

Dilemmas of Development: the Indian Experience

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S Venkitaramanan

R R KALE MEMORIAL LECTURE, 1998

**GOKHALE INSTITUTE OF POLITICS AND ECONOMICS
(DEEMED TO BE A UNIVERSITY)
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About the Author

Born on January 28, 1931, Shri Venkitaramanan holds a Master's degree in Physics from the University of Kerala and also a Master's degree in Industrial Administration from Carnegie Mellon University, Pittsburgh, U.S.A. and belongs to the Indian Administrative Service.

He was Secretary, Planning and Finance, in the State of Tamil Nadu between 1969 and 1974, when he actively initiated the work evolving and implementing strategy to eradicate poverty. He worked in developing anti-poverty programmes with particular reference to targeted nutrition and health programmes at Chennai. He helped to develop the now well-established integrated child development scheme.

During his tenure of three years in the International Bank for Reconstruction and Development between 1974 and 1977, as part of the newly established nutrition unit, which he headed, he helped to develop nutrition action projects in Indonesia, Brazil, India and Columbia.

From 1977 to 1983, he ran Southern Petrochemical Industries Corporation (SPIC), a fertilizer company in the private sector which had run into serious losses in 1977, and turned it around to profits by 1983. The company is now a major fertilizer producer and an important blue chip company in the Indian stock market and has undertaken major diversification.

Shri Venkitaramanan held the position of Secretary, Department of Power, Government of India, between 1983 and 1985 and was Secretary, Ministry of Finance, Government of India, for four years.

As Secretary in-charge of Power, he initiated a number of policy changes including the first time the Government of India took up the problem of deficit of power in the country. He also started expansion of power stations and initiated

As Finance Secretary, he initiated the first phase of liberalisation of the process of opening of the financial sector and bilateral sources and at a relatively low cost. As Finance Secretary, he initiated a strategy to eradicate poverty and was appointed Member of the

Shri Venkitaramanan was Secretary of the period from 1991 and initiated a financial sector reform. He initiated the financial sector by introducing other criteria on an international basis and operationalised the move and played a crucial role in the serious foreign exchange

Shri Venkitaramanan is a well-known non-governmental organization and Harkrishnadas Hosur Finance Limited, Chennai. He is also a member of a number of companies, such as SPIC, Finance Corporation Ltd, Tamil Nadu and Chairman of

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Dilemmas of Development – the Indian Experience*

S Venkitaramanan**

I am delighted and honoured to be here in the portals of the Gokhale Institute of Politics and Economics to deliver the Kale Memorial Lecture. The Gokhale Institute has been a path-breaking institution in the field of social and economic inquiry. Many distinguished economists and specialists have preceded me in the list of those who delivered the Kale Memorial Lecture. I am thankful for the privilege. I propose to speak today on the "Dilemmas of Development".

The reasons why some nations and economies grow and some others do not have been for long the subjects of inquiry. From the time Adam Smith wrote the "Wealth of Nations", the subject of growth has caught the attention of philosophers and economists. Causes of divergent growth have been variously ascribed to factors as widely different as religion, climate, culture and genetics.

In my younger days, it was, however, fashionable to believe that there was nothing sacrosanct about these factors. We were taught that a nation, which wills itself to grow, can do so provided it carves out a plan and implement it. The new civilisation in the Soviet Union was itself a beacon of hope to many of us, yearning for a better India. We were not alone. Leave alone our enlightened leaders of the Freedom Movement, like Jawaharlal Nehru, even some of the celebrated savants of the Western World, like Sydney and Beatrice Webb, and economists like John Maynard Keynes, were among those who believed that an interventionist State, – albeit without the totalitarian clout of the Soviet Union, – could definitely lift a society out of the depths of deprivation.

Soon came various theories to garnish this faith. We heard scholars, like Robert Solow, explaining how given a definite plan of investment, growth could be secured. Growth was part of our faith. We believed that every society could grow, provided only that it broke through the bottlenecks that either nature or nurture had placed in its path. We rejoiced in the vistas that were provided by the magnum opus of Nobel Laureate Arthur Lewis on growth. He himself had come from the Caribbeans and knew what poverty meant. Along came our own Mahalanobis, who, however, faulty his economics, did put forth a model that had seeds of hope and prosperity. We had, above all, a political leadership, which believed that a nation by its own effort could break through the integument of poverty and that the effort was not only worth making, but had to be made based on a plan. There was also a remarkable consensus, cutting across political lines, that such planning could enable India to break through the century old stagnation. True, there were voices of caution, like those of Dr.B.R.Shenoi and others, who protested bravely and heroically that the effort if not properly managed, would cause problems in macro-economic management. But, India persevered. Muddled ahead, would be a better description. We set up a planning and implementation system. It was unique, in the sense that it took care of the democratic imperative and that too in a federal polity even as it tried to "grow" the economy. As the years went by, we came across many contradictions inherent in the process of development. The dilemmas of development that we have faced and overcome pose an intriguing set of issues to all those concerned not only about the past, but also about the future of India. They are

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particularly important as we are increasingly situated in a globalising world, a world exposed to the winds of competition and creative destruction.

As I survey these contradictions and dilemmas, I must confess to a feeling of inadequacy. I am neither a professional economist nor a philosopher. I am essentially a product of my own personal history of service as a bureaucrat, I have interacted, over forty-five years or so, with politicians, economists, bureaucrats and the general public. I do not lay claim to any great profundity of thought or innovative ideas. What I am bringing together is the result of what I have seen over the years as the dilemmas that we as a nation have faced.

Let me list some of the important dilemmas. I am not using the word "dilemma" in the logician's sense of presenting two alternatives, both of which have undesirable consequences. Rather, I am using the word in the more popular sense of perplexing situations.

Most important of all, to my mind, is the dilemma of development in a democratic polity. Can under-developed economies achieve a high rate of growth in an open society? Will not the freedom of speech and right to dissent, - the presence of Trade Unions, the conflicts of political parties, the chaos of elections, - all lead to a slow down? Or, as some of the protagonists of guided development argue, will not a dose of dictatorship be essential for growth?

