State and Market: Altering the Boundaries and Emerging New Balances*

Chairman Mr. Swaminatha Reddy, Mr. Rao and Mr. Srinivasan,

I am delighted to be here among many affectionate friends. I am thankful to my college-mate, batch-mate, cadre-mate and a very affectionate friend, V.K. Srinivasan for giving me this opportunity. The Chairman, Mr. Reddy, has given an excellent overview of what I intend covering in this address today viz., the changing contours of borders between State and market.

The altering of the boundaries between State and market encompasses, what is variously described as, realigning government, structural reforms towards liberalisation or deregulation, and changing mix of the mixed economy. To enable an appreciation of this changing mix between State and market in India, a combination of descriptive and analytical approaches is adopted in this address, with a focus on what may be described as relevant functions, processes and balances. The presentation is arranged in five sections. The first section describes how the mix of the mixed economy was in the process of changing in India from the commencement of Planning in the fifties up to the current reform period. The second section describes, by applying a functional approach to the role of the State, how the boundaries between State and market in the mixed economy are currently being altered in the reform period. The third section narrates the process of altering such boundaries, illustratively at Federal (Central) Government level, and at Provincial (State) level. Since reforms in external and financial sectors have been covered extensively in some of the earlier addresses in the recent past, they are not discussed now. The fourth section explores the new balances that are emerging in our country as a result of such altering of boundaries between State and market. Analysts are advised, in light of these developments to focus their attention on the emerging new balances in order to appreciate the reform process and its outlook. The final section briefly mentions the response of the Reserve Bank of India (RBI) to some of the emerging new balances. It needs to be clarified at the outset that the word State is used here broadly to reflect the Government sector in totality, i.e., the Central, Provincial and Local Governments, encompassing legislative, executive and judicial branches. For convenience, the word Central is used for the constitutional expression, "Union Government" and similarly Provincial for "State Government". Further, the term, public sector is used broadly to signify aggregate of Government and public enterprise sector, and public enterprise signifies non-financial publicly owned corporate entities – whether under a separate statute or a Government company under Companies Act. Where publicly owned public enterprises of financial sector are included in the broad public sector, this fact is specially mentioned.

Mix of Mixed Economy : Uni-directional

There was a virtual consensus, at the time of independence, on three basic tenets for free-India, viz., democracy, federalism, and a strong role for Government in economic development or what came to be evolved into the concept of mixed economy. Mixed economy generally meant active and direct participation of the Government in economic life, combined with Government's direction of market forces, to subserve the goal of development and social justice. The mixed economy approach held sway over the mainstream economic thought and political debate (barring a right wing political party called Swatantra Party active for a while under the leadership of Rajaji) for four decades, i.e. fifties, sixties, seventies and eighties. During this period, the mix between State and market was characterised by two features. First, the role of State expanded, i.e. mix was moving unidirectionally, and there was seldom a retreat. Second, the pace of expansion of State was not uniform and in fact, there were many occasions of uncertainty and doubt on the role of State, but seldom was decisive action taken towards retreat of State *vis-à-vis* market, till the balance of payments crisis of 1991. These features are best illustrated by some periodisation, though any attempt at periodisation has some subjectivity.

1951-61 represents ascendancy of State, with an overwhelming consensus in favour of an active role for State, and such a role was sanctified by Directive Principles of State Policy, and operationalised through a process of planned development. The control apparatus of Government imposed during Second World War provided a readymade framework for legal and institutional instruments for State intervention. International consensus was broadly supportive of India's approach, to the extent that this approach combined democracy and liberal values. The constitutional provisions, legal framework, and interpretations of the judiciary were supportive of such a domineering role for State, mainly as a result of the Directive Principles of State Policy enshrined in the Constitution.

However, in the mid-sixties, following war and droughts combined with industrial recession, a "Plan-Holiday" had to be declared. Uncertainties, in particular, political compulsions, led to the nationalisation of major banks, providing the Government relatively easy access to household savings in order to finance its activities. Soon, the first oil shock affected international sentiment on capital flows to developing countries and some aid-weariness also set in. Overall, therefore, the period 1967 to 1977, could be treated as a period of uncertainty and mixed signals, but expansion of State did occur in spurts, particularly in the plethora of legislative actions.

