IV GROWTH AND EQUITY

The crisis of last summer has been brought under control. This does not mean that the problems have been overcome: the balance of payments will continue to be critical in the coming year, and there is some way to go before we can say that inflation has been contained. But both problems have been made more manageable; the Government can now give a credible assurance that if we continue in the policy directions worked out in recent months, a considerably better economic performance is within reach, and with it, better living and working conditions for the people.

After a long period of relatively slow and stable growth of 3.5 per cent a year, the Indian economy achieved a marked acceleration in the growth rate to 5.5 per cent in the 1980s. The acceleration was accompanied by several indications of improved performance. Capital-output ratios showed some decline. There was a distinct fall in the proportion of the poor in total population. The decline in India's share in world markets was halted. However, if the average standard of living is to be significantly improved, and more and qualitatively better employment is to be generated, the growth rate needs to be significantly stepped up.

Our past performance leads to a certain conservatism in assessing our prospects. But much more rapid growth is possible, as our neighbouring countries further east have demonstrated. Our people are as talented, and our resource base is at least as good. There is every reason to aspire towards a substantial improvement in our growth rate. The living standards of the poorest can only be raised if labour surpluses disappear and workers get the choice of moving into more productive occupations. Once growth exceeds the level at which new employment is simply accommodating the growing labour force, and labour begins to move to occupations with higher productivity, growth also begins to reduce poverty and improve income distribution. The process must, however, continue to be reinforced by special programmes aimed at providing direct support for income generation and employment among the poor and weaker sections of our society.

The availability of foreign exchange has again emerged as a dominant constraint on the growth of the economy. The analysis of the balance of payments crisis above led to the conclusion that the only long-term solution to the crisis lay in a rise in exports. The resources provided by the international institutions and friendly countries are in essence transitional. Foreign direct investment will play a role in improving the standards of technology and management. In comparison to domestic investment, however, the contribution of foreign investment is bound to remain minor. The balance of payments problem would have to be resolved largely with our own resources and ingenuity. This illustrates the general proposition that there is no alternative to self-reliance.

The analysis of inflation concluded that whilst a policy of demand restraint was unavoidable to control inflation in the short run, a more effective and durable way of stabilizing prices in the long run was to improve the supply response to price changes. This required the promotion of savings on the one hand, and the development of improved organizational structures in agriculture and industry on the other. These would make the producers more adaptable and innovative.

The current inflation has also highlighted the crucial role of agriculture in our economy. Inadequate growth of agricultural output has led not only to general inflation, but also to a relatively faster rise in agricultural than in industrial prices. With deteriorating terms of trade, relative profitability in the industrial sector has tended to decline. There has ensued an industrial recession in which industrial investment has slowed down. There will also be concomitant depressive effects on industrial profits and wages. Rapid industrial growth requires an acceleration in agricultural output.

On the basis of this analysis, seven major areas of policy reform emerge: fiscal policy, trade policy, industrial policy, financial policy, agricultural policy, poverty alleviation policy and human resource policy. The reforms have just begun, but the broad outlines of a programme can even now be defined.

(a) **Fiscal policy:** The immediate aim of fiscal policy must be to improve the fiscal balance in order to eliminate the inflationary pressure emanating from the budget deficit. The other objectives of fiscal policy reform would be to stop further accumulation of public debt; to reduce the level of subsidies in the economy and eliminate open-ended cross-subsidization; to direct Government expenditure towards providing essential public services of a high quality, and finally to restore the Government's capacity to make strategic investments in infrastructure and human resources, guide the economy and look after the weak and the less privileged.

(b) **Trade policy:** Decades of growth under a balance of payments constraint and high protection levels have resulted in a dualistic production structure. Some sectors are globally competitive whilst others are inefficient and have high costs. By and large, agricultural goods are produced at costs which are comparable to international prices or below, whereas steel, metals and chemicals are produced at costs considerably above the international level. High costs in a few parts of the system make the entire economy uncompetitive. To counteract selective uncompetitiveness we developed a system of selective export subsidies and selective access for exporters to imported inputs. But these selective privileges expanded and became increasingly expensive in terms of budgetary and foreign exchange costs. The benefits from increased exports in relation to them became increasingly dubious. Hence a systemic change became necessary. It began in July 1991 with devaluation and the abolition of Cash Compensatory Support on the one hand, and the issue of Eximscrips and the abolition of certain types of import licences on the other. However, much remains to be done. Trade reforms must continue, and their end result must be a tariff system which, while providing reasonable protection to Indian industry, does not distort domestic relative prices. Import and exchange controls have to be drastically overhauled so as to enable Indian firms to plan their operations unfettered by bureaucratic interference. The final objective would be to achieve a degree of openness which would allow trade to balance domestic demand and supply and permit the full exploitation of the country's dynamic comparative advantage.

