A PRAGMATIC ECONOMIC POLICY FOR A GOVERNMENT THAT WORKS

FORUM OF FREE ENTERPRISE
PIRAMAL MANSION, 235 DR. D. N. ROAD,
BOMBAY 400 001.

" Free Enterprise was born with man and shall survive as long as man survives. "

— A. D. Shroff
1899-1965
Founder-President
Forum of Free Enterprise

A PRAGMATIC ECONOMIC POLICY FOR A GOVERNMENT THAT WORKS*

Economic policy making has a certain momentum, or perhaps inertia, of its own. Often this is heartbreaking to the serious economist who, concerned as he is with the underlying long-term trends, finds that some basic changes which he has to suggest are not even being considered. Perhaps he has reason to be more hopeful now. Besides seeking effectiveness in action, the present government also seems to want to give new shape to the economy. The Prime Minister, of course, has the capacity to take the people with her in any unpopular decisions which may be necessary.

This survey of policy-making does not take up specific measures for examination in detail. What is brought under consideration is the **thinking** which seems to be at the back of the line of policy that is adopted. Some basic postulates are questioned and alternatives, which seem better, proposed — as a contribution to much-needed discussion.

On a year-to-year basis, increases in prices are ascribed to passing events like failure of rains, famine relief, inward remittances, strikes etc.—and that's where analysis customarily ends. But in India prices have risen continuously for three **decades** and the rate has accelerated from 1.5 per cent per year in the '50s to 6.1 per cent in the '60s and 9.7 per cent in the '70s. The bouts to remember have come in pairs of years : 13.9 per cent in 1966-67 and 11.6 per cent in 1967-68, 20.2 per cent

---

* This article by a study team of three appeared in "Economic Scene", (February 1931), published by the Tata Economic Consultancy Services, Bombay - 400 038, and is reproduced with kind permission of the Editor.

in 1973-74 and 25.2 per cent in 1974-75; and now 17.1 per cent in 1979-80 and 19.5 per cent in April-November 1980.

A movement of such persistency and magnitude must be regarded as **endemic** price increase, which can be explained by some chronic factor at work. It is suggested that, since the late '50s, what we havé witnessed is a **phenomenon** of **inflation,** its basic cause being an excess of **investment** in relation to our capacity to bear the burden. Strangely, year after year, the excess was overlooked—or ignored.

Would it be well to give a counter inflationary programme the first priority for two or three years? The answer suggested is, yes. Nobody would recommend drastic action of a kind that takes us headlong into a recession. However, without readiness to take **some** risk, the back of inflation cannot be broken at all. The mere **possibility** of a recession should not tie down our hands. Incipient recession is not uncontrollable. Action can and must be taken to lessen the impact of a reduction in monetary demand on employment and living standards amongst the poorest.

Perhaps what has impeded the adoption of an effective counter-inflationary programme is not so much a fear of recession as a peculiar tendency to think that money is all right as long as it is used productively. On this view, the distinction between productive and unproductive outlays becomes all-important. What gets discounted is the distinction between money representing genuine current savings and new money created out of thin air.

There can be no dispute about the desirability of bringing down the share of unproductive investment in the total, but the villain is the total. An excess in aggregate investment has been tolerated because of the belief that such excess is inevitable (even normal) in a developing country and that in some ways it helps the development process.

On both counts the view is wrong. The condition looks normal because the increases in the prices of capital goods and the wage level that occur are absorbed in the economy on the strength of the new money which in the meanwhile gets created. In other words, there is a succession of short term equilibria, each at a higher level of prices and wages than the preceding one. It is this that gives the illusion of normalcy. Cut off the elastic money supply, and the edifice must crumble under its own weight.

The process, far from being helpful, is harmful. In an overheated economy, additional investment financed by new money does not make a corresponding addition to the aggregate real investment. It makes all investment less fructuous because of the general increase in cost. There is, therefore, little gain. The evil comes in two ways. First, there is a distortion in the pattern of investment, with trading and hoarding getting the upper hand. Secondly, the desire to save gets eroded. Both are serious matters.

Some industrialists are in the habit of asserting : the best answer to inflation is increased production. The Prime Minister also expressed this view recently. As a general statement, this is misleading, for it is not true at all times. In the Indian context, it is not a suitable basis for policy. If we get additional goods free of cost or at less than average cost, there can be a counter-inflationary impact. This can happen when, for example, workers on strike resume work or double cropping is replaced by triple cropping. However, when real resources in the aggregate are overstretched, as has been the case in India all these years, the attempt to further increase production entails a **more than proportionate** increase in money incomes. This means more, and not less, inflation. Behind the three-decade inflation has, after all, been the laudable desire to increase production

Monetary policy in India has to be different from that in Western countries—it has to have a develop-

mental slant. This has been the constant refrain since Mr. H. V. R. Iengar's days, and it is wrong. What India needs is not a different monetary policy, but a monetary policy plus something else, viz : a savings promotion policy.