Second comes the dilemma of growth and equity. Philosophers have struggled with this over the years. Our own Nobel Laureate, Amartya Kumar Sen, was for long in a minority as he pressed forward with his vision that equity and ethics were essential elements of economic growth. For long, his ideas were not accepted. It is only now in the aftermath of the global collapse of many economies and the resulting devastation that Sen's own eminently sensible ideas have begun to be heard. Economics has for too long been a special hunting ground for the Anglo-Saxon Schools. This has itself led to a prejudiced way of viewing the "equity" issue. These institutions have encouraged voices that argued most persuasively that if we take care of growth, equity will take care of itself. "Trickle down" rather than organise for welfare became the counsel from the many money centres of the world that heaped financial aid and therefore influenced policy in the developing countries.

This leads us to the whole issue of monetarism, inflation management and financial reform. If growth involves the expansion of money supply and the latter is assumed to lead to inflation, "Is it not reasonable to sacrifice growth for inflation control?" ask these advocates of prudence.

One of the paradoxes of growth in developing economies is that agriculture as a sector tends to get neglected in favour of more glamorous areas of study and emphasis. Equity itself is a sufferer of this neglect. As a result, agricultural liberalisation has lagged much behind the rest of economic reform. The producer of agricultural products has still to face many barriers even in respect of internal movement, leave alone export. He is denied adequate credit and quite often, he is the victim of natural calamities because of neglect of proper and adequate maintenance of water sources and channels. There are no established means of redress, but the farmer is expected to face market forces, both from within India and abroad.

We have also to look at the many contradictions between the requirements posed by growth and fiscal prudence. Related problems also arise from the compulsions of competitive populism that force governmental expenses to expand and receipts to contract due mainly to wrong policies on fiscal and other questions. Ideologies that

elevate the management of fiscal deficit as such to a high pedestal and lay down specific ratios as either good or bad, however, lead to more conflict. The purveyors of these ideas have gained a remarkable ascendancy in the counsels of many Governments. Growth has taken a second place in the hierarchy of goals, whenever and wherever it challenges fiscal balance.

All this, of course, is a part of an ideological wave led by pro-market reformers, who have captured most of the citadels of power and influence in the poorer half of the world. Economic reform has thus come to imply the ceding of increasing areas of activity to so-called forces of the market. The dilemma "the State versus the market" is starkly posed, whereas the two have to co-exist. The belief that somehow markets can provide a magic wand that can bring about efficiency and lead to greater growth has trampled over the perceived and actual need to have a State that monitors the market and corrects for market failures. Where should the State end and where the market begins?

I also propose to refer in this context to the dilemma of the public sector as such situated in a polity, such as ours. The conversion of policy-makers to "divestment" is a nostrum for all economic ills has led them to ignore the real problems of the public sector. How to sort out these problems is a challenge that our society has to face.

Lastly, but not least, is the dilemma that the problems of our external sector present. There is a genuine conflict between the needs of India's industrialists in particular and the people in general on the one hand and the growing compulsions of globalisation on the other. True, technology has made globalisation inevitable in many ways. Access to our markets cannot be denied for too long to competing corporates abroad. What then should we be doing to compete successfully in the field of goods and services in the global markets? This takes us to issues of protection, exchange rate management and trade policy, one inter-connected with the other. Why is it that India has not been able to grow its exports in the same way on the East Asian giants? Does this require, as the current ideology indicates, permitting wholesale multinationalisation of India's industrial scene?

I turn now to a discussion of these dilemmas. I am aware that they do not cover all the sectors of our economy. I am also aware that these dilemmas are inter-related in many ways and my comments on one may have a bearing on the other. But, it is my hope that some of the ideas that I put forward will encourage a dialogue and questions regarding the current prejudices and postulates that dominate policy.

Democracy and Development

Can development take place in an open society in the same manner as it does in a closed and dragooned polity? A number of spurious but inverse correlations have been drawn up between rates of growth in a society and the degree of democracy achieved in it. Some eminent economists, like Robert Barro, wrote convincingly sometime back – before the collapse of Indonesia – that a diminution or deficit of democracy itself may serve to improve the prospects of growth. Indonesia and Brazil were trotted out as instances of success. So too, Singapore's own Senior Minister, Lee Kuan Yew, pointed out how it was the restrictions on democracy in his City State combined with dominance of what he called Asian values that had enabled Singapore to progress. There were, of course, patronising references to India's fumbling efforts at growth and lack of a decisive centre because of excessive access to democracy.

While I do not, even for a moment, minimise the problems of development in a democratic environment, I must also confess to not being enthused by the alternate

paradigm. We ourselves had experience of what even an enlightened (?) dictatorship can mean. When Smt. Indira Gandhi brought in the Emergency in the seventies, we saw that the silence of the lambs was not a necessary prerequisite of peace and progress. Nor has Indonesia, the beloved paradigm of the guided democrats covered itself with glory. Rates of growth achieved in "undemocratic" societies have invariably been associated with much higher levels of cronyism and corruption, besides enhanced inequality than in more democratic societies. While democracies, like ours, have not been immune to either of these evils, there are at least prospects of escape from their grasp, which dictatorships do not provide. Avenues of redress are not available, where the Press is not free and where those who are affected by the decisions of the Government cannot protest. There is no evidence that lack of democracy necessarily creates conditions for growth. Myanmar is an example of the contrary proposition that development *ipso facto* does not take place in a suppressed society.

It is true, that the demands of democracy have led to successive Governments of India to slowly, but surely, resort to compromises. It has also led to difficult decisions being postponed. I would wager, however, that taken as a whole the history of India's development has affirmed, rather than denied, the proposition that the dilemma of democracy and development is a healthy one. The seeming chaos of election has enabled smooth transfer of power rather than the processes, which dictatorships have seen. It is not right to translate experience of small City States, like Singapore, where guided democracy has succeeded, to large democracies like India.

Indeed, Amartya Kumar Sen has identified that the very problem of famine and death has been more cataclysmic in States, which have suppressed peoples' rights.

