"India's Economy in the Twenty-First Century: A New Beginning or A False Dawn?"

I am grateful to Dr. Kapila Vatsayayan and Shri N.N. Vohra for inviting me to deliver the Dr. C.D.Deshmukh Memorial Lecture today. This annual Lecture in memory of one of India's most distinguished thinkers and policy makers is a highly prestigious occasion, and one of the highlights of the India International Centre (IIC) calendar of events. When I was first asked, I must confess that I was reluctant as I was not sure whether matters which dominate my professional life these days – monetary policy and finance – would be of interest to the occupationally diversified and enlightened membership of the IIC. This is, however, too important an occasion to miss. As a partial compensation to you, I have decided not to talk about "money and finance" at all – except in very general terms. Rather, I propose to do some loud thinking on some issues pertaining to India's post-independence development strategy, and new strategic choices for us at the beginning of the Twentry-first Century.*

2. A long time ago, when I first took up an economic advisory position in the Government of India, a senior and wiser friend, who is also a brilliant economist, told me that the opposite of whatever one thinks is right about India's economy is also likely to be true, and *vice versa!* So, his advice was that, in considering policy or strategic options, we must always consider the opposite view and make a choice based on probabilistic assessment of alternatives. The inspiration for the title of today's talk is precisely this – as we look around, it is possible to take a most optimistic view of India's economy or exactly the opposite, as reflected in a recent piece by a well-known and thoughtful senior journalist with the title, "Quit the pretence, the economy is on the wrong track ...."[1]. On the one hand, we see India's economy clocking one of the highest rates of growth in the world, India's new technology entrepreneurs being celebrated as amongst the most innovative and successful, and India's managers occupying the highest positions in the world of finance and business consultancies. On the other hand, India's public and social services are reputed to be among the worst in the world, India's infrastructure – be it roads or power – are full of potholes, and many of India's largest enterprises, particularly in the public sector, are uncompetitive and losing money. Instances on both sides – the best and the worst of India –could be multiplied. What is the truth and where are we heading? In answering this question, it is necessary to do a bit of dispassionate introspection about the reasons behind our successes and failures. It is also necessary that, while looking ahead to the future, we prepare ourselves to abandon or modify strategies that have not worked, and move decisively in the directions which maximise India's comparative advantage in the world of today and tomorrow.

I. The Post-Independence Development Record, 1950-1990

3. As we reflect on the history of human civilization in the millennium that has just ended, it is surprising to recall just how recent is the story of economic growth. As Paul Krugman has noted in a recent book, "economic growth, at least economic growth that raises living standards, is a modern invention. From the dawn of history to the Eighteenth century, the world was essentially Malthusian. Improvements in technology and capital investments were always overtaken by population growth; the number of people slowly

increased, but their average standards of living did not."[2] Up to about the end of the Nineteenth century, the only countries where per capita incomes were increasing on a sustained basis for any length of time were the Western countries, particularly, England, Germany, France and the United States. During this entire period, the then so-called under-developed or Third World countries continued to be exporters of primary products and importers of industrial products with stagnant, and in some cases, declining per capita incomes. A large number of them were also colonies of the Western powers, and the connection between these two situations- the colonial state and income stagnation – was not missed by their leaders and intellectuals.

4. The development strategies of the newly independent and developing countries, including India, in mid-Twentieth century were framed against this background. The central and the leading role for breaking away from the colonial legacy and for speeding up the process of industrialisation was assigned to the State. The need for the Government to occupy the commanding heights and to lead from the top received further support from the astounding success of the Soviet Union in emerging as a rival centre of political and industrial power within a very short period. India, at that time, played a pioneering role in giving expression to the aspirations of the newly independent Third World countries in the economic field. Thus, in 1956, India's Second Five Year Plan outlined the goals of development strategy in the following terms:

> "The pattern of development and the structure of socio-economic relations should be so planned that they result not only in appreciable increases in national income and employment but also in greater equality in incomes and wealth. Major decisions regarding production, distribution, consumption and investment – and in fact all significant socio-economic relationships – must be made by agencies informed by social purpose."