The two are, of course, not unrelated. To put it crudely, price stability, which is the **result** of successful monetary policy, is the condition of success in mobilizing savings. It may not be necessary to create separate **agencies**, but the point to remember is that the two functions are separate and distinct. To bring that out, let us **imagine** two persons to be in charge of the two jobs. We can't then say that the Stability Man (the monetary authority) should be ignorant about social priorities or that the Growth Man should have no knowledge at all about the inflationary process. It makes sense, however, for each to concentrate on **his** job.

The Stability Man looks to how much money (of various kinds) there is and how active it is. He is concerned with the total liquidity in the system and not, in any basic way, with who has the money and what use is being made of it. He tries to keep the total liquidity within limits in order that the pressure of money against goods is not too great.

The Growth Man is concerned with raising the **proportion** of the aggregate income that is saved and has little use for the conventional tabulation in which an increase in the monetary value of assets is taken to reflect an increase in savings even when no additional money has been spent on the assets. He wants to know how a person, or a business unit, divides current money income between current expenditure and acquisition of assets. To see that as large a part as possible of the investment is in conformity with social priorities is a separate though important function.

There may be difference attached to each, but these are exactly the functions in all countries. Failure to recognize them as separate functions has led India to

persuade herself that the whole show needs to be managed **differently** here, and this has contributed to failure on both fronts : a high rate of inflation **plus** a low growth rate.

Black money is, of course, less amenable to control than white money is, but it is not right to think that the pressure on prices comes only from the former. The critical factor is the velocity of circulation. The holder of black money is believed to have restricted choice in putting the money to use. If so, it may well be that 100 Rupees of white money has more force than 100 Rupees of black money has. White money may then be the greater culprit. The solution to black money acceptable to the Stability Man would be cancellation of part or the whole of such money. He cannot look with favour on the kind of solution found recently by the Finance Minister—special bearer bonds. In fact, the **transferability** of the bond makes the bond itself a token of money. The transfer value may be less than the face value, say 90 against 100. Yet if the bond circulates more rapidly (as it well may) than the black money it replaces could, the net effect would be an **increase** in effective money supply !

Take now a look at another spot. An increase in the volume of fund flowing into the share market would make the Growth Man happy. He would take this as evidence of increased savings seeking investment. However, if there is a continuous increase in the **prices** of shares, the Stability Man would be worried. He would want to know if this didn't indicate an increase in the liquidity of the system. The reason? A person finding the value of his shareholding going up may, instead of buying more shares, become freer in spending the money he has **not** invested in shares. He may even be readier to borrow to spend.

All this shows that the Stability Man has more than enough work on his hands without his being asked to make social priorities and funds for the government his main concern. Controlling money supply (in the sense

of the liquidity in the system) may not be the only plank in an anti-inflationary drive. But we in India tend to overlook that it **is** a plank, and a very important one. The Stability Man deserves much greater authority than is given to him.

Trying to reduce the liquidity in the system necessarily implies adopting a tougher monetary policy. We can, to some extent, be selective in the rules we make but the policy as a whole must clearly be tough in fact, and not just in appearance.

As regards being tough with private business, it is suggested that the nationalization of banks hasn't helped; it has worsened matters—it has made slackened discipline more respectable. It was right to demand of the bankers that they be more energetic in discovering fresh good borrowers of limited means and with little security of offer. But from the standpoint of monetary policy, the aggregate credit extended still remained a critical factor.

Operating the liquidity ratio would be the principal means of making banks adopt a stiffer overall policy. The commercial banking system creates new money primarily with the help of the Reserve Bank. Another point is that, the more closely knit the system, the more independent it is in creating new money without the Reserve Bank's assistance. Taking an extreme case, if there were only one commercial bank, say the State Bank of India, then every cheque drawn on the bank would also be a cheque deposited in the bank. Lending could, therefore, expand enormously without the bank having to bother about reserves. This is something to take into account when we consider structural reforms of the banking system.

A system of high interest rates would be consistent with the tighter monetary conditions that are needed and also wih a policy for encouraging increased savings. It is difficult to say how far, if at all, the rates can be raised above the existing levels. Nevertheless, if industry has fully the freedom of operation that is due to

it, a higher interest burden will probably be less unacceptable.

To some extent bank loans to priority sectors (artisans, rickshawallas, etc.) prove irrecoverable and then there is pressure to write them off. It is suggested that any special treatment to be given to priority sectors should be given openly and at the exchequer's cost — it should not affect the banker's psychology as a lender. At present, the banking system seems to have taken kindly to the motto : "lend more and be lenient". This is not at all desirable.

As regards term finance, the lending institutions employ elaborate and sophisticated techniques for segregating good loan applications from bad. Which is right. The missing consideration is how much of the good thing in the aggregate India has the capacity to bear. The institutions appear to work under the impression that they must somehow meet all **bona fide** demands made on them. This is not a helpful frame of mind, for they are then inclined to think nothing of adding to their resources in an inflationary way. The institutions should be better prepared to say no, charge adequate interest rates and ask the borrowers to try to find more money on their own. Investment which, under a toughened lending policy, the institutions are not able to finance should generally be regarded as investment which India cannot for the present afford to have.