Growth and Equity

It had been argued, that where economies prioritise growth, equity will take care of itself. In fact, for a long time, this was the slogan of what has come to be known as Washington Consensus, although John Williamson, the originator of the phrase, had himself given equity a pride of place. When an economy pursues growth in a single-minded manner, considerations of equity do suffer. For instance, growth of industries in the larger sector can sometime place small industries in jeopardy. The technological sophistication of the large-scale manufacturer can put out of jobs millions of craftsmen and many smaller industrialists. There is also an in-built conflict between regions of a Country, implicit in the dominant models of growth that prevail today. When industries are free in their choice of locations and are unconstrained by demands as to the regional equity, it can, oftentimes, happen that some parts of the country do develop faster than others. Regional equity is an important consideration, often ignored in today's models of growth. How else can one explain the fact that there is mass migration of people to Gujarat, Maharashtra and some parts of Southern India, while there is great deprivation in Bihar, UP and Orissa? Is it possible that growth in a country as a whole can be sustained leaving vast areas under-developed? Mass movement of people can, in turn, create, massive social disequilibrium. It is just not possible that we can continue to have a pattern of unbalanced development between regions without disturbing social peace. We have to create, if necessary, by an act of State centres of growth in the long deprived areas of Bihar, UP and Orissa, if we have to ensure and sustain social and regional cohesion, over the long run.

Growth can also bring about complex situations in which industries can become obsolete either due to technology or competition from abroad. Does not society owe a

duty to those displaced as a result of such changes? Unfortunately, India's economic reformers have not paid adequate attention to the problems of such social disruptions. I recall how a large industrial unit was closed down, in the eighties, in Bihar as a result both of manipulations by the management and of technological change. More than 20000 workers and families lost their jobs. Families were disrupted. The entire area became a massive red right district. Unfortunately, all that Government could do at that time was to say, "We will refer the matter to the newly-created Board for Industrial and Financial Reconstruction (BIFR)". These problems were considered to be inherent in growth. While the erstwhile management of the company did not suffer even a wee bit as a result of the closure, for the thousands of people displaced from their jobs, who saw no effort to compensate them, there was no redemption in sight.

Experts from abroad, who preach the gospel of hire and fire, ignore the fact that India, unlike their countries, does not have a social security system, - no safety net for displaced labour. Those who are "re-engineered" and retrenched from jobs either in Europe or United States can receive reasonable compensations while they are out of or searching for jobs. This will at least keep their body and soul together. We do not have yet a system of unemployment relief. This problem cannot be solved by merely creating what is called a Renewal Fund - which is an apology for real unemployment relief. We need to start a social security set up, broadly on the lines that developed societies have. I can hear voices protesting that such a system will be too costly a luxury for India. When, however, I see the social devastation that sudden loss of jobs can bring, I believe it is not a question of whether we can afford social security for the jobless. It is rather a question of whether we can afford not to have such a scheme.

Inevitably, the dilemmas of growth and equity have led our Governments over the years to evolve different schemes, targeting poverty. I must mention here, however, that our approach to the whole question of poverty alleviation has been too patronising. As Amartya Kumar Sen pointed out some time back, targeting is perhaps the wrong concept. Targets are what we fire at. We have to adopt a different approach and include the poor in their own rehabilitation. It is, perhaps, for this reason that our poverty-alleviation schemes have not proved models of efficiency and there have been many leakages. As a result, there have been criticisms that they only enrich the rich and not the poor. Obviously, while much of the criticisms of our poverty alleviation programmes may be right, it is important not to abandon the concept of poverty alleviation, merely because of defective execution. If we involve local communities and their democratic organs more in the process of poverty alleviation, there can be a better solution of the problems of inefficient management. West Bengal is an example of how such involvement of local party cadres has enabled a better outcome.

Part of the paradox of growth, which leads to neglect of equity, is that in a country like ours, agriculture tends to get neglected in favour of more glamorous subjects, like industry, power, and finance. Agricultural economics is often considered a peripheral subject. John Kenneth Galbraith has, in his own garrulous fashion, mentioned how his specialisation in agricultural problems had for long kept him outside the pale of academic respectability. Liberalisation of Indian economy has not meant simultaneous liberalisation of Indian agriculture. Agricultural producers still labour under many constraints. Investment in facilities for agricultural marketing receives little or no mention. Our urban-oriented economists, as a class, look down on the farmers as profiteers, although God knows they are squeezed between many structural rigidities - small holdings, lack of financial strength and restrictions on product movement, to

mention only a few. We must be one of the few countries in the world where, even after liberalisation of the economy, as a whole, movement of food grains between different regions is subject to zonal or other restraints. It is a fact that many of these barriers are only a means of collection of what economists call rents and what laymen call sleaze, albeit of a minor variety. The one industry where agriculturists can score is sugar. It is also the one where Government interferes with what price a producer of sugarcane can get and whom he can sell to. Sugar is also the one product where we allow free imports at ridiculously low tariffs. To cap it all, agriculture gets only lip service from our financial sector. 9 per cent of all agricultural output is the measure of credit for farming, while industry gets 30 per cent of its output. That too, after what reformers criticise as provision of "directed credit" and priority lending. Ironically, although agriculture contributes a large part of our national output, it receives a minor share of economists' attention. They need to note that the regeneration of Europe and America was primarily based on the growth of their agriculture. Agricultural exports of both Europe and the America are still the bulwark of their trade. Is it not time to break this relative neglect of our policy framework on agriculture? The vicious cycle of our high poverty and low growth can be broken only if agriculture receives more resources and attention.

Growth and Monetary Economics

It was, I think, a perceptive observer of economics who said that too much time and energy of academics has been already invested on theories that hold sway today that for this reason, if not for any other, they dare not challenge it. This is particularly true of the school of monetarists. Tomes and research papers have been written on money and its variations. Elaborate econometrics has been spun around various measures of money supply (although people are not agreed on any one measure) and on working out relationships between money supply, the gross domestic output and price level. Results of the encounters of such theories with reality have, however, not been satisfactory. The relationships have been proved to be unstable. In the Mecca of monetarism itself, namely, USA, the pundits of the Federal Reserve gave up long ago their earlier single-minded adherence to targeting the various measures of money, $M(1)$, $M(2)$, $M(3)$ and so on. Instead, they preferred to go by other and more direct instruments.

While US practice - and similarly UK practice - have changed, disciples of the almost discarded doctrine continue to rule the roost, particularly in developing countries - and especially so in India's academia and the Central Bank. Researchers specially sponsored in this connection have, in fact, carefully measured the different variations of "money supply" and laid down normative limits. The moment the value of $M(3)$ measured by them crossed certain pre-ordained limits, the experts in the Central Bank can come down heavily on the economy, contracting credit and raising interest rates. All this, in order to bring down the level of an admittedly uncertain variable $M(3)$ and that too to slay the monster of inflation, although the link between inflation and $M(3)$, however measured, was weak. This has been countered by elaborate massaging of data, in that if $M(3)$ itself was not correlated, experts found a logarithm or a square root or a lagged variable, which would. The power of monetarist ideas has been so strong that even in spite of the continued affliction of the Indian economy under a recession induced by this ritual of contraction, the addiction to the "money supply" number had not shown any perceptible change of attitude among the doctrinaire central bankers. They and their pupils behaved like the lords of the inquisition, who sent many to the stake so that the souls of both the guilty and the inquisitors might go to Heaven. It was all done for the

good of the economy, the theory being that suffering itself would cleanse and purify. "No gains without pain" was the mantra.