5. In practice, it meant, that all allocation decisions were to be made by the Government or its agencies. The need of raising resources for development was, of course, considered important. However, the primary emphasis was to be on increasing the domestic savings rate by suppressing consumption, high taxation, and appropriating profits through ownership of commercial enterprises. Accelerated capital accumulation through these means was considered to be the key to development. In a celebrated observation which guided many a planner and policy maker in developing countries, Professor W. Arthur Lewis observed that:

> "The central problem in the theory of economic development is to understand the process by which a community which was previously saving and investing 4 to 5 per cent of its national income or less, converts itself to an economy where voluntary saving is running at about 12 to 15 per cent of national income and more. This is the central problem because the central fact of economic development is rapid capital accumulation (including knowledge and skills with capital)".[3]

6. In the process of capital accumulation, the role of financial system was essentially limited, as allocation decisions were to be made by the central planning authorities and not by the financial markets. To a large extent, financial system also had a limited role in providing incentives for savings and capital accumulation as interest rates were controlled, and generally "repressed", and household savings were pre-empted through

high levels of statutory reserve and liquidity ratio. New banks and financial institutions were set up, and old ones were taken over, in order to act primarily as deposit taking agencies and providers of credit and finance for designated and centrally determined purposes.

7. While the reasons for adopting a centrally directed strategy of development were understandable against the background of the colonial rule, it, however, soon became clear that actual results of this strategy were far below expectations. Instead of showing high growth, high public savings and a high degree of self-reliance, India was actually showing one of the lowest rates of growth in the developing world with rising public deficits and periodic balance of payments crises. According to one calculation, in 30 out of 35 years between 1956 and 1991, India had balance of payment problems of varying intensity. Thankfully, public memories are short! However, looking back, it is hard to believe that for as long as 40 years between 1950 and 1990, India's growth rate averaged less than 4 per cent per annum, and per capita income growth was less than 2 per cent per annum. This was at a time when the developing world, including the Sub-Saharan Africa and other least developed countries, showed a growth rate of 5.2 per cent per annum.

8. In my view, however, the most striking failure was not in terms of growth, or even in the precarious situation of the balance of payments. Although the argument is not convincing, it could still be argued by some that the low growth outcome was due to a number of factors beyond India's control, such as, the border wars, severe droughts, periodic oil shocks, and – finally – inhospitable global environment! The balance of payments difficulties could also – with some imagination – be attributed to the global woes of primary producers, and the struggle of a poor developing country like India to industrialise and become self-reliant in heavy industry (which hitherto was the monopoly of the rich industrialised countries). The most conspicuous failure, in my view, for which there is no *alibi*, and the responsibility for which lies squarely and indisputably at our doors, is the erosion in public savings and the inability of the public sector to generate resources for investment or provision of public services.

9. It will be recalled that an important assumption in the choice of post-independence development strategy was the generation of public savings, which could be used for higher and higher levels of investment. However, this did not happen, and the public sector- instead of being a generator of savings for the community's good – became, over time, a consumer of community's savings. This reversal in roles had become evident by the early Seventies, and the process reached its culmination by the early, Eighties. By then, the Government began to borrow not only to meet its own revenue expenditure but also to finance public sector deficits and investments. During the period 1960-1975, total public sector borrowings (including Government) averaged 4.4 per cent of GDP. These increased to 6 per cent of GDP by 1980-81, and further to 9 per cent by 1989-90. Thus, the public sector, which was supposed to generate resources for the growth of the rest of the economy, gradually became a net drain on the society as a whole. It is interesting to note that the Central Government's total internal public debt by the year 1994-95 was close to Rs.5,00,000 crore, and nearly one-third of it was accounted for by assets held in the public sector. The interest payments on public debt amounted to nearly Rs.40,000 crore, which was financed by new net borrowings, and represented nearly 70 per cent of the Centre's fiscal deficit. In effect, by 1994-95, one-third of the

interest payments was on account of the Government's past investment in the public sector. In the last five years since then, the Centre's internal debt has almost doubled to Rs.9,70,000 crore in 1999-2000. This sharp increase in internal debt is partly accounted for by the need to borrow higher and higher amounts to service the past debt.

10. A large part of the cherished "family silver" has thus been financed out of borrowings, and kept polished with further borrowings by an impoverished family.[4] In the annals of development history, it is hard to find another example of a perfectly sensible idea – the need for higher public investment for greater public good – leading to exactly the opposite result, *i.e.* higher public consumption with diminishing returns for the public!