State government overdrafts are a special problem which cannot be examined in detail. It would be helpful if the finance ministry and the Reserve Bank combined to adopt a tougher policy in order that deficit financing by states may be curtailed.

The main source of created money made available to the government is Reserve Bank credit to the Centre. This has been the principal factor in the endemic inflation from which India has suffered for the last two and a half decades. Asking the Reserve Bank to be tougher in creating new money for lending to the government

would, in practice, amount to asking the Centre to be strict to itself, and this calls for a new outlook on the government's part.

The basic attempt must be to have as little recourse to inflationary finance as possible even when it comes to financing productive investment. All borrowing from the Reserve Bank is, of course, wholly inflationary. While planning market loans, the government should pay greater heed to the fact that loans from the commercial banks are also, to a large extent, an inflationary source of finance. Gilt-edged is a sort of secondary reserve for banks, for in times of difficulty cash or credit can be secured against it from the Reserve Bank. The possibility of inter-bank transfers also implies that the lending capacity of the banking **system** as a whole improves with the absorption of additional government stock. Finally, to the extent the Reserve Bank seeks, through its "open market operations", to maintain the **prices** of different securities, government paper itself acquires the attribute of money.

Trimming its operations would mean the government taking deliberate steps to reduce the aggregate load of commitments. The load has continuously increased, for each government has been anxious to show that it was doing more for development than had been done earlier by itself or by the predecessor government. The result, of course, has been more and more attempted in an inflationary way. One would wish there were recognition that the government can't do **everything** worth doing !

Productive investment calling for inflationary finance must be looked at through a magnifying glass and permitted only in exceptional circumstances. Such investment is made directly in public sector projects and it is also made indirectly in the private sector through term lending institutions. For instance, the Industrial Development Bank of India gets its funds from the Reserve Bank. This is hardly proper.

In any case, in respect of **new** direct investment, the strictest control should be exercised for at least two years. Maruti is clearly an example of wrong investment. The government's argument was that it was acquiring excellent productive assets. That argument need not be contested. The point is that, had the government not moved in, some business man would have got for five lakhs of his own money those very assets for which the government paid five crores of created money. The public interest would have been served in a non-inflationary way at one hundredth of the cost.

In savings management our fatal error has been that we have been more concerned about the use of savings than about having savings ! We have been in haste to nationalize sources of savings so as to ensure that no part of the savings is "wasted"—overlooking one simple fact : the availability of outlets for investment is itself a factor in determining the volume of savings.

Why doesn't the government let there be a unit trust in the private sector? Unfortunately, on basic issues of this kind, in finance as in other areas, the government doesn't always make its mind known—fully and publicly. There is need for more "White Papers" on different subjects, papers which set out the pros and cons of policy and not just narrate achievements.

In the present case, the Finance Ministry's argument is believed to be that a private unit trust would succeed only in attracting savings from the existing public unit trust so that the advantage to society would be zero. This is fallacious—even if we ignore the observation the cynic would make that if it stood to lose money the moment a private trust was established, the public trust didn't deserve to have the money in the first instance. The fact that there are people wishing to transfer their money from a public to a private unit trust implies that there are also people who don't give their money to a unit trust when only the public unit trust is in existence. The savings attracted by a public unit trust

and a private unit trust **must** be larger than the savings attracted by a public unit trust alone.

State lotteries, which successfully play on the investor's psychology for generating an additional **flow** of savings, are an excellent refutation of the finance ministry's apparent conception of national money savings as a **static pool.** The Rupee one tosses to buy a lottery ticket is the Rupee drawn from consumption expenditure—it is, so to speak, the Rupee that would otherwise go to buy a packet of cigarettes. The savings generated by a state lottery are not savings diverted from any other source—they are money intended to be spent on smoking converted into savings. The only thing, incidentally, about state lotteries to which attention may be drawn is the kind of advertising that is done. Every packet of cigarettes carries the slogan "Cigarette smoking is injurious to health". Shouldn't likewise every one Rupee lottery ticket carry the slogan : "The chances of winning a one lakh prize are considerably **less** than one in a lakh?" Anyhow, state lotteries, backed by appropriate propaganda, are an admirable way of generating **new** savings by appealing to the average man's gambling instinct.

Besides the venturesome spirit, the other sources of saving to be cultivated are : business profit trying to earn more profit and salary income seeking security for future or additional income.

Profit is **money** in the businessman's hands, and the effort to earn larger profits is the basic source of saving. Businessmen, though rich as a class, are among the stingiest, as a class! They are keen that as much money as possible be used for expanding the business.

Just as, from the savings point of view, it makes little difference whether the effort to operate more efficiently and earn larger profit is in the private sector or in the public sector, we have really no reason for favouring retained profits as against profits distributed as divi-

dends. On certain counts, indeed, the latter is to be preferred. Dividends are an addition to income, part of which comes back as saving seeking a different channel of investment. Prospects of rising dividends, which are accompanied by capital appreciation, attract new people to the equity cult—and this often does mean reducing consumption expenditure to invest in shares. A company with a good dividend record is in a better position to make fresh issues of capital which tend to widen and deepen the generation of savings. Finally, retained profit means more "concentration" and may mean reduced interest in economy of operation.