We all know the penalties to which India's economy has, as a result, been subjected and where we have landed in pursuit of doctrinal purity. Just when the economy was gaining confidence and investment plans were being brought out by entrepreneurs in 1995-96, the credit squeeze and a rising interest rate came and succeeded in reversing investors' expectations and putting them on hold. The "unreal" financial sector has successfully dominated the "real" sector. "Asato ma sadgamaya" has to be our prayer.

Let me turn, for instance, to another idea, which our financial reformers have imposed on our system, viz., the concept of capital adequacy for banks and financial institutions. Capital adequacy, an important concept, within limits, is a desirable monitor. In particular, it was at one time necessary in order to obtain global respectability for our institutions, especially those which have to deal with international operators. Our banks have had to abide by these norms, which prescribe that a bank or a financial institution should have as its own equity a specified percentage of its "assets". The prescription accepted by India is eight per cent. The clamour now is to increase it further. RBI has accepted the proposal to increase it to nine per cent. What this means is that if a bank lends Rs.100 – has assets of Rs.100 – it should have a net worth of at least Rs. nine. The design of these norms at Bank for International Settlements (BIS) was done by a group led by Mr. Peter Cook, an eminent Accountant from UK, who assigned to Sovereign debt zero risk weight. Other debt was given appropriate "risk weights". Thus came about what is known as the Basle norms on a "risk-weighted" basis. The implication of these norms has so far been that if the bank lent more to risky borrowers or invested in other risky assets, its equity needed to be raised correspondingly. The resulting perverse dilemma has enhanced bankers' shyness to lend to non-governmental borrowers. A banker, who did not lend to non-governmental sources, did not need to go for enhanced equity. Thus, a banker can be quite comfortable lending more to President Narayan – doubly blessed since his security was good and his additional capital needs low. The capital adequacy norm has thus functioned as a built-in device to promote a credit crunch, a perverse effect far from what the reformers intended.

Essentially, the dominance of monetarism has implied an attempt to do by rules what should normally have been left to discretion. Perhaps, this was all part of the preachings of the Chicago School in favour of markets to which most monetarists belonged. By tradition, the Chicago School preferred the rule of "market forces" to that of the government. Therefore, it was advised that a Central Bank should go by specified rate of growth of $M(3)$, rather than by their own discretion or governmental direction. Unfortunately, this simple rule has not worked in practice. Even in USA, central bankers have had to fiddle, from time to time, with rates and money supply. Around the world, Governments have cast about for other methods of governing the rhythm of the economy. They have abandoned simple indicators, like $M(3)$. Governor Jalan himself seems to have realised that there are different sides to this debate and thus settled on a more omnibus indicator, which includes many more variables, than a mere $M(3)$. One hopes that with this change of emphasis, RBI will have better luck and more importantly. Hopefully, the Indian economy will be spared further experimental credit squeezes.

Fiscal Deficit and Development

The fiction prevalent among economic reformers is that too high a fiscal deficit *per se* is bad. This is part of the ideology, which seeks, in particular, to diminish the rôle of

Government, - an idea whose dominance can be seen from the fact that the European Monetary Union (EMU) itself incorporated it as a precondition and laid down a fiscal deficit criterion of three per cent of GDP - one of the famous Maastricht criteria. In order to reach the target of three per cent and qualify for the entry to EMU, many leading economies in Europe went through rather depressing episodes of "fudging the fiscal deficit" by accounting manipulations. All this, however, only showed that the fiscal criterion had become more a ritual than representing a fundamental fact. Expert observers in France and UK have pointed out how their own experience in earlier years had demonstrated the irrelevance of this criterion. In particular, in the eighties UK had a low inflation in many years in spite of its fiscal deficit being higher than seven per cent to eight per cent. The technocrats have, however, had their brief hour of glory and triumph. Three per cent finally became an essential precondition for entry to EMU. It is immaterial to the ritualists that the whole of Europe has now entered a phase of slow growth as a result.

But, the question whether a low fiscal deficit is a "good" to be pursued for its own sake is still unanswered. Fiscal deficit represents the mirror image of the public sectors' borrowing requirement. Our own experience with the fiscal deficit target has been that over-emphasis on the criterion of a low fiscal deficit, has meant a reduction in public sector borrowing and has led to investments in the public sector being brought down. Acceptance of the low fiscal deficit as part of the reform package has directly been responsible for the phenomenon of severe compression in Public Sector Undertaking (PSU) investments in the post-reform period. Under the Rao-Singh regime, Government of India (GOI) laid so much stress by the fiscal deficit criterion that even essential investments in infrastructure were given a backseat. It is no accident, therefore, that the period of reform (1991-1997) has also been one in which public and private investments in infrastructure as a ratio to GDP were in percentage terms substantially lower than the previous decade. The hope that the private sector will come in to fill the gap has turned out to be an illusion. The size and structure of investment in the private sector has also been different from that in the public sector. This, in turn, contributed to a fall in demand for many feeder industries, besides slowing down development of infrastructure sectors, such as power, railways and ports.

The dilemma before the policy-maker arises precisely when he or she sets the fiscal deficit/GDP ratio as a sacred Lakshman Rekha. This is unfortunate. If we look back a decade in our history, we would see that India in the eighties did have a Fiscal Deficit (FD)/Gross Domestic Product (GDP) ratio, which ranged higher between seven per cent to eight per cent. But, throughout that period, inflation was lower than in the more fiscally virtuous post-reform era of 1991-1997. Indeed, the contradiction will be even more striking if we set it against the fact that the post-reform period had seen a dip in global inflation.

There is a grave danger in focussing too much on the doctrine of decreasing fiscal deficit. We should have rather stressed on reducing the rising deficits on revenue account. To spend on consumption more than one earns is bad as much in public finance as in private finance. GOI's revenue deficit has, however, increased sharply over the years since reform began. Cutting investment by the public sector is a soft option, while the more difficult job is reduction of subsidies and other current delays.