By 1977 it was clear that, the Plan strategies were not paying rich dividends and a period of introspection started in 1977, lasting till 1984. A number of high level official Committees were appointed to examine physical controls, monetary policy, trade policy, public enterprises, etc. Each one of them recognised the need for a review of the mix between the State and market and recommended a definitive tilt towards marketisation of the mix. However, no tangible policy action was forthcoming, perhaps due to inadequate political consensus.

The next phase, from 1984 onwards, came to be described as New Economic Policy and was essentially an attempt to break the stalemate in State action and introduce market orientation. The new policy aimed at higher growth, but given the unwillingness to impose necessary fiscal discipline, significant acceleration of growth and growth-led exports were achieved at considerable cost, namely, relatively unsustainable levels of fiscal deficit, current account deficit and external debt, especially short-term debt. In fact, inadequate productivity from the use of resources, while first and second tranche of Extended Fund Facility from the IMF were drawn, also resulted in strains of repayment to IMF during the late eighties. Since higher growth was attempted without breaking what has been described by the author in the late ‘eighties, as the “stalemate in State action”, there was fertile ground for a crisis.

In brief, there was a changing mix, but it tended to be unidirectional, with varying pace but generally in favour of State, and often in spurts though during the latter period, with serious doubts.

Mix of Mixed Economy : Bi-directional

The year 1990-91 saw the Gulf war, which triggered a balance of payments crisis. The seriousness of the crisis, especially the dramatic act of sale and repurchase of Government's gold through the State Bank of India and pledge of RBI's gold, did evoke a national consensus on stabilising the economy and undertaking appropriate reform. The crisis provided justification for a serious effort to break the stalemate in State action. In other words, the unidirectional nature of changing mix between State and market since 1950 was virtually for the first time reversed in 1990-91. However, it was not merely the crisis, but the prevailing economic scene on the eve of reform, which enabled initiation of reform. The features of the scene may be summarised as follows:

First, there was an intellectual recognition of systemic problems, particularly in the areas of fiscal, public enterprises and overall competitive strength of industry.

Second, while there was respectable, if not impressive growth of over 5 per cent in the eighties, compared to the "Hindu rate of growth" of 3 to 3.5 per cent previously, it was clear to the policy makers that such growth was financed by unsustainable fiscal as well as trade deficits, and growth lacked institutional underpinning to take the economy to a higher growth path or ensure social justice.

Third, while the policies were originally aimed at protecting labour force, incentive mechanisms got distorted and institutional rigidities crept in, resulting in what has been termed by the author as “tyranny of ten percent” –ten per cent being the share of organised labour (both in public and private), select industrial houses and a rentier class encouraged by the political system. What was described as a soft State, tended over a period to be so soft to the ‘ten per cent’, that to promote the interests of this ten per cent, the State ended up being a hard State on the 90 per cent of labour force. This large workforce started becoming restive, being tired of promises of elimination of poverty not backed by delivery, and therefore, this large segment had to be pacified with what have been described as "populist schemes". It was no longer easy for the policy makers to be both soft on organised work force and, provide succour to the large unorganised sector.

Fourth, the educated constitute the most articulate section in our country, as in many other developing societies. In the fifties and sixties, and to some extent in the seventies, the flow of a significant portion of educated was absorbed through employment in the growing Government sector, the public enterprises and to a very limited extent, the private corporate sector. With a larger output of educated youth, and a deceleration in the growth of employment in organised sector, there was an increasingly larger pool of educated, self-employed or unemployed, outside the “ten per cent”. Politically, it was possible to counter, however feebly, the aggressive stance of the ''ten per cent'' since a significantly large part, almost the whole of the educated class coming out of high schools and universities were left out of employment in the organised sector and were thus outside of the "ten per cent".

Fifth, it was clear that the delivery of Government services had become costly and was generally perceived to be very indifferent and inefficient – be it schools, hospitals, or public utilities like water supply and sanitation. The legal and institutional set up gave rights to the stakeholders in the public sector even if these rights were to the detriment of the citizen. The stakeholders were not only employees, but also contractors or suppliers, or retail agents, etc. In fact, many felt that these stakeholders pre-empted financial resources sometimes at the cost of the original purpose of employing them. So, there were schools with teachers and no buildings, or teaching materials and hospitals with no medicines, electricity or water. Incidentally, the salaries of the public sector had assumed implicit productivity increases, viz., annual increments in addition to inflation indexation and any short fall in assumed productivity increases worsened the situation. The managers in the public sector including the financial sector often complained about the inflexibility introduced through inherited rights and work practices, resulting in erosion of scope for productivity increases to match salary increases.