Is it conservation that has led fiscal policy all these years to favour retention as against distribution? One doesn't know. In any case, the basic suggestion is : in order that savings should increase let the opportunities for earning profit multiply.

As regards saving from current non-business incomes, the most important factor is expectation about stability (if not decline) in commodity prices.

Only a little less important would be the breadth and variety of avenues for investment. Industrial borrowers, for instance, should be allowed to fully tap different sources. Capital issue control doesn't deserve to be fussed about as much as it is today. As regards deposits from the public, restrictions are, of course, needed for lessening the chances of unwary persons being duped. To be deprecated is control aimed at diverting more money to the banks—so that the latter may lend more to industry ! The ploys the businessman uses for collecting funds from friends, relatives and (lawfully) from the general public are a constructive force augmenting the supply of genuine savings.

Thanks to "control" being the watchword in our economic planning so far, we are accustomed to looking upon banks and financial institutions primarily as lenders, and it is the lending operations which we have tried to regulate. The role of those agencies in attracting

savings to themselves (which would largely mean inducing additional savings) is actually much more important but it is neglected. Though all banks may be required to follow certain general guidelines, there should be more competition among banks, for dead uniformity in all banking norms and practices (including interest rates) is not helpful from the development angle. A bank which manages its loan portfolio well and keeps its expenses down is in a position to offer attractive interest rates and provide other services to depositors. Shall we have the courage to denationalize some banks in order that there may be better competition, leading to better saving mobilization?

Term lending institutions in the public sector are supposed to be the king-pin in the financial plan for growth. The truth is that by adhering to a rigid structure we have denied ourselves the chance to explore all options and possibilities.

Excepting for the Unit Trust and the L.I.C. the institutions do not secure funds from the public. They must be made to. And we should surely allow private financial institutions to come up. We cannot have fully mobilized the saving potential if we do not.

Let us also not queer the pitch by calling funds in the possession of these institutions "public sector funds". These funds are either created money or money forked out of the people by closing all other alternatives to them ! If the government takes pride in calling the money its, the basis for the pride is yet to be discovered.

Suggestions have often been made in the past that a minority holding in the capital of public sector undertakings and banks should be made available to the public. This does not mean that the people will readily buy everything that is offered but the idea is entirely logical. The government's reasons for opposing it are not known. The advantages of people's participation on this basis would be : a substantial chunk of savings made immediately available to government; an opportunity for

competent people in society at large to scrutinize operations as shareholders, and giving the commercial principle greater scope in the management of the business.

Is enough thought given to what the government is to do, why and how, in the sphere of industry? It seems not. And that probably is the reason for our not being particularly successful in formulating (let alone implementing) an appropriate industrial policy. It is suggested that, as a first step towards clarity of thinking, by industrial policy we should mean the business of stimulating and regulating **privately** owned industry. On that basis, the build up of heavy industry in the Second Plan —whether one considers that to have, on balance, been advantageous or not—should be considered a result, not of Nehru's industrial policy, but of his investment plan.

Continuing the same argument, it would not be sensible to suggest (as a local contemporary constantly suggests) that the "skewed" structure of production (excessive production of nylons and inadequate production of coarse cotton cloth) indicates a failure of the government's industrial policy. Actually, what it reflects are the prevailing demand conditions. Private industry produces what it can sell at a profit: this is precisely how it contributes to the success of a mixed economy. One may lament the large number of cinema houses built, and the small volume of shoes produced, in the country. Yet, many a person uses his chappals sparingly in order to spare money to visit the cinema once more—and how can one deny him his choice? Nor would curbs and controls by themselves be of much help. A ban on the production of nylons would free some resources, but these need not (and except for a fraction will not) go to augment the production of coarse cotton cloth. The remedy to the "skewed" pattern, to the extent it is needed, must be looked for in fiscal policy, leading to a better distribution of incomes, and public investment, and not producing and selling coarse cloth at uneconomic prices. That, however, is outside the realm of industrial policy.

This is not a matter of semantics. It is the road taking us to tasks which **do** fall within industrial policy—and are not attempted !

Today, industrial policy encompasses just two ideas : control the big industrialist and help (protect) the small industrialist. This hasn't worked. While controlling the big industrialists it became apparent that the developmental efforts of the big industrialists were **needed** and that control impeded these efforts. Realising this the Central government chose to act in a practical way and circumvent the MRTP. This kept up the illusion of policy though robbing it of any purpose.

Secondly, as regards helping the small industrialist it was found that everything depended on the state governments. Actually, how help was to be given and what the Centre ought to do to help states help small-scale industry remained subjects which were not quite clear. In practice, so far as the Centre was concerned, the job reduced itself, not to helping, but to protecting, small industry. An easy route was "reservation" for certain industries by law for the small industrialist. That could give the Union Minister the feeling that he, at least, had done his part.

