

# **ECONOMIC POLICY FOR INDIA IN 1980s**

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**"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**

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India of today is very different from India as it was when we became independent. The economy that we have today is usually described as a mixed economy which means mixed between private enterprise and public enterprise. I would give a somewhat different definition to that term. I would describe our economy as a mixed economy, not because of the mixture of ownership, which exists in all economies, without exception, but because it is mixed between a command economy and a market economy. We have basically a command economy. Decisions are taken by government, as to what should be produced, by whom, with what technology, to whom the end products should be sold and at what price. These decisions are enforced irrespective of ownership, whether private or public, through the mechanism of physical control. There is then a much smaller section of market economy, where all these things — production, distribution, price — are left to be regulated by the market.

Why is it that we have this kind of economy? It is very important that we should know. We have it because of many reasons. One is, because we inherited

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\* The author, a distinguished economist and a former civil servant, is presently Governor of Jammu and Kashmir. The text is based on his lecture delivered at a Seminar arranged by Leslie Sawhny Programme at New Delhi on March 17, 1983.

it at the time when we became independent, immediately after the war. The economy was then full of controls of every kind, their objective being to ensure that all possible productive resources — manpower, raw material, transport — would be devoted to the one and only effort of prosecuting the war.

The war lasted a long time and the system continued so long that it became natural to us that we should look to government to direct us about what to do. It is interesting to think what would have happened to us if we had regained our independence a few years later or a few years earlier, when the fashion in the world was not physical controls and direction by government.

The second factor is that not only did India have this system, but the fashion of the time in the world was this system. The philosophy of socialism was the popular philosophy, the fashionable philosophy. All of us who were in the British Universities in the 1930's were all turned into fully convinced socialists — the more extreme, the more fashionable.

Another factor, and perhaps the prime factor, was that Jawaharlal Nehru, who after all not only created these economic policies, but all policies for modern India, had been very powerfully influenced by the philosophy of socialism, Fabian socialism. He was greatly attracted towards the Soviet Union — we all were at that time. The excesses of Stalinism were yet unknown to us and the policies they had adopted, as modified by the necessity of having a liberal democratic political system was what we ultimately adopted here. One of the reasons for this extreme devotion to socialism and anti-capitalism, was that in the Thirties, during the Great Depression, the capitalistic system seemed to have completely failed.

This was the background in which we had adopted this system. But there were certain objective reasons

for its adoption, irrespective of ideology, which I think would have led to our adopting these policies, irrespective of the great pull, emotional and psychological, that Jawaharlal Nehru had, and all the educated young men around him had, towards this kind of economic system. And these conditions were essentially that we were an economy of shortages of all kinds. Our essential, basic shortage was of capital. We had no capital. Our saving rate in the country at that time was somewhere around 5% of the GNP. Our GNP itself was low so that capital formation was very low. The kind of money required for development was certainly not available and, therefore, it was necessary that the little money that was available had to be taken and directed towards the direction in which we wanted the economy to develop. Similarly we had a shortage of foreign exchange. We had run through our sterling balances, which, in any case, were not available for all kinds of expenditure and there was extreme shortage at that time. So there again you had to have controls in order to ensure that the amount of foreign exchange that we had was spent for the best purpose.

The third factor was that we really had no basic industry. We had the Tata Iron and Steel Company, we had the Indian Iron & Steel Company, and that is about all, we had some cement, and we had some other odd industry. We had none of the sinews of development in this country, which were required for us to be able to develop from our own resources. Everything had to be imported and if we had to be self-reliant we could not possibly develop on the basis of imports. So we had to force the development of those basic industries — steel, cement, machine tools, heavy engineering and the like, which were necessary in order that we then would be able to develop from our own resources.

And lastly, but not leastly, we had an extreme shortage of managers and entrepreneurs. There just were not people who were willing to take risks to develop industry. They did not have the capital, they did not have the know-how, they did not have the experience, they did not have the courage, the capacity to take risks. And though, at that time, the established houses, which were very few, used often to say, "Why don't you let us do these things", when you examined how they were going to do it, all that they had to say was, "Oh, we will get U.S. Steel, General Motors or somebody else to come and do it for us. They will put up the capital, they will put in their men, they will import everything and what we will do is that we will have the name and, possibly, make profits." We did not, in short, have enough of the kind of people required.

These policies which we have pursued over the years have had their successes; they have had their failures. We are a nation of grumblers. We are never satisfied with anything that we have. But let us never forget that these policies have had their successes and great successes. Firstly, the infrastructure which was lacking has been developed. It is not there to the extent that we like, we want more. But we have roads, railways, electric power, steel, cement, fertilisers, anything you like. The basic things, the economic infrastructure, we have succeeded in developing. Whether we would have succeeded in developing them in any case may be arguable, but I personally think it would not have been possible in the time that it was done unless the economy was forced in the manner it was forced to develop this base. The industrial base has also been widened, it has been strengthened and we are now in a very good position to develop from our own internal infrastructure.