II. The 1990s–The Shift in the Development Paradigm

11. The State-dominated development paradigm has shifted rather sharply in recent years. Almost all developing countries have moved towards a more market-determined strategy of development. There were several factors which contributed to this change in perception. First and the foremost reason for questioning the earlier strategy, as mentioned above, was the simple fact that actual results in terms of growth of incomes or industrial development were well below expectations. While saving rates were rising, as per the Arthur Lewis model, so were capital-output ratios because of inefficiencies in the allocation and use of resources. Paradoxically, a strategy which was expected to reduce dependency on foreign aid and foreign trade, also resulted in greater dependence on aid and emergency assistance from abroad.

12. An equally important factor contributing to the change in perceptions was the astonishing success of Japan and the East Asian countries in accelerating their rates of growth by relying on market - oriented pattern of industrialisation (with, of course, varying degrees of "guidance" by the State). Japan's per capita rate of growth of 8 per cent per annum during 1953 – 1973 was unprecedented in the history of economic development. No economy had ever grown at that rate before, and Japan emerged from the ruins of war to become the world's second largest economy. Similar was the record of industrialisation in East Asia particularly in countries like Hong Kong, Singapore, Taiwan and South Korea. In the Fifties, their per capita incomes or the degree of industrialisation was no different from those of the rest of Asia. However, within a period of 30 years, they were able to catch up with the industrialised countries of the West. A final and decisive development leading to the demise of the old strategy was the collapse of the Soviet Union and the acceptance of market-led development strategies by all countries of Eastern Europe.

13. Beginning in 1991, when India was in the midst of an acute economic crisis, the Government of India also introduced a number of measures to improve the working of the economy. These measures, spread over a number of years, had two broad objectives. One was the reorientation of the economy from a statist, centrally directed and highly controlled economy to what is referred to in the current jargon as a 'market-friendly economy'. A reduction in direct controls and physical planning was expected to improve the efficiency of the economy. It was to be made more 'open' to external trade and external flows through a reduction in trade barriers and liberalisation of foreign investment policies. A second objective of the reform measures was macro-economic

stabilisation. This was to be achieved by substantially reducing fiscal deficits and the government's draft on society's savings.

14. Compared with the historical trend, the impact of these policies has been positive and significant. The growth rate of the economy during 1992-93 to 1999-2000 was close to 6.5 per cent per annum. The balance of payments position has also substantially improved. Despite several unfavourable external developments, including the imposition of sanctions in 1998 and sharp rise in oil prices more recently, foreign exchange reserves are at a record level. Exports have done well, current account deficits have been moderate, and India's external debt (as a percentage of GDP) and the debt servicing burden have actually come down since the early Nineties. There is also evidence of considerable restructuring in the corporate sector with attention being given to cost-competitiveness and financial viability. Industrial growth increased sharply during the period 1993 to 1996 to over 9 per cent per annum. The industrial growth rate came down to 5.5 per cent per annum in the next two years, but increased again to 8 per cent upto the end of 1999-2000. The rate of inflation also came down sharply – from 10.3 per cent in 1990-91 to a modest 3.3 per cent in 1999-2000. Fiscal deficit has also come down somewhat - from 8.3 per cent in 1990-91 to 5.6 per cent in 1999-2000.

15. There has been considerable debate in the country about the content, the pace and the results of the reform process. I do not propose to enter this particular debate, except to say that compared with the record of the first 40 years of development, there is very little doubt that India's economy – by any standard of measurement – is stronger and more resilient today than was the case a decade ago. I leave you to judge whether this outcome is due to the reform process, astute short-term economic management, favourable external circumstances, or just plain old good luck! There is also little doubt that India's "potential" for growth combined with external and domestic financial stability is greater today – at the beginning of the Twenty-First century than was the case 20, 50 or 100 years ago.

III. India in the New Global Economy

16. A most remarkable feature of the so-called "New Economy" is the role of the services sector (of which the IT or Information Technology sector is a part) in generating growth of income and employment. It will be recalled that the focus of attention in conventional economics, including development economics, was on production of goods –manufactured products and agricultural commodities. It was, of course, recognised that the services sector (which includes transport, communication, trade, banking, construction and public administration, etc.) was an important source of income and employment in most economies. However, overall, the growth of services was perceived at best as a byproduct of developments in the primary and secondary sectors, and at worst as a drag on the prospects for long-term economic growth. Services were believed to be mainly non-tradable activities with slow productivity growth and low employment potential. In developing countries, the conventional view of the growth of the services sector was even worse. It was seen to divert scarce resources away from production of goods, and contribute to accentuation of income inequalities.