The first thing is to settle the **goal** of policy and it's best to do it in simple terms. Let's define the goal to be : encouraging all kinds of productive effort that don't hurt society.

Encouraging is not a suitable word. Encouragement smacks of help, but the enterprise we may think of helping would ask first for freedom to help itself ! Therefore, the hypothesis to start with is that, subject to any rules made for protecting the public interest, every industrialist, big or small, must be free to manage his affairs for his own profit—expand and diversify the way he considers best.

Hurt to society comes in two principal ways; unfairly limiting competition and manufacturing products which, because of the particular resources consumed,

India as a society can't afford to have. Hurt to society from a small manufacturer is at the same level as that from a large manufacturer just as tax evasion by a bank clerk is as unethical as tax evasion by a smuggler. However, just as the tax gatherer for practical reasons ignores bank clerks and concentrates on smugglers, we must, while controlling hurt to society, ignore the small man and concentrate on the big man.

The implication, not always appreciated, is clear. If we think of a small sector, a middle sector and a large sector in industry, the dividing lines cannot indicate a qualitative difference—they can only be demarcations thought of for convenience's sake in enforcing the regulatory law.

A correct industrial policy cannot be conceived without recognising the important element of **universality** in it. The relevant considerations are the following :

1. Every industrial undertaking is both small and large at the same time. Even a very large one like ITC or TELCO is of modest size on the international plane and would certainly welcome facilities which help it compete on more equal terms with world giants;
2. Every industrialist, including the smallest, expects to look after himself. And expects also, barring unforeseen misfortune and sharp practices by others, to do well;
3. In some ways, smallness is a source of strength. On both economic and social grounds it is desirable to let this strength have full scope;
4. The advantages of largeness do not always have their origin in technology; external factors of an organizational kind also play a part. The principal areas are raw materials, marketing, testing facilities etc. If society were to organize services in these areas there would be a decentralization trend leading to a more efficient and a more satisfying industrial structure;

5. In view of the advantages of largeness, it would be fair to think of obligations and restraints the incidence of which is in some measure related to size.

These considerations, supporting an integrated or "universalised" industrial policy, would ask of the government : to exert to overcome the handicaps of smallness, industry by industry; and to impose certain "social obligations" in proportion to the capacity to bear—obligations conceived in the interest of the industry concerned or the interest of the community at large.

This maps out a big role, calling for vigour and skill, for the government. What has prevented action from being more effective?

First, it would seem, was pre-occupation with "getting into industry". Building up the public sector kept the government busy. There are, of course, areas where direct heavy investment by the government is essential, and we can't think of a society without a substantial public sector. Yet, in India, the importance of responsibilities other than that of establishing the public sector was not sufficiently appreciated.

Secondly, for understandable reasons, the government was inclined to pursue a policy which would **look** "progressive". Given the complexion of the politically vocal class, the formula was simple. The greater the number of industries reserved for the small sector and the more numerous the refusals to the large houses or the greater the extension of the public sector, the more "progressive" the policy !

From the historical angle the government was right in 1948 in issuing a statement which indicated the terms on which it was trying to "get into industry". Dividing industries into those which the government alone could develop, those which private parties could develop and those which both could develop made it clear that the government was interested in establishing new industrial

units and not in taking over existing ones. An assurance of that kind was necessary then.

Times have changed. The foundation of a broad and sophisticated structure has been laid. Ownership is not the issue it once was. The government has learnt from experience that it can make private units do what it wants them to.

Today there is no need for those dividing lines at all—they should be scrapped. There is need for flexibility in operations—and to this the government should awaken itself.

Actually, much more than owning a segment of industry is expected of the government in the general interest. Does this require bringing into use a new term? For instance, shall we speak of a public ARM, rather than a public sector, in industry?

ARM is a better word than sector because, free of territorial limitations, it shows strength—both strength in resources and coercive strength. There is use for this strength in a variety of ways as the government projects itself, not merely as a builder, but also as a promoter, manager, collaborator, specialist and trouble shooter.

The Central Government may, or may not, set up a few units in profitable consumer industries like tooth paste, soap or polyester. There is no particular reason for, nor any particular reason against, the government's having a go at profit-making.

However, there are strong profit advocates who suggest that the government should deliberately and in a big way go into a highly lucrative field like polyester in order to make up for the losses incurred in some other segments of the public sector in industry and also to raise resources for deployment in social fields like schools and hospitals.

This argument is weak. If the public sector as a whole makes losses, not because of inefficient operation, but because it includes undertakings (e.g. railways) which deliberately supply their services below cost, that is no discredit at all. Critics of losses in the public sector may just be told, they don't know.

Secondly, if by profit we mean the final net surplus (which represents genuine saving) the prospects may not be all that bright, for the net surplus is arrived at by deducting, from gross earnings, outgos in respect of interest on capital and reasonable allocations for the maintenance and modest expansion of the productive assets. Revenues earned from polyester will have to cover continued further investment in the polyester industry, and the balance which then remains may not be as attractive as seems to be the case when one looks at gross profitability.