Sixth, there was an emerging parallel economy not only in money, called black money, but in most public services (private schools, private hospitals and bottled drinking water rather than tap water becoming the preferred options). Further, there was resentment about delivery of services in public systems even among the 'ten per cent', when somebody else was supposed to deliver the service.

Seventh, given the fiscal situation, the public enterprises which saw the fiscal support drying up started clamouring for market access, autonomy and even some privatisation.

Eighth, the private sector, including corporate sector, realised that the capacity of Government to support them was getting eroded due to fiscal compulsions, while regulatory and other demands from Government continued to be perceived as a burden on them. In the absence of fiscal support from Government, they found it worthwhile to seek deregulation and liberalisation, arguing against what has been described as over-regulation and under-governance.

Ninth, there was a widespread realisation that the basic assumption of efficiency and effectiveness of State vis-à-vis market appear to be less valid than before, mainly due to technological progress and institutional characteristics of public sector. The success of alternate models in other countries, in achieving both higher growth and social justice was impressive and sustained, and was too apparent to be ignored by the public opinion in India.

Finally, it was widely believed that reform was on the cards even by late eighties. However, the Gulf war, which triggered the crisis, enabled projection of external factors as the main cause of the crisis. Thus, economic compulsions for reforms were clear for at least a decade before reforms commenced, but the issue was mobilising political support and evolving a consensus on detail of reforms in a democratic-federal set up - a problem for which a favourable environment emerged with the Gulf crisis.

Functional Approach to Altering the Boundaries

In the functional approach to the role of the State indicated by the author in the late ‘eighties it was argued that altering the boundaries between State and market could be analysed in terms of different roles of State. State's role in economic activity can be broadly classified into that of Producer-State, i.e. producer of commercial goods and services; Regulatory-State, involving setting and enforcing of rules that govern, encourage or discourage economic activities of market participants; Facilitator-State, involving provision of public goods such as police, judiciary, street lighting; and Welfare State, ensuring provision of a wide variety of merit goods such as education and health. In the functional approach, the process of altering the boundaries between State and market, are tracked, with reference to each of the four functions mentioned.

Retreat as Producer State

The process of retreat of State as a producer of goods and services involves exercise of several options in a variety of areas. As a producer of commercial goods and services, the major option exercised by the Government was to permit entry of private sector in activities that were reserved for public ownership. This option does not necessarily involve retreat of State in absolute terms though in relative terms, it amounts to a retreat. Currently, except for sectors such as defence, entry for private sector is permitted, and in many, in fact, encouraged. These include oil exploration, power production, telecom services, etc. The change was operationalised through a series of Statements on Industrial Policy. Second, exit of public enterprises in terms of closure, is technically permitted under the aegis of Sick Industrial Companies Act, which was amended to bring public enterprises within its jurisdiction. Third, exit of workers in public enterprises was also enabled and encouraged through adoption of voluntary retirement schemes and creation of National Reconstruction Fund. Fourth, some public enterprises were corporatised (that is converted into companies under Companies Act) and in many public enterprises, private equity holders brought in. Public enterprise sector which was invariably a 100 per cent Government-owned enterprise earlier became one in which there were some enterprises with diversified ownership, although in many cases, majority ownership continues with Government. Fifth, significant autonomy in functioning of public enterprises has been announced and some attempts have also been made in this direction. Sixth, in a few cases, Government took up financial restructuring of enterprises to enable these enterprises to compete with private enterprises and meet the threat of imports under a liberalised trade regime. Seventh, compared to the past, a hard budget constraint has been imposed on the public enterprises. Eighth, preferential treatment to public enterprises through exclusivity or price preference in purchases or sales within public sector has been formally dispensed with. Ninth, privatisation involving transfer of majority ownership to private sector and change of control was conspicuous by its absence.