17. In the last few years, there has been a phenomenal change in the conventional view of services and their role in the economy. The development of certain services is

now regarded as one of the preconditions of economic growth, and not as one of its consequences. The boundary between goods and services is also disappearing, as services of various kinds are delinked from the manufacturing process and become essential elements of the productive structure. Many industrial products are not only manufactured – they are also designed, marketed, advertised, distributed, leased and serviced. A significant and rising part of the value added by manufacturers now consists of services.

18. The change in the image and role of services has been brought about by unprecedented and unforeseen advances in computer and communication technology in the last two decades. An important aspect of the "services revolution" is that geography and levels of industrialisation are no longer the primary determinants of the location of facilities for production of services. As a result, the traditional role of developing countries is also changing – from mere recipients to important providers of long-distance services.

19. From India's point of view, some of the recent global developments, which provide opportunities for substantial growth, are the following:

- The fastest growing segment of services is the rapid expansion of knowledge-based services, such as, professional and technical services. India has a tremendous advantage of the supply of such services because of a developed structure of technological and educational institutions, and lower labour costs.
- Progress in information technology is making it increasingly possible to unbundle the production and consumption of information-intensive service activities. These activities – research and development, computing, inventory management, quality control, accounting, personnel administration, secretarial, marketing, advertising, distribution, and legal services – are performed in all economic sectors.
- Unlike most other prices, world prices of transport and communication services have fallen dramatically. By 1960, sea transport costs were less than a third of their 1920 level, and they have continued to fall. The cost of a telephone call fell more than ten-fold between 1970 and 2000. Moreover, the cost of communication is also becoming independent of distance. The most dramatic example in this area is, of course, provided by the 'Internet'. India's geographical distance from several important industrial markets (for instance, North America) is no longer an important element in the cost structure of skill-based services.
- Further, India does not necessarily have to be a low-cost producer of certain types of goods (e.g., computers or discs) before it can become an efficient supplier of services embodied in them (e.g., software or music). It is possible now to provide value added services without waiting to 'catch up' in technology for production of sophisticated equipment or products.
- The decline in the share of manufacturing in the output of rich countries implies a relative decline in their demand for industrial raw materials and fuels. This means that growth in exports of developing countries in the future will depend less on natural resource endowments and more on efficiency in providing services and service-intensive goods.

20. As a result of the above developments, the sources of comparative advantage of

nations are vastly different today from what they were 50 or even 20 years ago. And, there are very few developing countries which are as well placed as India to take advantage of the phenomenal changes that have occurred in production technologies, international trade, capital movement, and deployment of skilled manpower. India today has the knowledge and the skills to produce and process a wide variety of industrial and consumer products and services. Another important factor in India's favour is international capital mobility and integration of global financial markets. Domestic savings continue to be important for development. However, scarcity of domestic capital is no longer a binding constraint. Increased mobility of capital has ensured that global resources would flow to countries which can show high growth and high returns. It is possible now for India to take advantage of a virtuous circle of higher growth, higher external capital inflows, and higher domestic incomes and savings, which in turn can lead to further growth.

21. At the same time, it must be recognised that the "death of distance" and the growing integration of global product, services and financial markets in recent years has also presented new challenges for management of the national economy – not only in India but all over the world. The trend towards integration of markets, particularly financial markets, is by no means an unmixed blessing. Unlike the old days, a heavy price may have to be paid by national economies for somnolence, sloth and non-conformity to generally accepted international norms and standards of macro-economic management, disclosure, transparency and financial accountability. If a country does not put its financial house in order, fresh investments, trade and technology are likely to pass it by. Faced with this situation, only a few countries, with certain special advantages and resource endowments, may still manage to grow at an acceptable rate. Other countries which need capital and external flows to meet their trade or current account deficits, are likely to find it increasingly difficult to meet their import requirements of essential commodities (such as, oil), raw materials and machines.

22. Another consequence of recent global trends is the greater vulnerability of national economies to developments outside their own borders. In addition to the direct effects (which are currently most visible in the volatile stock markets), the indirect effects due to "contagion" can be quite serious. A crisis in any one or a group of countries, can be transmitted to other countries – including countries which may not have any strong economic linkages with crisis-affected countries. Thus, the Nineties have been marked by a large number of currency crises (for example, in Mexico, Russia, Asia and Brazil); substantial swings in exchange rates (including the exchange rate of three leading currencies –the dollar, the Euro and the Yen); and run ups in asset prices followed by sharp collapse (for example, in Japan and East Asia). While the crises initially occurred in one or two specific countries, their adverse effects were felt across the world.