Thirdly, though profits do mean resources, this particular brand of resources cannot be considered superior to the resources which the government attracts to itself by using its coercive power—in the present case, in the shape of excise duty on polyester. Though all government undertakings should, to the maximum possible extent, be run on business lines, other considerations are also involved. The private sector which looks to profit alone can be considered to be more specialised in earning profit than is the public sector which looks to profit **and** other considerations. Therefore, from the national resource standpoint, profits in private business and the coercive strength of the government would, in general, be a better combination than profit in public business and slackened coercive power.

Finally, a big search for profit may, on the psychological plane, militate against the adoption of right industrial priorities. Not that this **must** happen—but the risk is certainly there. Specifically, the government's entry into a **low** priority area like polyester (or, for that matter, a "people's" car) may make the government think that

the priority wasn't **that** low after all ! It may then be inclined to permit greater consumption of the item than is really justified in the social interest.

The foregoing are not arguments debarring the government from entering profitable consumer industry as a matter of principle. They are a warning against much being made of an effort in that direction.

There should, indeed, be no bar. If a government-promoted plant turned out real good quality razor blades or nail clippers, people may be surprised. . . .but they will be thankful !

Apart from helping to raise quality standards, there could be other advantages. For instance, it would be well for public officials to have a better feel of commercial operations. If some officials quit service to set up independent small undertakings of their own, that would be all to the good. To some extent the government factories could serve educational or demonstrative purposes. We can also expect the management of those units to accept "social obligations" of the kind we may think of imposing on large private establishments—testing facilities, R & D, dissemination of commercial and technical data etc. After the units have been successfully put on stream and their viability proved, the government may think of selling off the units at a profit either to a professional investor or to a co-operative of workers and technicians.

One principle applicable to all government units, whether in consumer or in other industries, is that they should bear the stamp of flexibility born of commercial considerations. Except for basic operational guidelines issued from time to time by the ministry, the units should be autonomous corporations, with varying public/private capital mix and, as regards employees, practising the norms appropriate to sound commercial enterprise.

It's not merely unnecessary but actually harmful for the notion to prevail that core and basic industries must be government's preserve, its monopoly.

The two principal arguments advanced concern "commanding heights" of the economy and resources. Both have a grain of truth in them, but let's not convert the grain into an impassable barrier.

None would deny that the government must have the final say on all crucial points of defence and development. What is needed, however, is a practical exercise to determine what exactly a "commanding height" would **mean** in each individual case to ensure that the final say does remain with the government. If that were done, going by the example of other countries, it would be seen that 100 per cent ownership and monopoly are not all that important everywhere.

As regards resources, it is true that no private party can get together the huge amounts needed, and the government may have to come in. The position is, however, worth looking into.

First, it is **desirable** that resources available to private parties should increase, the reason being that these resources reflect the value of work done. Operation of the MRTP and price controls have to be looked at from this angle, too.

Secondly, a project in the core sector is at times large because the government conceives it in that fashion. It can be made smaller or subdivided without detracting from its potency to achieve the public good.

Thirdly, the dependence of private parties on financial institutions in the public sector cannot be considered a disqualification. The government has the money, not because it has earned it or put it by, but because it has access to the Reserve Bank for meeting deficits.

Granted that the government must be in effective control and would need to provide in large measure the finance needed, the basic point is that there shouldn't be a barrier whether in action or in psychology. Today the three lists do operate as a barrier. The government should exercise leadership and keep thinking all the time

about the strategic needs of development, yet the task must be considered a **national** task. Private citizens with money, initiative and the desire to venture into difficult new fields should have the opportunity to contribute.

Let's consider an imaginary scenario to illustrate the point. Suppose a new Jamshed, wishing to set up a steel plant, comes along and says that he would make his own arrangements for electric power and coking coal. The government should then surely say : "Fine, go ahead, you can have all the iron ore and limestone you need. But remember one thing. You'll have to follow the guidelines we lay down in respect to what categories you make, to whom you sell and what prices you charge. Yes, you can call it coercive power. And don't count on any money from us. We won't come in your way as you raise your funds, including Eurodollars if you can get them. We may decide to put in some money but that will be only as a shrewd investor—for our own gain."

A reborn Jamshed's labours would be valuable not just because India needs additional ingot capacity. They would free the government to do, in steel, something else which is also important and which it alone can do—a steel small lot corporation that supplies the precise grades and specifications which small engineering firms across the country require but cannot stock for themselves. The prices may be higher lest the corporation should run out of supplies. The small firms would still find it advantageous to buy—and one handicap of smallness will have been overcome.

The hypothetical Jamshed scenario was introduced on purpose : it shows the paramount need for a change in attitude. The government must **welcome** opportunities for divesting itself of responsibilities which other agencies seem willing and capable of shouldering. With the three lists of industries should go also attachment to the public sector of the kind the miser has to his gold. There must be imagination and enterprise in wielding the

public ARM in industry—accompanied, it must be added, with readiness to give up, in greater or lesser degree in respect of both ownership and management. A good builder and promoter can never be a hoarder.

