 1990 had also said : "A return to the regime of direct, indiscriminate and detailed controls in industry is clearly out of the question. Past experience has shown that such a control system is not effective in achieving the desired objective. Also the system is widely abused and leads to corruption, delays and inefficiency." In relation to foreign trade policy, the aim was to liberalise the regime with respect to imports and try to bring about a closer link between exports and imports. Yet another objective is to reduce the tariff rates. A question is raised whether a policy of liberalised foreign trade regime will land us back with the kind of problems that we faced in 1990-91. The large trade deficit that the country had to face in the late 80's is simply not a consequence of liberalised import of capital goods. While the import of capital goods did increase during the period, the high level of imports was also caused by the increased import of POL products and the growing divergence between the data on imports as provided by the DGCI & S and the Reserve Bank of India which is accounted for by defence and other items. In fact, the Exim Scrip Scheme and the subsequent Partial Convertibility Scheme were essentially intended to ensure that the import growth was not out of line with exports. As regards import duties the policy has been gradual even though it is accepted on all hands that the tariff rate in India is perhaps the highest even among the developing countries. A progressive reduction becomes essential in order to avoid a high cost economy. As regards foreign investment, the new policy measures certainly make a break with the past. In an era in which capital is mobile and moving across borders in a big way and where technology transfer is through investment we cannot afford to close our country to the flow of foreign investment. In fact, the flow of foreign investment into the country has been meagre. If retained earnings are excluded the flow is almost negligible. The relaxations that we have made in relation to foreign investment are yet very modest as compared with the concessions offered by many developing countries. Many of the fears expressed in this context are in the nature of putting the cart before the horse. We must take action when and if it becomes apparent that the flow of foreign investment is excessive and it is undermining the domestic economy. Finally, in relation to the financial sector it has to be noted that while there has been a considerable widening and deepening of the Indian financial system many inefficiencies have crept into the system during the past 15 years. An administered interest rate structure had put the whole system in a straight jacket. The extent of cross subsidisation in lending rates has undermined the profitability of the banking system. Equally due to various pressures the quality of loan assets has also deteriorated. With low profitability, the banking system in particular has not been in a position to provide adequately for loan losses. The capital of the Indian banking system is woefully inadequate. Thus a reform of the financial system to provide greater autonomy to the institutions both in terms of interest rate structure and operational matters had become necessary. These thoughts, however, are not new. These have been discussed for the past five or six years and some modifications in the interest rate structure were made. There is some concern that whether, in view of the serious malpractices that have come to surface in the recent period, a more liberalised system is justified. The only way to avoid scams is really to see that when a scam surfaces the guilty are found out and punished adequately and the systems appropriately improved. But this does not take away the need for financial sector reform aimed at improving the viability and efficiency of the sector.

To sustain economic growth on a sound footing stabilisation policies supplemented by structural reform policies are needed. However, there are some who feel that stabilisation policies are required but not structural reform policies. There is also a class of people — who may be in a minority — who believe that structural reform policies are needed but not necessarily stabilisation policies. Economists come in all colours.

Coming to the issue of the impact of New Economic Policy on the vulnerable sections, analytically we need to address two sets of issues. One is whether the new economic policy affects in any way the specific policy measures that we normally undertake in order to improve the conditions of the poor. Second, is there anything in the New Economic Policy which *per se* has an anti-poor bias? The New Economic Policy which may be a convenient expression to refer to the measures introduced since July 1991 is not the total economic policy of the Government. There are many other elements which continue to remain as an integral part of the overall economic policy. Among these are the measures which can be broadly termed as anti-poverty programmes. In the total economic policy there are four elements which can be identified as being meant specifically for poverty alleviation. First, since agriculture is the mainstay of the majority of the population, growth in agriculture and, therefore, resources allocated for agriculture are an important part of the attack on poverty. This is not an acceptance of the trickle-down theory. It is common knowledge that in States in which agriculture has made spectacular progress poverty levels have come down. Therefore, allocation of resources for agriculture is an important indicator. Second, we have evolved over time a reasonably satisfactory food security system. An integral part of this is the public distribution system. With all its shortcomings, the public distribution system has played a notable role in avoiding acute conditions of scarcity and met to a certain extent the minimum requirements. Third, there has been a substantial expansion in programmes which are intended to provide additional employment. The various Employment Guarantee Schemes as well as the credit-related Integrated Rural Development