23. The lessons of recent developments are clear. Advances in IT, the increasing role of services, the integration of financial and capital markets, and the diminished role of distance provide tremendous new opportunities for countries like India. At the same time, like other countries, we are also likely to be subject to greater vulnerability and new risks. Thus, at the beginning of the new century, the challenge before us is in two directions – how to seize the new opportunities, while at the same time, protecting ourselves against unanticipated risks? Insularity or isolation is not the answer, as such an approach would

promote neither growth nor stability.

24. India has to move vigorously to take advantage of expanding opportunities in trade and become a location of choice for IT and other industries and services so that growth rates, along with employment, are substantially enhanced. It must also keep some safety nets handy by building a diversified and efficient financial system which can aid and protect the development process at all times – good and bad. Can these objectives be met? This is the real question to ponder for the future.

IV. India's Tryst with Destiny?

25. There has been a fair amount of debate in the country on the implications of the new directions in India's economic policy. As far as I can see, there is no major disagreement with the ends or objectives of new economic policies. Most, though not all, commentators seem to agree that efficiency in the use of resources and growth performance of the economy need to be improved. There is also broad agreement that the Government's fiscal deficits should be reduced, that exports should be increased, and that more should be done for improving the health and education of the poor. There is, however, a substantial difference of views on the instruments that should be used to achieve these objectives, and whether current policies will succeed in raising the growth rate of the economy in the long run. Concern has also been expressed on certain political and social implications of the new policies, particularly whether they will make the country more amenable to external pressures and hurt the development of the country's domestic resources. These issues are important, and deserve to be fully considered in the evolution of India's economic policy in the Twenty-First century.

26. In considering these issues, it is not possible to escape from the responsibility of paying attention to the nature and character of our State apparatus, and to our previous record. We cannot decry the widespread corruption and 'criminalisation of politics' – a phrase which has figured prominently in Parliament in recent years – on the one hand, and ask for more discretionary powers for the State on the other. To do so is to suffer from a form of 'cognitive dissonance'. It is also important to remember that, as pointed out in the earlier part of this talk, the results of India's old policies in promoting growth or reducing poverty were highly unsatisfactory, and in any case, far worse than those registered by more open and competitive economies. As for external pressures, there is hardly any doubt that an aid-dependent economy with persistent balance of payments crises (as was the case in India from 1956 to 1991) is likely to be much more vulnerable than a country which is not so dependent on aid or emergency assistance from abroad.

27. In my judgement, keeping in view the actual economic and non-economic results of the old strategy, the phenomenal changes that have taken place in the world economy, and India's present comparative advantage, the present direction of policies to make India more open and more competitive is right and deserves to be accelerated. Without a major transformation of our economic policies and effort to align them with contemporary realities of global trade, investment and technology, it is not feasible for India to occupy the high ground and realise its full potential for growth and development.

28. A decisive move towards more and deeper economic reforms is the first strategic priority for the future. However, it will be a grave mistake to misconstrue the need for economic reforms with a call for less role for Government or public policy in widening

opportunities and creating a positive environment for equitable development. In developing countries, such as India, with massive illiteracy and underdevelopment of infrastructure, Government must continue to have an important and crucial role in creating the necessary conditions for growth through investments in areas, such as, education, health, water supply, irrigation, infrastructure, etc. These tasks cannot be taken over by the market. Successful economic reforms must result in strengthening the ability of Governments to do what they need to do by helping to generate higher growth, higher revenue and higher productivity. As the recent experience of several transitional and emerging market economies shows, economic reforms are necessary but by no means a sufficient condition for growth and development.

29. In this connection, a core issue, with multiple dimensions, which would need to be resolved in years to come is what can perhaps be described as growing "public-private" dichotomy in our economic life. It is a striking fact of our present situation that economic renewal and positive growth impulses are now occurring largely outside the public sector – at the level of private corporations (*e.g*. software companies), autonomous institutions (*e.g*. IIMs or IITs), or individuals at the top of their professions in India and abroad. In the Governmental or public sector, on the other hand, we see a marked deterioration at all levels – not only in terms of output, profits and public savings (to which I made a reference earlier), but also in the provision of vital public services in the fields of education, health, water and transport. These two elements – fiscal deterioration and inability to provide essential services – are, of course, intimately connected. Most of our public resources are now dissipated in payment of salaries or interest on past debt with little or no resources available for expansion of public or publicly supported services in vital sectors.

