

"The bubble of the Indian liberalisation programme, embarked by the P.V. Narasimha Rao Government, may soon burst if the post-reforms scene is not properly adjusted... Clearly, it will be foolish to dismiss the Mexican crisis as not relevant to the Indian reforms programme." Former Chief Economic Adviser to Government of India DEEPAK NAYYAR talks to Prof. B. K. CHANDRASEKHAR about the nature of the economic reforms and their consequences.

FISCAL EXERCISE

What was the background to the economic reforms introduced in 1991?

The origins of the crisis lay in a cavalier macro management of the economy during the 1980s. I should emphasise that the origins do not lay, as claimed by some, in a misplaced strategy of development since the mid-1950s although that strategy witnessed both successes and failures.

For instance, it neglected human resources, agrarian reforms and exports. Declining productivity of investment and lack of international competitiveness emerged as problems which needed immediate attention. However, the real crisis was the fiscal mess which began in the early 1980s and the debt crisis which appeared in the early 1990s which together left little room for manoeuvre to live on borrowed money or borrowed time.

It was in response to this crisis that the Government embarked on the programme of macro-economic stabilisation combined with fiscal adjustment and structural reform.

What are the different components of the reforms package meant to achieve?

The stabilisation part of the reforms is concerned with demand side and seeks to reduce the level of aggregate demand in the economy. Its object is to pre-empt a collapse of the balance of payments situation and also to bring down inflation. These are supposed to be achieved in the short run.

The programme of structural adjustment which is based on policy reform recommended by the multilateral finance institutions deal with the supply side. The principle here is to increase the rate of growth of output and this is sought to be achieved in the medium term. Structural reform is meant to shift resources from import competing activities to export activities, and simultaneously from the government sector to the private sector.

Structural reform also seeks to increase the degree of openness of the economy on the one hand and by changing the structure of incentives and institutions to reduce the role of the state on the other.

Reliance on the market place will be central to the new dispensation. Earlier, loans from International Monetary Fund, in 1981 and in 1991, were primarily meant to deal with our external payments problem of "stabilisation".

But with the present reforms, stabilisation which is the IMF's special responsibility has been combined with structural adjustments which are supervised by the World Bank. The combination of stabilisation and structural adjustments is a precondition to countries that seek loan from the two institutions.

The recent study on the impact of liberalisation by S.P. Gupta finds that most low income countries experienced 4-5 years as a contractionary phase in the reform process. As a result, unemployment and reduced standard of living specially affected the already vulnerable sections of society. The study also recommends the urgent need for supportive medium-term poverty — ameliorating programmes to help sustain the reforms on social, moral and political grounds.

That is correct. You need a political and social constituency which would support the necessary elements of reforms. There is also much talk of reducing public expenditure. It is important that the cut should not be in major capital expenditure on infrastructure and human resources development. Unfortunately, the Government has not shown any concern for social and moral grounds of reforms. Instead, it is quite pleased that the press and the English-reading public have endorsed the reforms.

What is the assumption behind these concepts?

There is a presumption that the global economy has been functioning efficiently because of competitive market; if, in such a situation, a country experiences problems of external payments, it can only be because of its internal maladjustments.

After the assembly elections in Andhra and Karnataka, the impact of reforms on the poor has suddenly, and for the first time since mid 1991, become an issue. What is your assessment?

Apart from the tendency of the reform package to stifle long-term growth prospects, almost without exception they have had an adverse impact on poverty in the countries of Latin America and Sub-Saharan Africa which followed the IMF and World Bank prescriptions. Without firm correctives, the burden of adjustment is inevitably carried by the poor.

The rhetoric about social safety nets notwithstanding economies in crisis, such as India's, simply do not have or provide resources for this purpose.

Inflation tends to make the rich better off as it redistributes incomes from wages to profits. By the same token the poor will be worse off since inflation erodes their real incomes. As we have seen, public expenditure in social sectors such as poverty alleviation, health care, education and welfare programme get squeezed.

Available evidence suggests that reform on the supply side always imposes a burden on wage labour and thus will hurt only the poor. The talk about adjustment with a human face is an illusion.

It is possible to interpret the election results as an expression of protest by the poor against the way the economy is operating i.e., against the steep rise in prices of even the basic needs.

Specifically, what has been the impact on employment in so far as one could estimate this?

As your question rightly implies, one can only sketch a plausible hypothesis in the absence of concrete evidence. First, the growth in employment in agriculture was not affected much in so far as the increase in output was sustained because of the sequence of good monsoons and despite stabilisation policies.

Second, growth in employment in the industrial sector was dampened by the near-stagnation in output. For example, industrial output dropped by 0.9 per cent in 1991-92 and rose by a mere 1.4 per cent in 1992-93. The decline in manufacturing output was much more at 2.3 per cent in 1991-92 while the revival was somewhat less at 0.9 per cent in 1992-93.