It is possible to argue that the entry of private sector has been insignificant in some sectors, possibly due to incomplete process of regulatory reform; that, in reality extension of jurisdiction of BIFR to public enterprises has not yet served any purpose; that impact of VRS or labour-flexibility has been very marginal; that diversified ownership was merely a process of revenue generation for Government, often by shuffling of portfolio in public sector either through 'cross-holding' among public enterprises or directed-holding by Government owned All India Financial Institutions; that revenue generation in a few cases was obtained by assuring the investors of a monopoly-status for a number of years thus undermining competition; that autonomy was not really exercisable in practice; that financial restructuring was done at enormous cost to Government and only to dress up an enterprise to avoid reference to BIFR or privatisation; that Disinvestment Commission had been ignored; and that institutional rigidities still remain in actual reform of State as producer of commercial goods and services. In particular, it is argued that unbundling of so-called natural monopolies has not been given attention while diversifying ownership. Notwithstanding the above criticisms, a workable framework for reform has been initiated and undoubtedly further progress requires significant thrust.

Regulatory State

While there were attempts to reduce role of State as a 'producer', correspondingly, there has been deregulation in some and expansion of State in other as a regulator. Dismantling of industrial licensing and liberalisation of trade are best examples of retreat of a Regulatory State. But, in many other areas, there has been expansion. For example, in Telecommunication, in the area of Ports and Electricity, national level regulatory authorities under appropriate statutes have been established. Similar initiatives are being considered in some other sectors also. The regulatory authorities are expected to exercise independence from the ministries or a public or private enterprise concerned and provide a framework for entry and operating conditions, especially tariff, in a way that would ensure assurances and protections to investors and consumers, whose interests often conflict in a monopoly like situation.

Though at a macro-level there has been deregulation, it is often argued that there are still a plethora of regulatory clearances that are required, thus undermining the full impact of deregulation. The process of expanding regulatory role is sometimes described as incomplete, if not inadequate, on the ground that the constitution of regulatory authorities is not necessarily apolitical or designed to counter political cycles; that they are being undermined by Ministries concerned either on account of narrow interests of public enterprises or to serve what the Ministry perceives to be larger public interest, and that the regulatory authorities are inadequately provided for, in regard to physical, financial or human resources, to perform their task efficiently and effectively. However, it is undeniable that, a basic framework for a more transparent, accountable and, expanded role of State as a regulator has been put in place in many crucial sectors, though a focussed attention to the strengthening of these authorities may be necessary. More important, there may be many other areas, in particular, an overall competition policy, customer-protection (especially inadequately compensating the customers for negligence of producers of goods or services in public or private sector) setting minimum acceptable levels of standards in services sector, restrictive practices adopted by trade unions affecting consumer interests etc., that need to be pursued further.

Facilitator State

In its role as a facilitator State in India, the major thrust is to redefine what constitutes a true public-good and then find means by which such a public good is funded and provided for in an adequate and equitable measure. It is also possible to unbundle an existing public good into its true public good and commercial component. It is ensuring provision of a public-good that is relevant and not necessarily whether State does it on its own or through use of private sector.

The evidence available on review of scope and coverage of public goods by Central Government is rather limited except perhaps in the context of roads and bridges where toll charges have been introduced. A detailed framework for review of what are public goods, how to assess adequacy, how to ensure provision and means of adequate financing need to be addressed by the State as markets cannot respond to these questions. For example, there can be a policy decision to treat a way of delivery of a good as a public good as distinct from another way. Further, water supply in a street tap may be a 'public good' while water supply in a tap at home is a pure commercial good. It must also be recognised that a significant part of provision of public goods falls in the jurisdiction of Provincial Governments and not in Central Government. Overall, there is a significant scope and a need for review of role as facilitator.

Welfare Provider

While in some developed countries, major source of fiscal stress and consequently major area of reform has been revamping or cutting down on role of State as a Welfare State, in India there is a large consensus on expanding rather than contracting role of State in provision of welfare. The consensus covers entitlements such as primary education and medical attention as also old age pensions. In fact, Constitution of India mentions compulsory primary education as a Directive Principle of State Policy, though actual performance of State has admittedly been inadequate. A study of the process of providing welfare, say though primary schools may provide some insights into the current meshing of State and market. The approach so far has been for Government to build and run most of the schools, often in a centralised fashion from Provincial headquarters, prescribe syllabus, print, subsidise and distribute text books on a Government monopoly basis; recognise and often fund, to a substantive degree, some private sector institutions also. In some cases, mid-day meals are provided to children in elementary schools while in a few cases, cash in respect of female students are being provided. Reform process in this regard has not been uniform among the Provinces though recent initiatives relate to provision of adequate buildings and teaching material, increasing number of teachers in Government sector and in a few Provincial Governments encouraging local initiatives in starting or running the school.