30. In considering the reasons for the decay and deterioration that is taking place in our public services, I am reminded of an observation by A.H.Hanson nearly 40 years ago on the reasons for the then prevailing crisis of Indian Planning. He was an admirer of Indian planners, but after seeing the results on the ground, he was compelled to ask:

> "The men are able, the organization is adequate, the procedures are intelligently devised. Why, then, have the Plans, since 1956, so persistently run into crisis?"

Hanson's answer to this question is also revealing:

> "For various reasons, Indian Planners have never treated the 'objective function' with sufficient respect. Their tendency is to give themselves the fullest benefit of every possible doubt ... Too many of their aims are contingent upon the adoption, by various sections of the Indian community, of attitudes they are exceedingly unlikely to adopt ...... "[5]

31. That was 1963! Today, in 2001, and after more than 50 years of experience of independent administration, we still seem to be giving ourselves the benefit of the doubt. Over time, our problems in the management of public resources at different levels have only become more and more intractable. Let us look at some of the problems that now bedevil our public delivery systems:

- We can be justifiably proud of the fact that the "rule of law" prevails in our country, and that even the mightiest are not above the law. The delays in the judicial process may be legendary, but there is a widespread respect for the “rule of law”. However, for historical reasons, it is also a fact that our legal system provides full protection to the private interests of the so-called “public servant”, often at the expense of the public that he or she is supposed to serve. In addition to complete job security, any group of public servants in any public sector organisation can go on strike – hospitals, universities, schools, banks, buses, post offices, railways, municipalities - in search of higher wages, promotions and bonuses for themselves irrespective of the costs and inconvenience to the public (in whose name they have been appointed in the first place). Problems have only become worse over time and there is little or no accountability of the public servant to perform the public duty.

- The “authority” of Governments at, both Centre and States, to enforce their decisions has eroded over time. Governments can pass orders, for example, for relocation of unauthorised industrial units or other structures, but implementation can be delayed if they run counter to the private interests of some (at the expense of the general public interest). Similarly, Governments may decide to restructure public utilities to cut down waste or output losses, but these decisions do not necessarily have to be implemented if they adversely affect the interests of public servants employed in these organisations.

- Governments at different levels may announce plans and programmes to provide social services (such as, expand literacy), but these initiatives are unlikely to be implemented on the ground because of fiscal stringency. For example, in 1994, the Tenth Finance Commission projected a rate of growth in real terms of 2.5 per cent for expenditure on elementary education upto the end of the century in respect of four States where the incidence of poverty and illiteracy was among the highest in the country. This projected rate of growth in expenditure was lower than the growth of population in the relevant age group, and grossly insufficient to cover new programmes of adult literates. In the five years since the Tenth Finance Commission’s report, it is interesting to note that the real expenditure on elementary education, outside of salaries of Government teachers, in these four States has actually been negative!

- The process and procedures for conducting business in Government and public service organisations, over time have become non-functional. There are multiplicity of Departments involved in the simplest of decisions, and administrative rules generally concentrate on the process rather than results. There is very little decentralisation of decision-making powers, particularly financial powers. Thus, while local authorities have been given significant authority in some States for implementing national programmes, their financial authority is limited. Transfers to local authorities for health spending, for example, average less than 15 per cent of State Government budgets.

- The multiplicity of functions and responsibilities placed upon ill-equipped and ill-trained staff in public offices and local institutions make it almost impossible to deliver services with any degree of efficiency, particularly in rural areas. For example, a “multi-purpose” female health worker is required to perform as many as forty-seven tasks to be undertaken on a regular basis!

32. Let us also ponder, for a moment, who suffers the most from fiscal stringency and the atrophy of the public delivery systems. It is certainly not the affluent classes, or persons elected or appointed by the people to serve them. They can always go to private hospitals, private schools, autonomous universities or institutes of higher education, and have similar alternative means of meeting their other requirements. The worst affected are likely to be the poor, the unemployed, and the illiterate who are dependent on public services, public investment and public programmes. It is useful to keep this perspective in mind as a fair amount of defence of the "*status quo*" in respect of the public sector is done in the name of the weaker sections of the society.