These trends together with the contraction in public expenditure must have had an adverse effect on rural non-agricultural and urban informal sector employment.

Was the problem heightened by increase in food prices?

Yes, food prices have increased sharply between end 1990 and into the end of 1994. Inflation in India is food price-led. While the general index of wholesale prices rose by 44 per cent, the index of foodgrain prices rose by about 54 per cent in that period as against around 38 per cent during the years before the start of the reforms; pulses rose by 67 per cent, that of egg, fish and meat by 77 per cent and that of the sugar group by 77 per cent.

Most people, including the Member-Secretary of the Planning Commission, have been arguing for an expansion of the Public Distribution System (PDS) in order to use it as an effective instrument against price-rise. But it has neither been expanded nor prices pegged at their level during 1992-93. In early 1994 prices were hiked to nearly free market levels.

A quintal of PDS then cost Rs. 402 while the open market price

of comparable wheat was Rs. 425; rice cost Rs. 537 while the open market rate ranged from Rs. 525-540. As a result, several millions of the poor must have dropped out of PDS.

There appears to be some confusion in the manner of estimating inflation. Can you amplify?

I believe that a point-to-point statistic is meaningless. It is important to look at the "average of period" rates of inflation. One could compare inflation, say, for 52 weeks in one year and 52 weeks for the next year. Inflation on that basis for the P.V. Narasimha Rao period has been above 10 per cent as never before in Independent India.

What about the success stories of similar reforms in East Asian countries: some of them are held up as role models?

Their development experience has been different. Their success has been due to the visible hand of state and not due to the invisible hand of the market place. This is well recorded by Amsden (Asia's New Giant: South Korea and Late Industrialisation, 1989 and Wade: Governing the Market — 1991).

Those countries have achieved institutional reforms in agriculture (land reforms, modern

technology and marketing network) and human resources development. In the later stage of industrialisation of those countries, functional State intervention sought to correct for market failures whether general or specific.

But what about the experience of Mexico? Is that a setback to IMF, World Bank recommended reforms especially because objectives of reforms in both Mexico and in India seem to be comparable: substantial foreign exchange reserves, privatisation, voluminous foreign investment, control over fiscal deficit etc. There are also similarities, for example, inadequate attention to infrastructure, acute price rise of essential commodities etc.?

The post-reforms scene in Mexico, which witnessed significant gains in the foreign exchange area, suddenly saw a crisis. Foreign investors are withdrawing their capital, its currency, Peso, as well as the stock market have collapsed. What is worrying is that even the substantial direct foreign investment in Mexico's industry has not helped. The Mexican experience certainly reinforces some of the doubts I have expressed.

The problems with the poor should become a major agenda, the rich should be subjected to more direct taxes while increasing the tax net itself, avoiding mindless privatisation etc. Clearly, it will be foolish to dismiss the Mexi-



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can crisis as not relevant to the Indian reforms programme. Our situation is worse because only a small part of the foreign capital accounts for direct investment and the rest in stocks and shares.

You were saying that we have neglected human resources development and agriculture. What do you think has happened?

The consistent decline, in real terms, of expenditure on education proves the point. It implies that the state has little or no role to play in the development of human beings as resources. We make this mistake because we go by the mantras prescribed by outsiders.

China and Far-East have contracted more direct foreign investment because they have hundred per cent literacy and a productive labour force. Has there been a single country in the world which has built a modern industrial economy without first tackling mass illiteracy?

Indeed, the World Development Report of 1991 authored by the World Bank itself conceded that education was the most important single variable influencing income inequality. Countries such as China, Columbia, Cuba or Sri Lanka have a Human Development Index (a set of parameters developed by United Nations Development Project) ranking higher than Income rank suggesting a judicious use of their income to develop the capabilities of their people.

According to the 1994 Human Development Report finds that the absolute increase in the HDI value in the East Asian region (by two and a half times between 1960 and 1992) shows that "the fast pace of economic growth was built on a solid foundation of human development".

As for agriculture, it has been totally untouched by the reforms while there has been substantial decline in the capital formation in this sector. From what used to be Rs. 5,246 crore out of a gross domestic capital of Rs. 28,000 crore in 1978-79, agriculture could manage to attract only Rs. 4,640 crore of a total of Rs. 48,770 crore in 1991. It has been reduced to around 4,569 crore in 1992-93. This may not only hit future production but one is worried also whether, as the National Council of Applied Economic Research fears, exports would be at the cost of domestic consumers.

Are these problems and mistakes due to the specific context in which reforms were introduced?

Yes. The origin of reforms and the conjuncture in which they are introduced are important determinants of success or failure. Reforms are either strategy-based or crisis-driven. To the first category belong the successful East Asian economies. Crisis-driven reform is accompanied by certain features.