From society's point of view, as important as one huge project costing Rs. 200 crores could be 20 functional or service projects of Rs. 10 crores each. The steel small lot corporation illustrated effort in one direction. Consider now khadi. There is today a Khadi Commission selling khadi at subsidised prices. What is needed is a textile display commission stocking khadi **and** mill made fabrics. The commission may, or may not, sell; its function is to present a **comparative** picture of the technical qualities (and the prices) of different competing fabrics. This kind of common and objective advertisement is precisely what the small man in industry needs. And it need not be at public cost. There could be a small fee for entrance to the showroom and there could be a "display fee" charged to all fabric producers in proportion to the turnover of each.

That brings out an important principle. Just as private agencies (both their money and their energies) must be fully utilised for securing public ends, all government-initiated schemes in industry should, as far as possible, pay for themselves. Flexibility in operations must be combined with business outlook. Hence the emphasis on "skill" in the way the public ARM functions in industry.

Given expanded support in raw materials and marketing, there will be less need for a "reserved" sector—in fact, it's not often that the small man cares for reservation. The spread of the reserved sector deserves to be curtailed, for it represents an inefficient and counter-developmental method of decentralizing the industrial structure. What must, in any case, not be forgotten is that reservation is at best a mechanical aid in the implementation of policy; it is not itself policy.

Besides declaring certain industries to be reserved for small units, the Central Government thinks of "district industrial centres", or "nucleus plants" as they are now called, and expects state governments to do the work. This is not a fair or thoughtful action. There can be an information centre in each city and district, for then a small industrialist may not have to go far to know what he can get and where. However, the services themselves have to be organised on functional-cum-industry-by-industry lines. The industries being national industries, the services for the small unit must be primarily organised by the Centre. The states can be asked to give supplementary support, but the responsibility would be the Centre's.

In their own interest, state governments would be willing to supply certain basic common facilities, such as roads, factory sheds, power, transport, etc. Beyond this, they must assist the Central agencies in the activities conducted in their territories. For securing their collaboration in this regard, the commercial principle would be relevant. It may be too harsh to say that states unwilling to provide the necessary **quid pro quo** should be missed out altogether in the arrangements the Central corporations make. That, nevertheless, is the line along which pressure can be applied.

Industry serves the developmental process best by generating "surpluses". Large units are more to be reckoned with in this regard just because the surpluses are larger and more readily traceable. We may think of placing burdens on a large firm because of its largeness —yet, in general, nothing in industrial policy should be such as impairs the will or the ability to generate a surplus.

That acepted, in relation to the "largeness" of size, the government would be concerned with imposing social obligations and enforcing rules. The basic idea, as mentioned earlier, is of universal scope, though size limits like Rs. 20 lakhs, small, Rs. 5 crores, medium, etc. can be used for administrative purposes.

What do we ask the large unit, because of its largeness, to do? Set up plants in rural areas? Provide housing for its work people? Both may have merit in them but they are outside the sphere of industrial policy.

Much is made of ancillarisation, yet the point missed is that ancillarisation is a matter of positive action and not of force. The goal of policy would be conditions in which a manufacturer who doesn't make sufficient use of ancillary suppliers is thrown out of business by a competitor who does. Ancillary producers have to be assisted in improving their operations, better contacts have to be established with potential buyers—but all this is ordinary economics. Ancillarisation comes about because it is in the interest of either party. The scope for enforced ancillarisation, as a social obligation, is small. It is much smaller than the scope for positive action by public agencies.

The social obligations relevant to industrial policy are : training facilities for outsiders; R & D in the interest of the industry as a whole; sharing of technical and commercial data and product and material testing facilities for small units.

Today, industry trains its own workers and also operates an apprentice scheme as per government rules. What is proposed is on a much bigger scale and with a new dimension. Industry must contribute to a national drive for shop-floor practical training as a means of spreading industrial awareness in society at large.

Every progressive manufacturer conducts R & D for his requirements, but here too a new dimension is proposed. Assuming there is a central agency engaged in R & D for the technological upgradation of small units in a given industry, the large units in that industry must contribute to that effort. Besides cash contributions, the units should make some physical facilities available for the purpose. And they should release their own men for short periods for rendering public service.

An industrialist is entitled to keep his secrets, but can one be too secretive? Yes, one can, and in any case there has been no opportunity so far to see what information can be shared with others without serious damage to one's own interest. If made public, all such information would surely make for more efficient and more sensibly organised operations in the industry as a whole. Large units must learn to conduct more "open" business—though much, in practice, will depend on the tact and competence of the public agency entrusted with collecting and utilizing the technical and commercial information.

Testing facilities would always be in short supply and they are best used by people "in the know". Large units owe it to society to let reasonable public use be made of the facilities owned by them. They can charge a fee, of course.

It makes administrative sense to limit licensing requirements to investments above a certain size, say Rs. 10 lakhs or 20 lakhs. Apart from that, is it "progressive" policy to relax or tighten licensing procedure? The question, rationally, need not be asked, for licensing has only one proper purpose to serve and the system, therefore, should be designed to achieve just that purpose. The purpose is to ensure that products which India cannot afford to have or are reserved for the small sector are not manufactured by large units.