33. In addition to economic reforms, which already figure prominently in the national discourse, it is now important to embark on an urgent programme to revitalise the governance and public delivery systems at all levels of Government –centre, state and districts. Without strengthening the ability of the Government to do what it alone can do, and narrowing the focus of its activities to what matters most for the future development of the country – education, health, clean environment, and a functioning infrastructure – India cannot adequately seize the opportunities that lie ahead.

34. In my view, this is really the harder part of the so-called second generation reforms. The non-governmental sector now has a dynamism and momentum of its own. While there will be problems, and there will be arguments for and against a particular policy to liberalise, to open up, or to introduce more competition, I am confident that progress in the desired direction is unavoidable and irreversible. At the same time, it is also clear that unless we put our fiscal house in order and improve our public delivery systems, no amount of macro-policy reforms by themselves will be sustainable or yield permanent results. If lakhs of primary schools run by Government agencies, thousands of primary health centres set up by district authorities, and hundreds of Central and State Universities continue to under-perform or decline, two or three hi-tech cities and one or two new business schools and technical institutes cannot make up for the gigantic loss of human resources. It is simply a question of relative proportions, and inextricable linkages between public good and private progress.

35. In order to overcome some of the problems that I mentioned a little while ago, we need to move on a number of fronts. We need legal reform to focus sharply on the interests of the public, and not those of the public servant, in the functioning of the governmental and public delivery systems. Clear mechanisms for establishing accountability for performance are essential, and all forms of special protection for persons working for Government or public sector agencies (except for armed forces or agencies engaged in maintenance of law and order) deserve to be eliminated. We need institutional reform. All public monopolies should be eliminated, and there should be no purchase preference for public sector enterprises or agencies. Government should be free to engage the services of non-governmental organisations or private service providers at competitive costs to ensure effective delivery of essential services. We need freedom of information and full disclosure of all financial decisions made by Governments and its multifarious agencies on a daily rather than quarterly or annual basis. We need a new "political-bureaucratic" compact based on well-defined division of responsibility and accountability. The public system cannot function without respect for conventions and mutual trust and harmony among different agencies of the state. Above all, we need

fiscal empowerment as, without financial resources, it is not feasible to lay a road or build a school. The last is a most difficult task in view of the deadweight of the past, but it can no longer be avoided.

36. Let me end with two prognostications about India's potential for long-term growth that I came across recently. The first is by a well known Indian economist with a distinguished record of forecasting. He has observed that, "it is possible for India to have a per capita income of US $ 30,000 by the year 2047. If the Indian economy does as well as some of the world's fast-growing economies have done, it could be even higher."[6] The second projection is by a Professor in business management in the United States.[7] He estimates that, by the year 2025, India's GDP would exceed that of Japan and India would then be the third largest economy in the world (behind US and China).

37. Both forecasts, independently arrived at in two different parts of the world, are, of course, contingent on a number of factors. There is, however, no doubt that, if we have the will, and we are able to realise even half our potential in the next 20 or 25 years, India's poverty would have become a distant memory.

Thank you.

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* Parts of this Lecture draw on some of my previous publications, particularly *India's Economic Crisis: The Way Ahead*, (Oxford University Press, 1991); *India's Economic Policy: Preparing for the 21st Century,* (Viking/Penguin, 1996); and *Finance and Development: Which Way Now?* (Administrative Staff College of India, Hyderabad,1999)

[1] Shekhar Gupta in *Indian Express,* Mumbai, November 11, 2000.

[2] Paul Krugman, *The Return of Depression Economics,* The Penguin Press, London, 1999.

[3] W.A. Lewis, "Economic Development with Unlimited Supplies of Labour", *Manchester School*, Vol.22, 1954.

[4] It may be mentioned that some parts of the public sector, particularly oil and telecommunications have been quite profitable. This partly reflects their erstwhile monopoly position and the administered price regimes. These profitable sectors have been largely self-financing without the need for budget transfers.

[5] Hanson A.H., "The Crisis of Indian Planning", *Political Quarterly*, October-December 1963, reprinted in Hanson A.H., *Planning and Politicians,* London: Routledge and Kegan Paul, 1969.

[6] Kirit Parikh, "Economy" in *India Briefing – A Transformative Fifty Years,* published by M.E.Sharp Inc., New York, 1999, for Asia Society. Parikh's per capita income forecasts assume a dollar-rupee exchange rate based on purchasing power parity.

[7] Rosensweig J.A., *Winning the Global Game,* The Free Press, New York, 1998. Rosensweig's forecasts are also on purchasing power parity basis.