Competitive populism has led to subsidies claiming an increasing share of public outlays. Subsidies, both direct and indirect, - calculated as the difference between costs incurred and charges recovered as well as transfer payments made to make up for high

costs of goods and services – have been variously estimated. The Economic Survey of Government of India itself, as well as, the documents of the World Bank have, from time to time, pitched the figure at around two per cent to three per cent. As against this, a study conducted by the National Institute for Public Finance and Policy (NIPFP) following a model laid down by International Monetary Fund (IMF) has raised the figure to as high as 14 per cent. The methodology of the latter survey has been rather suspect in as much as it classifies as subsidies even legitimate public spending in areas, such as, education and health, wherever there is under-recovery of costs. Public health outlays or expenses on law and order are entirely different in kind from conscious under-recovery of costs, such as, involved in subsidies on fertilisers, food or power. Leaving aside the methodological dispute on definition of what constitutes subsidies, it is important that GOI focus more on issues, such as, reduction of subsidies for fertilisers, food and power rather than divert attention to cutting down outlays on health or education.

Food subsidies are insufficiently and inefficiently targeted, as shown by the fact that the poorest States of UP, Bihar and Orissa have a minuscule share in the total food subsidy disbursed by GOI. The lion's share of these subsidies goes to well-organised States, which have more extensive food distribution systems. Kerala, Tamil Nadu, West Bengal and Andhra Pradesh are examples. While there may, indeed, be a strong justification for maintaining an efficient public distribution system to act as a countervailing instrument to obviate market failure, it is neither necessary nor appropriate to lay down that prices of food distributed through the Public Distribution System (PDS) shall be significantly cheaper than that distributed through private channels. The difference should be so calibrated that it does not by itself become either a temptation for the rich to jump the queue or for producers to be disincentivised. In any event, the cost of food subsidy should be kept under a ceiling by relating the prices automatically as so many percentage points below the market price rather than operate in terms of fixed price for the PDS. There are other ways, than straight subsidies, of manipulating the prices of food grains in a system like ours. There are also clearly identifiable disadvantages from the producers' point of view in depressing food prices to too low levels.

So far as fertiliser subsidies are concerned, I believe it is high time they are dispensed with. It is a fact that the beneficiaries of these subsidies are mostly the richer farmers. We must note that the cost of fertilisers as inputs is scarcely six per cent to seven per cent of the total inputs of a farmer. Other inputs, such as pesticides, do not receive subsidies. What is of greater significance to farmers is easy and timely availability of credit for fertilisers. Indeed, the employment creating potential of subsidy on fertilisers is miniscule. If only there were a corresponding programme to divert the outlays on fertiliser subsidies to operate an investment programme in rural areas for irrigation system and roads, there would be undoubtedly much larger spin-offs and benefits to the agricultural economy.

Equally critical is the question of subsidies for rural power over the years. This has become a Frankenstein's monster. Taking all the States of India together, the total subsidy bill on power for agriculture ranges as high as Rs.10000 crores a year. Not only is this an economically inefficient way of pricing a costly service, it is also financially counter-productive. "Cheap power" can soon lead to "no power". Fresh investments are dissuaded by low returns and high demands on the fisc. Many private promoters of power projects are hesitant because of the problems posed by supply of free power and the resulting non-viability of Power Boards. It is also well known that in many areas

power supply for agriculture being free, is diverted for use in non-agricultural units. There has to be a national consensus on this issue to ensure widespread acceptance of the need to cut back on the movement towards free power. Addiction to cheap or free power for agriculture is a self-inflicted injury imposed on the economy by the politics of our country.

The State versus the Market

I have said sufficient so far to indicate where precisely my sympathies lie in the debate whether the State should cede all areas of activity to the market. I am in distinguished company. Even Adam Smith had been fully aware of the need for the sovereign to intercede lest the invisible hand became a grabbing hand. In recent years, however, protagonists of the efficient market have started whittling down the role of the State, especially in the pursuit of what has been known as the Washington Consensus. A generation of economic reformers has been going around with the gospel, "Tear down the State and the markets will turn hell into Heaven", a propaganda, which has had its impact not only on economists but on economies as well. An inarticulate, but major, presence in many of their teachings is today a belief that the State is evil. Particularly is this so, except for a minority among Indian economists and commentators. Running down the State for its alleged role in the decline of the economy has been a favourite pastime of some of our critics. There is an accompanying clamour for regulating the private sector. The contradiction follows that regulation, however, involves the State apparatus in some form or other, however you call it, - Reserve Bank of India (RBI), Securities Exchange Bank of India (SEBI) or Central Electricity Authority (CEA) or Telecom Regulatory Authority of India (TRAI). If we give markets and the private sector an important role, the State will necessarily have to come in to pick up the pieces when things go wrong and take steps to prevent such catastrophes.

In India's history since independence, the public sector has played an important role not only in drawing up a plan for the economy, but also in genuine entrepreneurship. In the early years of Independent India, partly because of the lumpiness of the investments needed and partly because of their own lethargy, very few private entrepreneurs were willing to take up the large projects which were involved in steel, mining and power, to mention only a few sectors of importance. At that time, even the leading lights of industry in the private sector, like J.R.D.Tata and G.D.Birla, had recognised that the Government had an important role to play. India's key industries - steel, heavy engineering, oil and petro-chemicals - would have never been built up even to their current levels if it had not been for GOI's initiative. This should not be forgotten in the cacaphony of criticism that the public sector faces.

It is also important to note that regional disparities and inequalities of income cannot be redressed by market forces alone. One example alone would suffice. As I have already mentioned, post-reform industrial investment has consciously avoided the poorest States of India, in spite of their rich endowment of natural resources. Regional disparities worsen. Is there any completely market-based solution to this, except to say that States like Bihar, UP and Assam, deserve their fate? Or, take for instance, the need for affirmative action to redress social and economic inequalities. All our poverty alleviation programmes are posited on a functioning State apparatus. However, much we reduce and diminish the State and its bureaucracy, we need the State, at least to discipline its alter ego, the market, for its failure.