While there has been a widely expressed discomfort at the relatively low level of expenditures on education. However, it has also been pointed out most recently by Dr. C.Rangarajan that the level of Government expenditure on education in India, is comparable to Sri Lanka or China and hence the inadequacy is not in the level of public expenditure on education. It has also been recognised in various empirical studies that, in some States, two thirds of primary school teachers in Government schools do not attend the school and in many Provinces, text books are made available in the midyear only. There is a marked preference for private schools among most parents and a few studies show that literacy is increasing in India on a demand driven basis rather than utilisation of supply created in Government sector. While it is possible to argue that those who can afford, should be persuaded to pay school fees, often, Government schools are not preferred by those who can pay. Similarly, while efforts are made to regulate the fee structure in private schools, they are often circumvented. The relative roles of Government, local Panchayat and private initiative in regard to setting standards of physical environment, academic requirements, funding, provision, etc., are yet to be addressed. In brief, the role of State relative to the private sector continues to be inadequate and ill-defined in most parts of India, in regard to spread and quality of education, especially at primary level. Similar logic can be applied to health or medical facilities or sanitation.

The major constraint for adequate provision of services is the *defacto* country wide phenomenon of priority to entitlements of instruments of welfare provision (employees, contractors etc.) over the purpose (schools, dispensaries) or entitlements of the people to whom welfare is sought to be provided. Some Provinces are attempting to overcome this through effective decentralisation of initiatives and management.

Notwithstanding the above, there are some Provinces which have progressed significantly while new initiatives are being attempted in some other Provinces. An all-India framework, such as in operations black-board, for a review of relative roles of public, private, local, and non-Governmental organisations, in terms of different combinations of funding and provisioning is yet to emerge. Similarly, regulatory framework in these areas especially medical and health services, is being developed in select Provinces since private funding and provision is expanding rapidly. Improvements in what has been termed as inefficient provision by public sector and a regulatory framework to govern unbridled private sector in addition to evolving appropriate mix of funding and provision by public and private sources appear to be the reform agenda for the future in the realm of State as Welfare provider.

Provincial Level Reforms

Significant attention has been paid in both academic circles and in public debate about the challenges posed in reforms at Provincial level. These include fiscal, power, irrigation, roads and road-traffic, education, health and water supply. Different Provinces have adopted a variety of approaches.

On the fiscal front, apart from revenue raising, cost recovery for services and traditional expenditure-containment, measures include, statutory limit on guarantees, limits on public employment, and establishment of Sinking Fund. It is necessary to recognise the fact that initiatives on fiscal front, both statutory and non-statutory are far more impressive in some Provinces than the Centre. In fact, substantial part of recent fiscal stress is perhaps justifiably, attributed by Provinces to the recent liberal pay hike by the Centre. Though, legally Provinces are not bound by Centre's decision, during 'seventies and 'eighties socio-political compulsions and centralising tendencies in public systems made Centre’s decisions *defacto* binding on Provinces. It is necessary to recognise that inspite of impressive initiatives in some Provinces, the fiscal stress at Provincial level is acute.

In the area of power, measures relate to private sector entry in power generation; reorganisation of power monoliths into separate corporates for generation, transmission, distribution; privatisation of assets; and, statutory steps for establishment of regulatory/tariff authorities. There are still many Provinces, which subsidise power heavily and overall, power sector is still far away from total cost recovery. Yet, in terms of organisational restructuring and legislative actions, some Provinces have progressed significantly, and well ahead of Central Government in respect of similar activities (say, power supply or passenger transport by road in urban areas).

In the area of irrigation, stress has been on decentralisation of water management especially participative approaches, and upward revision of water rates. Different Provinces have adopted varying systems, but overall, however reasonable, cost recovery is yet to be seriously attempted. While progress in regard to cost recovery is tardy in most cases, the progress in institutional improvements for decentralised and user involved management has been impressive in a few Provinces. Similar approach towards decentralisation is yet to be demonstrated in Central Government.

In regard to education, bringing primary education under panchayat system and local involvement in setting up and part-funding of such schools have been some of the initiatives in a few Provinces. There is no evidence of any such initiatives, as yet, in respect of a large number of secondary schools under the aegis of Central Government.