Reform in a situation of deep macro-economic disequilibrium causes stabilisation policies to squeeze the supply side. You may end up with neither stabilisation nor adjustment. Secondly, when reforms are guided by multilateral financial institutions, there is a steady externalisation of policy formulation. Orthodox responses rather than dynamic ones, keeping in view the social and political realities, will rule. Lastly, the costs of the reform process surface soon while the benefits are a distant promise to the people. The poor cannot indefinitely live on promises.

The resulting disillusionment can be avoided or controlled only by supportive political and economic constituencies.

Ours is a crisis-driven reforms programme introduced by external initiative. On the otherhand a strategy-based programme, which signifies our own initiative, represents a natural transition in a long-term development outlook. It can both sustain and succeed because it creates a capacity to manage problems of transitions. Most important, the change is most likely to be acceptable to polity and society because of the social safety net and of the enhanced priority given to the social sector.

to minimise the adverse effects of the slow down in growth, following stabilisation, on employment and poverty. It was unable to do anything about the unequal distribution of the burden of adjustment. The decline in central government expenditure on social sectors and poverty programmes substantiate for the period 1989-90 to 1992-93 substantiates this. Perhaps I should mention some figures here. While the allocations for the social sectors and poverty alleviation programmes maintained their share in total government expenditure (5.13% in 1989-90; 5.43% in 1992-93); such expenditure stagnated in real terms and declined a bit as a proportion of Gross Domestic Product (from 1.05% in 1989-90 to 0.99 in 1992-93).

Similarly, expenditure on poverty programmes, at constant prices or as a proportion of GDP was lower in 1992-93 than it was in 1989-90 (from 0.61 in 1989 to 0.45 in 1992-93). Likewise the number of families assisted under IRDP - which seeks to promote self-employment among the rural poor - declined steadily from 3.4 million in 1989-90 to 2 million in 1992-93.

Continuing on Government intervention, one of the purposes of PDS is to supply food at subsidised rates so that inflation is kept under check. But recently subsidies have been attacked on the ground that the promise of items such as rice and wheat at affordable prices to the poor as 'populist policies'. It is correct to characterise such programmes as populist?

Only the ruling ideologues would call this populist. In the absence of employment and incomes, food at affordable prices must be made available to the poor. Perhaps state governments should think of raising revenue to finance such schemes by a hike in power and irrigation tariff and on transport.

These are unquantifiable subsidies for unintended beneficiaries. We are giving such public utilities at a much lower rate than even marginal cost. Instead, why not let the farmer buy power and the government give him money, which is a better method of subsidy. Lowering income tax level, raising in income-tax exemption, reduction of tax on luxury goods are examples of populism. But the responsibility to supply the most basic needs of the people cannot be termed populist. Government intervention hitherto has considerably reduced the degree of exploitation by the trade.

There is a feeling that those who criticise IMF-WB proposals, for reforms have no alternative to offer. Is this right?

Those who say so have a strong vested interest in following the Bretton Woods Institutions. But let me state that I am not per se opposed

to economic reforms or to foreign participation wherever necessary. Indeed, stabilisation programme has been necessary in a situation of deep macro-economic crisis.

And that would not be a departure from the past. My point is that we should be in command of decision-making and not by nose-led by others.

It was essential to go to I.M.F. in mid-1991. We do need their imprimatur for our economic standard in the world. But it should have been only a tactical move to buy time and to put our house in order. The government, instead, turned it into a strategy.

Several people have presented alternatives for fiscal reform, industrial reform and trade policy reform. It is not possible for me to go into these proposals here. But the lines of approach are clear enough. The choice of stabilisation policy must result in a squeeze on the consumption of the rich and a cut in imports. It must also impose a severe squeeze on expenditure and outlays which enhances the demand for import intensive production. We should not allow any cut in the consumption of the poor or on investments. Similarly the market should not be a vehicle of oppression in the sale of labour power of agricultural labour, small and marginal farmers, rural artisans or those involved in petty trade.

The immediate task is to control inflation by bringing down revenue deficit. The share of direct taxes in government revenues must increase while avoiding any cut in the outlays on social sector. A selective export sector can be developed without hurting the domestic sector. Japan and Korea have achieved this. We

must also turn our attention to the reform of agricultural sector in terms of land reforms, programme of dryland agriculture with people's participation. This should be combined with rural industrialisation complementary to agriculture.

Is the B.J.P.'s Swadeshi Slogan an alternative?

Not at all. It is a parody of the original Swadeshi struggle launched on August 7, 1905 by Tilak and Mahatma Gandhi. That

was a call for the boycott of foreign goods when India was under foreign rule. The Swadeshi slogan of today is contradictory. Some of the B.J.P. leaders welcomed the liberalisation programme in Brussels and Washington but they recommended boycott of foreign goods by the ordinary people. The real issue is the role of foreign capital and the actual process of its operation in this country. The new Swadeshi slogan, which attempts to repeat history, but in a totally different economic and political context is unlikely to take-off.

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