There is no way economies, like ours, can totally obviate the need for a strong and responsive State. While I greatly admire the contributions of eminent economists, like Amartya Kumar Sen in stressing the role of a democratic and open society in prevention of famines, I believe that economists have generally ignored the equally important role, viz., that of the bureaucracies, which the Indian State has built up over the years. Be it the Bihar famine of 1967-68 or the Maharashtra drought of the sixties and seventies, it was a dedicated bureaucracy, which helped to pull together the elements of a successful food distribution scheme. A functioning democracy by itself could not have wrought the miracle of the Employment Guarantee Scheme (EGS) or the relief works in Bihar or Orissa in 1967-68. When I stress the role of the bureaucracy that supports it, let me not be mistaken as differing from the fundamental point made by Amartya Kumar Sen about the need for a democratic set up as a condition precedent.

Even in developed economies, the dilemma of the State versus the market has not been resolved. The percentage of GDP devoted to Government outlays has ranged between 40 to 50 per cent in some of the so-called market-oriented nations, like USA and Germany. Subsidies for agriculture in European economies are among the highest in the world. So are outlays on social welfare and health-related payments. It is, therefore, not right to argue that diminution of the role of the State is a necessary precondition for an efficient economy.

It is another matter that our "State bureaucracies" need to be toned up and made both responsible and responsive. An efficient State cannot be built on the foundation of a weak and frightened civil service nor on an arrogant and overtly imperious bureaucracy. Efficiency has to be secured without frightening the tools of the State, at the same time as we ensue their transparency and accountability. These are parts of the challenge in an evolving democracy. The issues that concern this challenge will take us far out of the remit of this lecture. Suffice it to say that an effort at improving the economic management of India, which ignores the need for a well-trained and responsive civil service, will face failure.

India's Public Sector

As I have already mentioned in the preceding paragraph, the State has necessarily to use the public sector – as its chosen instrument for carrying out its objectives. Unfortunately, the public sector in India suffers from a number of handicaps, many of which derive from its being seen as a limb of State. Although the public sector occupies some of the key positions in India's economy, its operations are subject to severe restrictions. These have become part of the working environment. Firstly, for various reasons, Government officials seek and obtain information on a number of details of decision-making, especially because of possible queries of Parliament members, either singly or in Committee. The fact that Ministers form the interface between Government and Parliament means that their answers make them responsible for what happens or does not happen in a PSU. The prospect of Parliament questions often offers an umbrella for many delays and excessive analysis. The same holds good for the impact of enquiries by CBI, Vigilance and so on, which tend to cast doubt on the motives of those who take decisions. These enquiries often judge decisions in the afterlight of events, which could not have been foreseen by those who decide. No commercial organisation can function efficiently if its decision on matters of purchase or sale is similarly subject to detailed post facto enquiries and the motives of decision-makers questioned if their outcome is wrong. It is the responsibility of those who decide to point out how or why the wrong

outcome was not due to factors, which they could have anticipated. No private sector agency can operate successfully under such a restrictive environment.

Lastly and most importantly, PSUs are treated as a limb of the State as they are controlled by Government and therefore fall within the ambit of Article (12) of the Constitution, which read as follows:

Article (12) says, *inter alia*, "the State includes the government and Parliament of India and the government and the legislature of each of the States and all local or other authorities within the territory of India or under the control of the Government of India". As a result, a Chief Executive Officer (CEO) of a PSU is subject to judicial jurisdiction in regard to decisions on contracts, hiring and firing of personnel and so on. Where the need for judicial scrutiny of State actions is not something to be treated lightly, the prospect of judicial intervention in commercial matters means that the executives of the firms in the public sector have to be much more circumspect in vital decisions as to what to buy, whom to appoint as sales agents, or give contracts to, hiring or firing personnel. A PSU works with its hands tied behind its back.

Various suggestions have been made as to how to improve the efficiency of PSUs. Some of them go to the extreme step of suggesting that PSUs may convert themselves to entities with Government holding below 50 per cent. Once the majority Government share is not there, the handicaps that go with being owned by Government cease – so the argument runs. I am afraid this is a devious way to reform PSUs. We have to understand the basic problems of excessive intervention by Government, Parliament and the investigators as also the constitutional requirements. In addition, come the problems of the structure of emoluments, which at higher levels, are tied to those of Government officialdom. For historic reasons, relativity with Government has been the norm. This makes the public sector a playground for those in the private sector, who hunts for top executives. These problems can be solved only over time. With the public sector running at a loss in many segments, dramatic upward revisions of emoluments for executives are not possible. In a sense, therefore, the public sector is running a hurdle race.

Enhancement of efficiency of the public sector has to be the thrust of Government policy. If it necessitates a concordat between Parliament, Government, the Judiciary and the Trade Unions, so be it. Parliament may have to agree to a self-denying restriction on the invasive questions of details of management, which constrict the freedom of PSUs. So too, Government should give more autonomy to PSUs, at least to those, which seek no budget support. Government should also simultaneously take steps to remove legal impediments in the working of PSUs. For instance, Government should request the Supreme Court itself to lay down criteria, which can enable it to interpret the Article (12) in a liberal manner such that it does not constrain the operational freedom of PSUs. So too, Trade Unions and Government should sit together to evolve methods of restoring confidence and strength to PSUs. All this, in my view, is not a dream. It is eminently practicable, given the will.

In my view, it is neither necessary nor proper to go through non-transparent methods of reducing Government majority in PSUs merely in order to make them efficient. Let us recall that the British Airways was made a successful enterprise well before it was privatised. A majority of British Airways' shares remained with Government all through this golden transition to a successful airline. So too, Singapore Airlines became a byword for efficiency, although it was owned 100 per cent by the Government of Singapore. Only recently, we saw how the Chancellor-elect of

Germany, Gerhard Schroder, took on the challenge of saving a public sector giant, the steel company, Salzgitter, in his native State, Bavaria. He made it one of the world's most successful. Around the world, if we seek, we can identify successful cases of PSUs, which show that private need not necessarily mean perfect. After all, let us remember that many of the loss-making units, which are today PSUs, are those that had to be taken over by GOI to save decaying private industry. Thus, the losses of private textile mills, which were taken over, still haunt India's public sector unit, National Textile Corporation (NTC).