The development of agriculture has been a great success, although unfortunately now it is faltering. The

further success, and a remarkable success, has been the developing of manpower. In the beginning of our process of development, we neither had managers nor did we really think that management was important. We woke up to this very late, after we had made many mistakes, that management was important. We have in this interval trained a very large body of very efficient managers who are now utilising the resources available in the best possible manner. The same is true of our technicians. The chief export of India, today, seems to be scientists and engineers, lawyers and doctors. We have an excess of trained manpower for the simple reason that economy has not developed at a rapid enough pace to absorb them all. And we have entrepreneurs. Today I find that the old houses are still active but a large number of new entrepreneurs have risen, who are willing to take risks, who have had experience, who graduate from smaller industries to larger ones.

Our failures also, unfortunately, have been great. Essentially, the first failure has been that our rate of growth has been exceedingly slow. It has averaged over the years 3.5% and 3.5% of a miniscule GNP is very little indeed. This rate of growth is not a good rate in our conditions.

The second has been the failure to control our population. I suppose that that is not an economic failure but it has economic consequences. But the fact that our population has grown during this interval at the rate of 2.15% means that we have bettered the *per capita* income only by 1.35% per annum and that is why we get the feeling that we are not moving at all.

The third failure has been that our distribution has been very bad. Our economy has developed, GNP has grown but 48% of our people are below the poverty line, which is defined in India virtually at the subsistence level. This is an absolute disgrace. Wealth has been

created but it has not percolated. There is something wrong in distribution and it is particularly wrong because we are supposed to be a socialist society. And one of the tenets of socialism is that there should be equality or comparative equality in incomes.

The other failure has been that we have not been able to control inflation. We have had an inflationary rate, I am told, of 5.6% — some people tell me it is more than that — 5.6% per annum compounded for 35 years. You can well imagine what has happened to the price level.

Penultimately, our public sector management has on the whole been bad. It has not produced the kind of results that we expected it to produce. And finally, we are suffering from corruption which is a cancer eating not only into our body politic but into our soul because we seem to have accepted it now as a way of life. As a consequence, partially of this and partially of political interference in the administration, we have virtually caused a collapse of the administration. This is a consequence to some extent of our economic policies, because corruption follows where you have physical controls and regulations, and maladministration follows where you have corruption. This is not to say that any society can exist without regulation. It is to say that when you have the kind of excessive regulation that we have — and sometimes completely meaningless regulation — and when you have a plethora of it, the only way to get what you want is to use the lubricating power of money, which is liberally used and which is liberally generated, and without which, possibly, our economy would not have functioned even the way it does.

This is a broad picture of what has happened. What do we do to correct it? Why do we need to modify our policies? The answer is pretty simple. Our objective today is exactly what it was 35 years ago — to increase

the rate of growth of the economy as rapidly as possible, which means to make the economy as efficient as possible. Number two, to ensure that the production of our economy, the wealth that is created, is distributed better than it is under the present system and, thirdly, to ensure, in so far as we can, that we develop from our own resources. This does not mean that we have to be autarchik — it does not mean that at all — but it means that we should not be dependent as we have been in the past and, unfortunately, to a certain extent, still are today, on foreign monies and foreign help.

The objective conditions of our economy having totally changed, it is not necessary for us to continue with the policies we are continuing. Indeed, if we want to achieve these objectives that I have just outlined, we need to change those policies and change them in some respects very drastically. We now have a saving rate of no less than 20% which is a fantastic rate of saving for a poor economy. Even the rich economy of U.S.A. has a saving rate which is much lower than ours. And if we save 20%, we do not need anybody's capital. We have plenty here if we only manage it properly. We are still short of foreign exchange, of course, but we are certainly not short of foreign exchange as we used to be and we have built for ourselves a good rating in the international market. If we want to, we can go and borrow, naturally a limited amount, unless you want to do as Mexico and some others have done. (I sometimes think, why not? They have got away with it and we might get away with it too!) We have now, as I have said before, a plethora of manpower. We are not short of technicians, we are not short of managers, we are not short of entrepreneurs. People are wanting to do things and they should be allowed to do things.

Those conditions having changed, in what direction should we move now? I suggest that the basic thrust

of our policies should be to get away from the philosophy of controls and a command economy to a market economy. Not a completely *laissez faire* market economy, an unregulated market economy, because an unregulated market obviously has many, many disadvantages, particularly when distribution is as bad as it is now in our country; therefore, a regulated market economy. There is no country in the world which has an unregulated market economy. In fact, the United States, which is supposed to be a completely free enterprise system, has one of the most strictly regulated market economies that I have known. (I read the other day, that there was a regulation in the United States saying that the owners of honeybees dying as a result of pollution should be compensated by the State because the State had failed to control pollution. As a result of this regulation, no bee now dies of natural causes!) The thrust then should be to get away from controls towards a market economy. The command economy is not an efficient economy, when it is regulated by the intelligence or knowledge of the bureaucrat — even if the bureaucrat is brilliant. It does not and cannot have that finesse which the market gives to it. It is not sensitive enough, it does not have the knowledge the market has because of its wide nature.