In respect of health facilities, a few Provinces have been contemplating legislation to regulate private health care facility.

As regards public enterprises at Provincial level, there have been almost universal attempts to review the portfolio and identify non-viable enterprises. While attempts to privatise have been made, there have been only a few successful cases. The public enterprises at Provincial level, other than in power, road, transport and industrial financing, are relatively of smaller magnitude in most Provinces. However, many Provinces have attempted a systematic evaluation of public enterprises, and hard budget constraint has been quite severe in almost all Provinces. The variety of options by several Provinces in dealing with State level public enterprises is impressive.

Features of Reform Process

The major features of reform process of nineties in India, can thus be summarised as follows:

First, the expectations from reforms in India is not in terms of across the board retreat of State in favour of market but, in terms of enhancing States' capacity to permit efficiency-gains and expand availability of public and merit goods.

Second, while State is retreating in some areas, such as pure commercial goods or services, it is both retreating and expanding in other areas such as regulation and is expected to expand further in public and merit goods.

Third, a variety of options have been initiated by the Central Government to redefine the role of State *vis-a-vis* market and the framework is comprehensive, though a significant ground is yet to be covered. In general, the direction of reform is retreat as a Producer State and retreat combined with expansion as a Regulatory State.

Fourth, at a Provincial level, while there is some marginal retreat as a Producer State, substantive expansion and redefining of the role of State as a Facilitator and Welfare-provider appears to be in order. A variety of options have been exercised by different Provinces, though significant progress is required if the fiscal sustainability is to be combined with an expanded role for the State, at Provincial level.

Fifth, the differences in the pace and direction of reforms in different Provinces are perhaps explicable by the political management of the process, technical capability to design measures, institutional underpinning to implement them and nature of support from Central Government.

Sixth, there is evidence to show that, even in areas where State has to expand, mainly at the Provincial level and as a welfare provider, decentralisation of initiatives and management away from Provincial head quarters down to local levels seems to be a preferred option. This would imply that State may reorient and expand, by changing degree of centralisation.

New Balances

The descriptive account of the evolution of the mix between State and market in India, with special reference to process of recent reforms, reveals many interesting aspects, especially on the nature of changing mix relevant to us, as also the variety of options exercised. It also reveals the significant progress yet to be made, though a preliminary framework is available. However, to assess the dynamics of the changing mix, it would be useful to track what may be termed as new balances that are emerging as both causes and consequences of a changing mix between State and market. The changing balance between State and market does not happen in isolation, but is related to other balances also. An attempt is made here to track these new balances in a somewhat exploratory fashion or even as conjectures. These balances are vertically between Centre and Provinces; horizontally between Provinces; within Governments, both Centre and Provinces; between public and private sectors; funding and provision in delivery of services; old and new industrial houses; poor and non-poor, organised employment and self employment; and finally rural and urban.

Vertical : Centre and Provinces

As the reform progresses, it appears that the relative balance between Centre and Provinces tends to tilt in favour of Provinces for a number of reasons.

First, the most important areas for the Central Government's responsibilities are in international trade, financial sector, telecommunications, aviation, and especially banking and corporate law/practices. In most of these areas, factors such as multilateral agreements (say, WTO), globalisation, and recommended best practices of the world, tend to circumscribe, over a period, the discretionary power available in normal times to Central Government.Second, the capacity of Centre to reach tax levels as well as tax regimes, very different from international practices (customs, excise, corporate or income tax) also tend to get constrained, over a period, since the free and rapid flow of commodities, skills and finances among the countries would require us to be not too much out of alignment.

Third, major thrust-areas needing expansion of State are in physical infrastructure such as road, waterworks, power and social infrastructure, such as, schools and hospitals. Whether it is direct intervention or indirect intervention, the regime that governs funding and provision in these areas is to be determined by Provincial Governments. Thus, relative to Centre, Provinces are currently in the expansionary modules of State in the State-market mix. Provincial Governments currently have more freedom to access resources for financing economic growth from the market both from domestic and in some ways, global sources. Hence, the proportion of net official flows from centre to Provinces as a proportion of total capital flows to Provinces tend to get reduced.

Fourth, Provinces could also seek advice on growth strategies not only from Planning Commission as in the past, but also institutions like Institute of Public Finance and Policy; or Asian Development Bank or the World Bank.