The External Front

The dilemma before India's policy-maker on the external front has been particularly complicated by the recent crisis in global financial markets. Until recently, received wisdom stressed almost unequivocally that it is economically more efficient for countries to throw open their borders to trade in goods and services. Protection of any kind was condemned as promoting inefficiencies in industry and agriculture. The developed world and its academics promoted this benign view of a free trade world, although in practice the old practices continued, especially in countries like USA and Japan. The rise of the anti-protectionist wave in the developed world and the spread of teachings of the trade reformers in the university had their inevitable impact on developing countries. The philosophy of growth led by import substitution, which had a certain relevance in the early stages of growth and had been dominant under the leadership of intellectuals and development economists, like Prebisch, was systematically attacked. In particular, the ills of economies, like India and Brazil, were traced to their high tariff and non-tariff barriers. The new battle cry of economic reformers was to bring down trade barriers, as quickly and mercilessly as possible.

While some of the arguments of free trade enthusiasts did have considerable force, it was also true that they were overstating their case. It cannot be denied that if one went back in history, the growth of the US industrial base itself or even of Germany and UK owed a great deal to the high tariffs those economies had. Much of the growth of the Asian tiger economies had also taken place behind walls of protection and subsidies. The mistake may have, however, been to carry it too far.

Be this as it may, the result of the successful "educational" campaign of trade reformers has been that one of the important items on the agenda of economic reform in India is to bring down the effective rate of protection, in keeping with the general trend in the World as a whole. The coming into existence of the World Trade Organization (WTO) has speeded up the process. There was no way India could have opted out of WTO, the Chinese example being not entirely applicable to our case. However, once the developed countries co-opted the WTO organisation and made it their own platform, it has come the centre of a further barrage of attack not only on tariff and non-tariff barriers, but also on our procedures of industrial and trade policy, - in particular, investment-licensing for foreign investors and treatment of intellectual property rights. WTO has become, to some extent, a launch pad for the richer countries to mould the world into a free trade area, - wherever it suits them, even as they protect their own industries behind various anti-dumping procedures and non-tariff barriers. It has also become an instrumentality for intervention in non-trade-related areas, like labour practices and environment protection. When it comes to a question of developing nations, it is advice, as usual. "Do as we say, not as we do".

What is a pity is that India's policy-makers have not fully woken up to the dangers posed by this single-minded attack from the developed world and WTO. Our approach to WTO continues to be dilettantish, while developed nations engage batteries of lawyers and administrators experienced in WTO matters, many of them steeped in the earlier experience of General Agreement on Trade and Tariff (GATT). Particularly, with our practice of the doctrine of rotation in our mandarinates, we tend to lose even the little expertise and advantage we possessed, as we disperse experts to new areas or lose them to entities abroad. We have to rebuild expertise, every time an incumbent changes. The dilemma is that while we want to present the world with a picture that we are as good free traders as the best of them, we do not realise that behind every "free" trade enthusiast from USA or European Union (EU), there stands a strong belief in managed trade for the country's own interest.

The Indian industrial scene today bears graphic witness to the potential damage that unimaginative devotion to "free trade" philosophies can sometimes lead to. Many of our engineering and textile units trace their current troubles, at least partly, because of price competition from abroad. To add to it, the perverse tariff structure introduced by fiscal reformers in the nineties has made it advantageous for Indian businesses to import finished products and trade in them rather than to manufacture them in India. The theory that "uniform" tariff is more economically efficient than a structured tariff has led to condemnation of an earlier practice, where the duties on final goods were held higher than those on raw materials or intermediates. The fiscal theoreticians have won a pyretic victory. Their reform has led even multinational hardware manufacturers, like IBM, referring to import finished computers and trade in them. They have closed down many of their assembly operations.

Our enthusiasts for reform, who have surrendered to the Trade Related Aspects of Intellectual Property Rights (TRIPs) regime have also forgotten that developed nations first "grew" their research and development in a scenario in which process patents were the norm. The history of scientific development of processes itself shows that success lay not only in discovering new products, but also in unravelling new processes by which known products could be made more efficiently. The new regime in regard to intellectual property imposed by WTO implies that every "product" is unique, and a new process to make it does not give an inventor the right to patent it if the product has already been patented by the researchers abroad. Thus, even if today you invent a new way to produce ammonia or aluminium, you can violate the product patent concept. This ignores the fact that the Italians, for instance, developed their pharma industry only under the cover of process patent. There has been a great deal of hustling on this front – and little popular awareness. Suffice it to say that once the pharma buccaneers from the West take over the India's health care industry through this route, our peoples' access to cheap medicines may well be a thing of the past and a story in our history books.

This is all, of course, part of the reformers' struggle to open the economies to trade in services. The West, led by USA, has been aggressively pushing for free trade in services. We had also agreed to this in the hope that there will be real reciprocity. Reciprocity is often a myth. One is reminded of Roman Rolland's famous story where a poor man asks, "What is equality?" He is told that the poor man has "equal rights" with the rich to sleep under the bridges of Paris. Equally illusory is equality in respect of services. To mention only one example, the US authorities deny our personnel the freedom of entry in respect of precisely those areas of expertise where we have comparative advantage while demanding it fully in their own areas of advantage.

I turn now to the vexed issues of exchange rate and exchange management. There has been a "transposition" of ideas to this sector from the field of free trade in commodities and services. As the eminent Economist, Dr. Jagdish Bhagwati has pointed out, the concepts of free trade in goods may not be fully valid in the case of movement of currency transactions. While the freedom of current account transactions is obviously becoming increasingly a necessary feature of international trade, it is not equally true that capital account should also be fully freed. I myself had earlier been an enthusiast for fast movement towards capital account convertibility. Recent experience in Asia has made us all revise our views. I believe that caution in convertibility on capital account is justified.

The main argument in favour of a freer regime of capital movements is that they can and will lead to efficient use of global capital resources. The fact is that Indian industrialists were, indeed, able to access global capital sources at lower rates of interest, thanks to the freeing up of restrictions. But, we owe it to the sagacity of our policy-makers that they continued to keep a watchful eye on exposure to external debt, particularly at the shorter end. We have to calibrate our movement towards a fuller capital account convertibility carefully till we see a more stable global financial system in place.

Lastly, I turn, ever so briefly to the dilemma of exchange rate management. It is all too easy to fall into the trap of devaluation of a currency as a solution of domestic problems, although this was, for long, received gospel. International Monetary Fund (IMF) and International Bank for Reconstruction and Development (IBRD) used to insist on devaluation as a rite of passage. Consequent on the entry of speculation by banks and other operators in the forex markets, stability of value of currency has come back to be regarded as important. Leading experts, like Paul Krugman, have now pointed out that IMF's advice to devalue may itself have been partly responsible for the collapse of some of the Asian economies. Be this as it may, our problem in India is that some of our policy-makers are still guided by the earlier "faith" in devaluation. It is gratifying that our Central Bank has not fallen a victim to this soft option.