The second reform which I would suggest is an improvement in the public sector of our economy. After all, today it provides the basic inputs on which the entire economy is built. And if the public sector is inefficient, steel is inefficient, coal or transport or power is inefficient, then the whole economy is inefficient.

The reasons for this inefficiency are very clear — publicly owned enterprise and the kind of free political democratic system that we have do not fit in very well together. In the Soviet Union, the system works because it is internally consistent. The State owns the means of production and the State is run by civil servants —

there are no politicians in the Soviet Union — who are experts, and they run the economy. We own the means of production but the economy is run by politicians who are not experts and are not expected to be experts and who interfere with the autonomy of the public sector. It is the Minister, it is the MLA, it is the MP, the Secretary to the government, who will not allow the manager of the enterprise to do what he should be doing in the interest of the enterprise. Indeed the best run public sector in a liberal democratic system is the Italian public sector, which own 45% of industrial enterprise in Italy. It is the best run public sector for one simple reason. They have found this inconsistency also and have abolished government! They don't have a government and so they run beautifully. We are not yet ready to do so and, therefore, we should make ourselves consistent on some other front.

The third is that the public sector absolutely must get rid of the accretions that have come into it for no reason except to provide jobs for MLAs, who cannot be made ministers. If you look at the list of public enterprise, particularly in the States — there are some in the Centre also — you find the most incredible variety. Is there any reason why we should be making beer or biscuits or baking bread or making scooters or combing wool and doing all that at a loss and then getting the taxpayer to pay for that loss?

We have to revamp the administration. You cannot carry out an economic policy, or any other policy, if the instruments with which you have to carry it out do not exist.

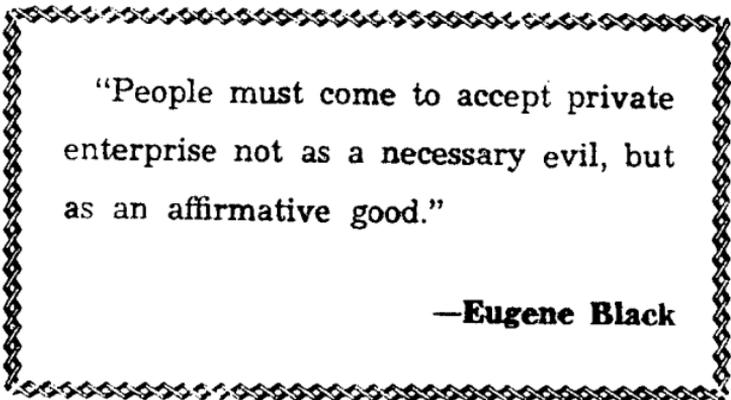
And then we must alter our Trade Union structure. We have adopted a Trade Union structure which we have borrowed, — as we have borrowed most of our institutions — from the U.K. Many of these institutions are not suitable to this country. The Trade Union structure

is one of the worst that we could have borrowed from Britain. It has not done them any good! it has not done us any good. There are many Trade Union structures in the world which operate much better and I don't see why we should not take courage in our hands and do something about it.

And, finally, we must index money. We have, a 5.6% rate of inflation. We howl about rising prices. But in a democracy, more than in other forms of government, inflation is endemic because there is too much pressure to spend money, more money than is available. Governments do spend this money and, therefore, inflation is permanent. And if inflation is permanent, even though it may not be as large as the Latin America's, all the relationship between rights, obligations and expectations as expressed in money and as expressed in real terms is changed. This causes grave and harmful distortions in the economy. One distortion is in the rate of depreciation allowed to industry. This is on historical cost which bears no relation to present day cost and, therefore, what you are telling industry is to live on its capital. Number two is in direct taxation policy, where your rates of taxation assumes that your unit of account remains what it has always been, the Rupee remains what it has been, and though you do make corrections now and again for the lowest slabs of tax, the cumulative effect of the assumption that the Rupee has remained what it is, although it is worth 5 paise now compared to what it was in 1947, has been quite absurd and disastrous. Number three, the effect on the wage structure has again been disastrous because we have had partial indexation. The lowest income groups have been indexed, the rest of the groups, the higher income groups have remained flat. So that now the differentials on which all society must be based simply do not exist.

The policy changes I advocate seem to be very logical but what are the resistances to change? Resistance number one is ideological. We think that the form of socialism that we adopted in 1947 is the only form of socialism. It is not. It has changed all over the world. No socialist society believes in the things that they all believed in and we believed in, 35 years ago. The second is vested interest. Our present economic policies have developed very strong vested interests among politicians, among bureaucrats, among established industrialists. These are the three vested interests in this economy, which are standing in the way of change because the present system benefits all of them. It harms only the common man.

*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

# FORUM OF FREE ENTERPRISE

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.

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