<u>Horizontal Inter-Provincial Imbalance</u>

The balance, especially, economic balance among Provinces is also likely to be affected to the extent the overall Governments' role in allocation of resources tilts in favour of markets. Thus, Provinces will be competing more intensely than before, in market place for resources in future and, Provinces may find it somewhat difficult to place a significant responsibility on the Centre for their relative performances.

Second, with growth in communications, especially on economic and financial issues, people will tend to benchmark economic performance of States. There may be a slow beginning but the momentum could pick up, as evidenced by varying capacities (both in terms of amounts and interest rates) to raise financial resources for Provincial level public enterprises, on the basis of their guarantees.

Third, there are a variety of options for managing change which are adopted by different Provinces. For example, a single Electricity Board for each State was an earlier model, while now each Province is looking its own model of combination of institutional arrangements as well as transition path. There are plenty of opportunities to learn from each other's experiences and make modifications. Thus, inter-Provincial interaction tends to be more intensive, by themselves or through institutional consultants, who may be interacting with several Provinces.

Fourth, there is, in this decentralised scenario, a potential for increasing the divergence in levels of income among Provinces or even intra-Province. To this extent, there may be pressure from less developed Provinces on the Centre to play a more active role in countering markets’ possible neglect of less developed Provinces.

Fifth, there could be competition among Provinces to benchmark, perform and excel but, the new balance will have to ensure healthy competition.

<u>Within Governments</u>

The balance between the Ministries representing the combination of political executive and Government bureaucracies *vis-a-vis* exercise of ownership functions as well as regulatory functions may also change somewhat adverse to Ministries. The process of privatisation, diversified ownership and autonomy of public enterprises may erode the discretionary element of the Ministries. Once separate regulatory bodies on statutory basis are established and strengthened, they are meant to be semi-autonomous. Often, their membership need not coincide with political cycles and thus may impart greater stability to regulatory regime. Increasing role of semi-autonomous regulatory bodies tilts the balance away from the Ministries and in favour of less volatility in policies.

Further, experience at Provincial level in some areas has shown that the preferred route to enlarging the role of, and efficiency in functioning of State is decentralisation in Government. For example, in primary schools or water management, the approach in some Provinces seems to be through decentralisation or localised water management users' committees or village panchayats. This may also involve emerging new balances between ministries or departments at Provincial headquarters and local bodies, in favour of the latter.

Public and Private Enterprises

The relationship among public enterprises and between public and private enterprises could be subject to new balances in several ways.

Firstly, a large public enterprise sector may continue but it will have to reckon with growing competition from private sector.

Second, regulatory agencies may insist on level playing field between public and private sector.

Third, the public enterprises faced with hard budget constraint, threat of private sector entry and accountability to the private shareholders where they exist, may have to carve out new pattern of relationships with the government and within the organisation.

Fourth, strategic cooperation and cross holdings between public and private sectors are inevitable, thus replacing water tight compartmentalisation between the public and private sectors. Infact, this process may necessitate the termination of the concept of Government Companies under Companies Act.

Finally, the managerial and other highly skilled people, who were concentrated significantly in public enterprises may find alternate and attractive avenues in private sector; and consequently their clout within public enterprises may tend to improve. The emerging flexible market for talent could indeed alter balances, between and within enterprises.

Funding and Provision of Services

There can be several permutations and combinations of public funding, private funding, mandatory cross-subsidisation in private funding, private provision, public provision and mandatory provisions by private to meet public interest, etc. A recent example of private funding and private provision with some elements of public-funding and regulation has been evolved by the Supreme Court of India, in respect of private engineering colleges in Karnataka. The scheme covered fees chargeable, mix between merit *vis-a-vis* discretionary seats in admission, local *vis-a-vis* non-resident Indian quotas etc., and mandatory loaning by public sector banks at concessional interest rates. While the decision of the highest Court provided a framework in a specific category, there are large areas, in drinking water supply, education and healthcare, where public-private mix is entering new balances, in regard to ownership, funding provision, official recognition and governmental regulation. The traditional water tight division between Government or public and private sector each combining within itself funding and provision may get blurred and larger scope realised for intermingling of the two. Further, such intermingling may involve non-Governmental organisation as well as local initiatives. These are perhaps in nascent stage but evolution of new balances between public and private sectors is clearly in the horizon.