Another purpose kept in view today is to ensure that fresh investment is not made by large units in an industry in which adequate capacity exists or has already been sanctioned. This sets the licensing men in chase of industrialists who have secured a licence but are tardy in implementing it. The whole thing is wrong. Investment (or setting up capacity) is a commercial decision, and licensing authorities would only be fair to themselves in refusing to make it. The man who invests in manufacturing a product for which, he finds later, there is no market ruins himself. To that extent, say Rs. two crores or five crores, there is misapplication of

national resources. Yet the misapplication of national resources would run to hundreds of crores if we took away from a man who wants to make a commercial decision at his cost the right to make it. Experience with centralised industrial planning has surely shown that India cannot afford **that** kind of misapplication of national resources.

Related in a way to licensing is MRTP insofar as "concentration of economic power to the common detriment" is concerned. Here the proper purpose of law would be to make acceptance of social obligations a condition for the grant of permission. It is only to be suggested that the authorities implementing the policy are fair, practical and quick.

On very large companies, one special demand can, in some cases, be reasonably made. When a company owns undertakings in different industries and each such undertaking is large, there may be advantage in letting an individual undertaking be organised as an independent unit. A true promoter will not mind this, provided his pride is not hurt, for he can then turn to something else to promote.

MRTP must not come in the way of growth. A large unit must not merely be allowed but encouraged to become larger—even when the sons and nephews of the promoter stand to benefit from the expansion. The growth of a socially conscious undertaking, even when it is large already, cannot be to the **common detriment**. Will the government courageously put it like that in Parliament?

The other job for MRTP—and it's an important one—is the prevention of abridgement of competition. Here we have failed, the reason being an astonishing blunder while copying the provisions in the British statute book !

In Britain, the Monopolies Commission, on receiving a complaint, is required to look into the working of an industry, provided there is **prima facie** ground for

suspecting insufficiency of competition in that industry. The **prima facie** ground is defined as a situation in which one producer accounts for more than 30 per cent or three producers collectively for more than 50 per cent, of the industry's output. If, after examination, practices destructive of competition are found to prevail, the necessary orders are issued and these have the force of law. For a period of time thereafter, or till another complaint is received, whichever is later, nothing more is said or done about the industry.

In short, the British system, going about the business in a practical way, seeks to ensure competitive conditions on an industry-by-industry basis.

In India, we don't inquire into the working of an industry. We look for a producer who accounts for more than 30 per cent of the output and give him the epithet "dominant". Thereafter, everything he wants to do requires the government's sanction as long as he holds a dominant (i.e. 30 per cent) position. Sanction is required even when the industry in which he holds a dominant position does **not** suffer from insufficient competition. And sanction is required even in respect of what he wants to do in an industry in which he does **not** hold a dominant position.

In India we have substituted a witch hunt lacking any rational purpose for an attempt to promote competitive conditions on an industry-wise basis.

Transformation of the economy on the lines suggested in this essay will more easily come about in a disciplined society. Here India is at a handicap. Not because people are different from peoples elsewhere. But because discipline is not **understood**—by the leaders !

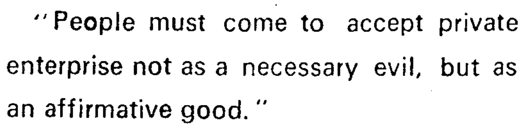
The discipline that makes a disciplined society doesn't mean obeying the orders issued by the leader in what he defines as the national interest. It means readiness to think for oneself and having in one the

desire and the strength to do what one thinks is right. A disciplined mind is a mind which tries, above all, to understand and has the strength born of understanding.

Discipline flourishes in a society in which the people are treated as citizens. They are given full facts, and they are heard, and their views are respected. From the openness of the debate comes faith and the will to work together.

It is for the leaders to play their part—for the progress of a free society.

The views expressed in this booklet are not necessarily the views of the Forum of Free Enterprise



"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

— **Eugene Black**

HAVE YOU JOINED THE FORUM?

416

The Forum of Free Enterprise is a non-political and non-partisan organisation, started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions, and other means as befit a democratic society.

Membership is open to all who agree with the Manifesto of the Forum. Annual membership fee is Rs. 15/- (entrance fee Rs. 10/-) and Associate membership fee Rs. 7/- only (entrance fee Rs. 5/-). Graduate course students can get our booklets and leaflets by becoming Student Associates on payment of Rs. 3/- only. (No entrance fee).

Write for further particulars (state whether Membership or Student Associateship) to the Secretary, Forum of Free Enterprise, 235 Dr. Dadabhai Naoroji Road, Post Box No. 48-A, Bombay-400 001.

Published by M. R. PAI for the Forum of Free Enterprise
235 Dr. Dadabhai Naoroji Road, Bombay-400 001. and
Printed by U. K. Goshalia at Ruby Printers.
30-D, Cawasji Patel Street, Bombay-400 023

13/JUNE/1981