Conclusion

I have tried to survey a number of perplexing issues that face the policy-makers and the people of India. There are no simple solutions to the problem of development. I have not covered all the areas that constitute this mosaic of problems. But, I hope, I have said enough to indicate that the mould of policy in India cannot be what is dictated by conventional wisdom. The problems of India are unique. We have inherited a number of them from the colonial regime. There is, above all, the social and legal context, which prevent the transposition of many of the remedies that are available in other less formal societies. We are not operating on a clean slate. Our reformers have rightly treaded warily. A shock treatment can very well cause serious problems that undermine stability and the possibility of progress. Too slow a pace of change can lead to the quality of reforms itself being attenuated to the point of failure. This, above all, is the dilemma of the reformer.

Before I conclude, let me not leave you with the impression that I am a pessimist. I believe that just when it looks darkest, India has found ways of emerging triumphant. Nearly three and odd decades ago, two American economists had published a book, which forecast that India would join the world's scrap heap, merely because of the shortage of food. It was also at that time that the Green Revolution came about, marrying science and technology to Indian agriculture. Many economists could not bless

the new techniques. They were afraid it would not work and if it did, it would increase inequity. The farmers of India proved the pessimists wrong. The agricultural revolution of the sixties and the seventies proved, in particular, that there is great potential in India's farmers, if properly tackled.

Even as the bumblebee flies, although aerodynamics has proved why it cannot, so too the Indian economy can rise to great heights, although reformers continue to despair. Above all, I urge the young economists who go forth today from the portals of this great school not to become victims of the accountants' curse. Let us not rule out every prospect of development just because it does not satisfy the criterion of financial profits. True, the test of pecuniary return is needed. But, the vision of greatness is even more essential.

R.B.R.R. KALE MEMORIAL LECTURES

<u>Lecturer</u>	<u>Subject</u>	<u>Year</u>
1. * V.G.Kale	Modern Tendencies in Economic Thought and Policy	1937
2. + G.S.GHURYE	The Social Process	1938
3. + B.R.AMBEDKAR	Federation Versus Freedom	1939
4. * K.T.SHAH	The Constituent Assembly	1940
5. + A.V.THAKKAR	The Problem of the Aborigines in India	1941
6. + V.L.MEHTA	A Plea for Planning in Co-operation	1942
7. S.G.VAZE	The Formation of the Federations	1943
8. * JOHN MATHAI	Economic Policy	1944
9. * S.R.DESHPANDE	A Statistical Approach to Vital Economic Problems	1945
10. * J.V.JOSHI	India's Sterling Balances	1946
11. + C.D.DESHMUKH	Central Banking in India: A Retrospect	1948
12. + D.G.KARVE	Public Administration in Democracy	1949
13. R.L.DEY	Policy of Protection in India	1950
14. M.VENKATRANGAIYA	Competitive and Co-operative Trends in Federalism	1951
15. A.D.GORWALA	The Role of the Administrator: Past, Present and Future	1952
16. * LAXMANSHASTRI JOSHI	Indian Nationalism	1953
17. + W.R.NATU	Public Administration and Economic Development	1954
18. * P.C.MAHALANOBIS	Some Thoughts on Planning in India	1955
19. + S.K.MURANJAN	Reflections on Economic Growth and Progress	1956
20. + B.K.MADAN	Financing the Second Five-Year Plan	1957
21. * V.K.R.V. RAO	Some Reflections on the Rate of Saving in Developing Economy	1958
22. K.P.CHATTOPADHYAY	Some Approaches to Study of Social Change	1959
23. B.VENKATAPPIAH	The Role of Reserve Bank of India in the Development of Credit Institutions	1960
24. B.N.GANGULI	Economic Integration: Regional, National and International	1961
25. A.APPADORAI	Dilemma in Modern Foreign Policy	1962
26. + H.M.PATEL	The Defence of India	1963
27. + M.L.DANTWALA	Agriculture in a Developing Economy: The Indian Experience (The Impact of Economic Development on the Agricultural Sector)	1964
28. * PITAMBAR PANT	Decades of Transition – Opportunities and Tasks	1965
29. + D.R.GADGIL	District Development Planning	1966
30. S.L.KIRLOSKAR	Universities and the Training of Industrial and Business Management	1967
31. E.M.S.NAMBOODRIPAD	The Republican Constitution in the Struggle for Socialism	1968

32.	J.J.ANJARIA	Strategy of Economic Development	1969
33.	RAJANI KOTHARI	Political Economy of Development	1971
34.	* V.V. JOHN	Education as Investment	1972
35.	K.N. RAJ	The politics and Economics of "Intermediate Regimes"	1973
36.	H.K.PARANJAPE	India's Strategy for Industrial Growth: An Appraisal	1974
37.	ASHOK MITRA	Growth and Diseconomies	1975
38.	S.V.KOGEKAR	Revision of the Constitution	1976
39.	M.N. SRINIVAS	Science, Technology and Rural Development in India	1977
40.	J.P.NAIK	Educational Reform in India: A Historical Review	1978
41.	TARLOK SINGH	The Planning Process and Public Policy: A Reassessment	1979
42.	ALOO J. DASTUR	Problems of Indian Minorities	1980
43.	V.M. DANDEKAR	Measurement of Poverty	1981
44.	I.S. GULATI	IMF Conditionality and Low Income Countries	1982
45.	I.G. PATEL	Inflation - Should it be Cured or Endured?	1983
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51.	MALCOLM S. ADISESHIAH	Eighth Plan Perspectives	1989
52.	D.T.LAKDAWALA	Indian Public Debt	1990
53.	B.S. MINHAS	Public Versus Private Sector: Neglect of Lessons of Economics in Indian Policy Formulation	1991
54.	V. KURIEN	Agricultural and Rural Development in the 1990s and Beyond: What Should India Do and Why?	1992
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56.	G. RAM REDDY	The Financing of Higher Education in India	1994
57.	MADHAV GADGIL	Patenting Life	1995
58.	A. M. AHMADI	Constitutional Values and the Indian Ethos	1996
59.	VASANT GOWARIKER	Something Happening in India that this Nation Should be Proud of	1997

* Not Published

+ Out of Print

No lecture was delivered in 1947 and 1970.