Old and New Industrial Houses

The traditional core industries in the tradeable sector, especially sectors which enjoyed high levels of protection in the past, are currently under pressure of competition and they tend to be apprehensive of rapid reform. They are often balanced by the newly emerging internationally competitive industrialists, in areas such as drugs, pharmaceuticals, software, chemicals industries etc. As the latter improve in strength and importance, the balance will tend to tilt in favour of more rapid reform. There is evidence of a tilting balance even now. Even within the traditional industrial houses, one can see changing balances in the composition of activities, boards and management.

Poor and Non-poor

A major issue of concern in the context of reform is whether the poor will be worse off than before in absolute terms due to the reform and whether the balance between poor and non-poor, in relative terms, will worsen as a result of reform. In the pre-reform period, there were programmes in the name of the poor but their reach and benefits were often questioned. Given the stalemate in State action that has been explained, the poor may not be worse off than before and may even be able to articulate their needs better in the absence of bureaucratically determined services, though commercialisation of services may tend to give a sense of relative deprivation to poor. Perhaps this is an emerging area of new balances, with significant social dimension that needs to be analysed and feedback utilised in policy actions.

Organised employment and self-employment

In fifties, sixties and onto seventies, the major segment of engineers, doctors or other skilled professionals coming out of colleges found jobs in Government or public enterprise or publicly owned financial sector. However, since the eighties a larger and larger percentage of the skilled and the articulate tend to be in self-employed category as against employees-category. The growing services sector also adds to this trend. Indeed, leasing of goods and services, contracting out or outsourcing instead of in-house provision are considered to be more suited to changing times. In democratic systems, these changing balances between job-orientation and work-orientation tend to exercise a strong influence on the policies relating to employment in the organised corporate sector.

Rural-Urban

Contrary to the generally held fear that reforms would lead to markets holding sway and thus metropolitan or large centres would thrive to the disadvantage of rural areas, there is evidence that rural prosperity has been improving significantly in the recent years. The rural-urban continuum would perhaps assert itself, but in any case, rural-urban, as well as agro-industry linkages are set to get strengthened especially when the services sector is growing rapidly. Briefly stated, there may be new balances replacing the traditional rural-urban divide or dichotomy.

Role of RBI

Before concluding, it is useful to place on record how RBI is responding to the emerging new balances. This will be illustrated by RBI's recognition of the fact that finances at the Provincial level are critical to the realignment of the role of the State and market.

First, the RBI has started a close and more intensive interaction with the Finance Secretaries of Provincial Governments on a regular basis, and on a wide range of relevant subjects.

Second, a Committee of Provincial Finance Secretaries have with the active involvement of the RBI, recommended limits on Government guarantees. Some Provinces, such as Karnataka have already legislated on this subject.

Third, the system of Ways and Means advances to Governments has recently been revised by the RBI in consultation with the Provinces to introduce better incentives with regard to financial and cash management.

Fourth, with support from the RBI a Committee of Finance Secretaries of Provincial Governments is presently working on the issue of improvements in transparency of the Budgetary system.

Fifth, Provinces have been encouraged by the RBI recently to access the market for a part of their market borrowings. These include, Andhra Pradesh, Uttar Pradesh and Punjab which have raised funds directly from the market

Sixth, in view of this development, the issue of monitoring of the financial health and other relevant parameters of the Provincial Governments by the market assumes greater significance. A Committee of the Finance Secretaries of Provinces is currently acting in an advisory capacity to oversee the indicators of financial parameters being developed by RBI.

Finally, the RBI is actively advising the Provincial Governments in areas such as cash management and funds management.

Conclusion

To conclude, the concept of mixed economy that we adopted was the right one. What is called for is a dynamic and bi-directional movement between State and Market. Indeed, growth in technology has recently led to drastic redefining of the relative roles of State and market and such a redefinition need not be a unidirectional retreat or an across-the-board expansion. The reform process in India has been able to capture the basic elements of this complex reality and there is, at least, at a conceptual level, a pragmatic framework. More importantly, there are emerging new balances and a dynamism has to be located in these new balances. Analysts need to have an appropriate understanding of these emerging new balances to appreciate the stability and pace of economic reform.

Thank you.

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* Address by Dr.Y.V.Reddy, Deputy Governor, RBI at Indian Institute of Economics, Hyderabad, on August 16, 1999. The Address is based on outline of a public lecture delivered by Dr.Reddy at Stanford University, USA on November 24, 1998.