(c) **Industrial policy:** For decades, the most profitable activity in industry was import substitution. Blanket import substitution gave producers of new products a temporary monopoly which was eroded in some cases as more producers entered the market. However, monopoly positions in some industries and excessive entry in others prevented an adequate buildup of technological competence. It is necessary to adopt a concerted strategy to make Indian industry internationally competitive. Steady and continuous competitive pressures must be created by dismantling restraints on internal competition and by having a stable, moderately protective tariff structure. It was with this aim in view that industry was extensively delicensed in July 1991. Delicensing only removed an administrative obstacle to domestic competition.

Market structures will change only if new firms enter industries and chronically inefficient ones go out or are taken over. To achieve this, the attractiveness of different industries in terms of the rate of return on investment needs to be brought to the same level. The factors that discourage investment, including price and distribution controls, need to be dismantled. We also need to establish a credible safety net which would protect workers against the risks arising from firm failure, and make their compensation independent of the fortunes of the sick firms.

(d) **Financial policy :** The financial sector is at the centre of economic activity; its health affects the entire economy. Its performance was reviewed by the Narasimham Committee. The Committee's conclusions will be the starting point of financial reforms in the coming year. They will be directed towards improving the financial strength of the banks, and will cover directed credit, adequacy of reserves of banks and financial institutions, methods of prudential regulation and stock market reform. The variety of institutions in the financial sector has diversified in recent years; this diversity must be encouraged, and entry and exit should be eased. Similar diversification is in evidence in financial instruments, and deserves to be encouraged. Rates of return on various financial instruments and investments were centrally regulated till recently. This central control has begun to be relaxed, and should be further relaxed; ultimately, financial market prices and investment practices should be such as to direct funds efficiently and to harmonize the rates of return. Special arrangements will, however, continue to be necessary to ensure that funds flow to new, small or rural enterprises and investments of high social priority which may not be adequately served by the mainstream financial institutions.

(e) **Agricultural policy :** Our existing policy has elements which go back to the mid-sixties when the country was faced with a crisis of food availability in its urban centres. The country has achieved remarkable success in meeting the food needs of a growing population. The problems have, however, changed. Agriculture must supply growing requirements of food and raw materials using our limited resources of land and water. This calls for a continuous improvement in the technologies of production, storage and marketing. Special efforts have to be made to improve the productivity of dry-land agriculture. Systematic attention has to be paid to the control of land and water degradation. The various institutional and economic constraints on the fullest exploitation of the vast potential of agriculture in the Eastern region will have to be overcome. The agricultural credit system which has suffered greatly in the wake of the ill-thought loan waiver scheme of 1990 has to be revamped. Agricultural research and extension systems need to be modernized taking into account the challenges that lie ahead. Agriculture is the least protected sector of the economy; its access to world markets needs to be improved, and barriers to access need to be removed, so that it can make a more substantial contribution to exports. A credible system of food security must be maintained. The Government's capacity to invest in agricultural improvement and in rural development has been eroded with its worsening fiscal situation in recent years. It must be revived; at the same time, the capacity of agriculture to grow, to use resources efficiently, to innovate and diversify needs to be nurtured.

(f) **Poverty alleviation policy**: It is the task of the Government to ensure that the people's basic needs are met and distress prevented. This task becomes more important at times of economic stress and change; that is when there is the greatest need for extending a safety net to the weak and the poor. The Government is committed to expanding the scope and coverage of direct poverty reduction programmes. The Public Distribution System has been extended, and supplies of essential commodities through it have been increased. The task ahead is to target the poverty alleviation programmes towards the worst affected sections of the people, to make them more responsive to felt needs and to improve their efficiency.

(g) **Human resource policy**: The people must be helped to enhance their own capabilities. They should have considerably better access to education and training, and opportunities to use them in productive work. Renewed efforts are necessary to expand health care and to improve its quality. Social and economic uplift of women must be given special emphasis. Not only is the potential of the women capable of being more fully exploited, but their advancement is essential for moderating population growth.