Programmes are examples of such programmes. Fourth, expenditure on education and health has also an important bearing on reducing poverty levels. In order to evaluate the emerging situation, it is, therefore, necessary to look not only into the recent policy statements but also other documents such as the Eighth Plan which are also a reflection of the thinking of the government. The Eighth Plan seeks to increase the proportion of investment going into agriculture. There has been considerable concern about the declining ratio of investment in agriculture both in public and private sectors. As the Eighth Plan is formulated, it is expected that there will be a significant step up in the allocation to agriculture in the public sector. This ratio will go up from 8.18 per cent during the Seventh Plan to almost 14.4 per cent in the Eighth Plan. Taking the Central Plan alone the proportion of budgetary support going to `agriculture and allied activities' in the Eighth Plan has been fixed at 10.5 per cent as against the actual of 8.3 per cent in the Seventh Plan. As regards the public distribution system, the intention of the Government is to bring larger segments under this programme. However, the time has come to take a relook at the public distribution system as it is operating now. Several suggestions have been made to make the System more focused and provide the commodities only to the real poor. One possibility is to take out the higher income groups from the purview of the public distribution system. The other is to provide smaller quantity against the ration cards for the higher income groups and at prices which are not subsidised. However, the major thrust of economic policy continues to be one of maintaining the public distribution system as far as the low income groups are concerned. Third, the Eighth Plan provides for even larger allocation for the employment generating and poverty alleviation programmes. There has been a step up in the ratio of outlay for 'rural development' from 5.01 per cent in the Seventh Plan to 7.93 per cent in the Eighth Plan. As several studies have shown, a mere allocation of resources by itself is not an answer. There are many organisational improvements which are called for if these programmes are to achieve their objectives. Fourth, the Eighth Plan places greater emphasis on the provision of social services whose allocation also goes up from 16.31 per cent in the Seventh Plan to 18.20 per cent in the Eighth Plan. The Prime Minister made a point recently that if we have to provide for a larger level of investment in social infrastructure necessarily public sector investment will have to move out of the other sectors. Therefore, on programmes which are intended mainly to provide relief to the poor, there is no let up and in fact the allocations have been increased.

Is there anything in the New Economic Policy which is inherently anti-poor? The poor is affected most when growth is low and when prices rise. The slowdown in growth in 1991-92 and the sharp increases in prices in the same year sometimes are cited as consequences of implementing the New Economic Policy. This is not a correct assessment. There was a decline in agricultural production in 1991-92 and it is well known that the performance of agriculture from year to year is mostly a function of weather. The collapse of industrial production in 1991-92 can be traced in a large measure to the high degree of import compression that was brought about which would have been inevitable in any case whether or not we shifted to a new policy orientation. Has the attempt to contain fiscal deficit affected any way the poor more? While there has been some attempt to reduce fertiliser subsidy as part of the efforts to moderate fiscal deficit the food subsidies have been maintained. There is a dilemma here which we have to resolve. Unless we make the public distribution system more focused and directed towards only the weaker sections and low income groups, keeping the issue price unaltered or changed moderately despite increase in procurement prices, will not be sustainable over a long time.

One aspect of the New Economic Policy which has created certain misgivings among the organised labour relates to the several suggestions that have been made with respect to non-viable public sector units. While the approach should be to reorganise the loss-making public sector units in such a way as to improve their viability, quite clearly, there are cases in which their viability will depend on some reduction in the labour force.

The government are again going slow in this area because of the anxiety not to create a difficult situation for labour. That is why various alternative schemes have been thought of such as the sale of the company to the labour if they are willing to accept it, setting up a National Renewal Fund to provide compensation for people who may be rendered jobless, etc. The public sector units being compelled to carry on all the labour force irrespective of whether or not the units are viable is also a situation that is not sustainable over a long time. Hence a solution which is also reasonable and acceptable to the labour will have to be found.

Redundancies and closures occurring as a consequence of modernisation and technological upgradation are not a new phenomenon. This has occurred in a big way in centres like Ahmedabad and Kanpur where there has been a concentration of textile industry. It must be recognised that restructuring of workforce becomes necessary for efficient growth which alone can lead to sustainable employment growth in the medium and long term. At the same time, workers rendered unemployed in these processes cannot be left high and dry. Provision for fair and reasonable separation benefits is necessary, but more important is their redeployment, with training if necessary as a part of the overall strategy of expansion of employment opportunities. What, in fact, is being attempted in the new economic policy, with the instrumentality of the National Renewal Fund, is that the hardships of the workers affected in the unavoidable and inevitable loss of jobs are minimised by providing them a fair deal in terms of separation benefits and opportunities for their productive redeployment. The National Renewal Fund constituted on a non-statutory basis envisages provision of resources solely for the rehabilitation of labour resulting from modernisation, technological upgradation, restructuring (including revival) or closure of industrial units. It will assist workers in this process for their retraining, redeployment and placement in new employment, besides contributing towards compensation payments including legal dues and those under Voluntary Retirement Scheme, under the Fund called National Renewal Grant Fund (NRGF).

Far from adversely affecting employment elasticity, the restructured growth during the 1990s is expected to be far less capital-intensive and far more employment-friendly. First, with the removal of distortions in the factor markets, the new economic policy regime can be expected to lead to greater use of labour in the production processes as has been the experience of several labour surplus developing countries which have succeeded in increasing their exports and overall growth of manufacturing industries. Second, the processes of de-regulation and liberalisation are likely to particularly benefit the employment intensive small and decentralised sectors which , it must be recognised, had to bear a heavy burden of bureaucratic hurdles in the past. In the restructured economy these sectors, particularly rural non-farm sector, agro-processing and agri-business in general, urban small enterprises and services sector, all of which have shown high potential for employment generation, are likely to grow faster. Third, the overall objective of the New Economic Policy is to improve productivity and efficiency. In a competitive environment, both public and private sector units are expected to show improved productivity and greater expansion in output.

We lived beyond our means in the 1980's. A correction is thus called for. It has to be made in a manner that the burden does not fall heavily on the weaker sections. It is for this reason that the programmes meant for alleviating poverty are not only being kept but being strengthened. The stabilisation policies coupled with the structural reform policies should ultimately result in accelerated growth which is the best answer to poverty.