FUNDAMENTAL CHANGES NEEDED IN ECONOMIC POLICY

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

—Eugene Black

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By

M. H. Mody*

We enter the eighties leaving behind three decades of domestic planning and two internationally adopted development decades. The net effect of these efforts is not insubstantial. But many of us feel that much more could have been achieved for the efforts and resources deployed. While supporters of planning tend to highlight the diversification of the Indian economy, if one looks at the grass-roots, there is no reason for any sense of satisfaction or complacency. During thirty years of planning, the average rate of growth of GNP was less than 3 per cent and above 1 per cent in the case of per capita income. While the economy did achieve an average of 4.1 per cent rate of growth during the Second Plan, the growth rate has been consistently lower subsequently even though in particular years when agricultural production increased, national income lurched upward sharply.

In the seventies our performance was dismal. According to the World Bank Report, during the eight years between 1970-77, our GNP increased at an annual rate of 2.8 per cent — close to the bottom of the league of laggards. Countries like Bangla Desh and Pakistan have surpassed our rates of growth. In terms of per capita income, during these seven years, the country recorded a rate of growth of only 0.6 per cent on an average. Industrial production did not even increase by 50 per cent. In Korea it increased by over 400 per cent.

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The seventies was also a decade of inflation. In India the average price index increased by nearly 135 per cent, which means that between 1970 and 1980 the value of the rupee has gone down by 60 per cent.

The last year of the seventies was typical of the trend of the decade. National income declined by 3 per cent, agricultural production by 10 per cent and industry stagnated. In fact, in Indian economic history, there are few years when both industry and agriculture stagnated, and 1979-80 was one such year. Inflation crossed the 20 per cent mark.

In spite of our large industrial base and the endowment of a variety of natural resources, we remain amongst the poorest nations of the world. According to the World Development Report 1979, India is among the bottom sixteen countries in the world ranked by per capita income, average per capita income being around \$150. The fact that over 40 per cent of the Indian population live below the poverty line is a telling comment on our management of the economy.

Throughout these three decades of planning we witnessed uncontrolled explosion of population. The population grew at an average rate of 2.2 per cent during the seventies, nullifying the fruits of the growth achieved by us. It is against this background that one has to crystal gaze for the immediate future. An already difficult task is made even more difficult by the uncertainty of the political and economic situation.

The World Bank itself is pessimistic in its predictions. It estimates a growth rate of 4.7 per cent for the decade 1975-85 and that by 1985 the per capita income of the developing countries would be \$200. For the industrialised countries, the per capita income however, during the same period, is expected to increase from \$5860 to \$9380. These figures are truly shocking. The *addition* to the per capita income of the industrialised countries at \$3500 will be over seventeen times the average per capita income of the developing countries including India. The actual per capita income will however be nearly fifty times higher for the industrialised countries compared to the developing countries.

Before we move into a discussion of the imperatives and options, it should be borne in mind that the seventies saw the virtual abandonment of sixties-style planning. By the beginning of the decade, planning had lost its elan. The Fifth Plan was a non-starter, and the Sixth Plan was still-born. The new Sixth Five-Year Plan is still to be debated at the political level although we are well into its first year.

What are the imperatives and options in the short run? In the short run, specially the first half of the eighties coinciding with the proposed Sixth Plan of the new government, the imperative should be growth through consolidation. This is true of the infrastructure and that large part of Indian industry which has unutilised capacity. Last year industrial production declined in absolute terms in the case of a number of crucial and basic industries like steel, aluminium and cement. Our immediate effort to revive the economy would be to utilise existing capacity fully. I do appreciate the new government's concern for putting the infrastructure on a sound footing. In 1979-80 it has been estimated that at least Rs. 3000-4000 crores worth of additional production could have been achieved had coal, power and transport bottlenecks not existed. This situation has to be rectified. It is essentially a management problem and should be solved as one. I would recommend the constitution of task forces of two or three persons with overriding powers for implementation in each of the crucial areas so as to enable a rapid increase in production. These overriding powers must be such as to enable the persons assigned the task to cut through the maze of licences and regulations to which the infrastructural sector is subjected.

It is increasingly obvious that the state-owned sector's ability to implement national plans for production of goods is severely limited. This limitation arises from a multiplicity of pressures to which they are subjected, in spite of our adopting the British model of the independent state-owned corporation, as a device to insulate a commercial business from the political pressures of the government. The manner of making appointments and transfers, the low levels of salary and perquisites, the general sense of mistrust which pervades entire organisations, have all contributed to decline in efficiency and total demoralisation of the state sector. My suggestion should therefore be looked upon as the only way to ensure that the wheels of the economy are made to move again and to get an adequate return on the vast investment in the state sector.

We have created a state sector with a huge investment of over Rs. 14,000 crores, with the pious hope that it would function efficiently and provide not merely an impetus to the growth of the economy but generate resources for further growth. Yet we have done everything possible to make sure that the state sector does not succeed in terms of achieving its goals of either production or profitability. The state sector giant after it was seen to scale the commanding heights of the economy, has been found, on reaching there, to be a puny dwarf not fit to occupy such glorious heights.

Unless we drastically change our approach to the state sector, we shall forever get bogged down in a morass of our own making. The Finance Minister has announced that he is constituting a committee under the Chairmanship of Mr Mohmad Fazal, Member, Planning Commission, to study in depth each of the public sector undertakings, to examine the problems and indicate remedial measures. This is good as far as it goes. But the problems of the state sector are generally well-known, more particularly to its managers, among whom are many capable professional men. If only they were given the freedom to use their skills without interference at every decision-making level, they would demonstrate that they are just as capable as their brethren in the publicly financed sector.

I have deliberately referred to what is popularly known as the public sector as the state sector which in my judgment is a proper way to describe this area of our national activity. What is otherwise referred to as the private sector should in my view be referred to as the publicly financed sector and should be contrasted with the state sector which does not have any element of true public ownership.

Another problem, essentially of management in the short run, is the fast deteriorating industrial relations situation. The loss of man-days in 1979 due to strikes and lockouts, provisionally estimated at 44 million, is perhaps the largest since independence. Unless the government ensures industrial truce in the next one or two years, all other efforts to improve the economy by better management of the infrastructure will be of little avail. I will have something more to say on this later.

In the short run, therefore, the existence of underutilised capacity provides us with the opportunity to increase production through better management of both the material and human resources of the economy.

The long run options are as clear as the short term ones to which I referred earlier, viz. clear as mud. But seriously one could ask for

- a 7 to 8 per cent rate of growth of GNP; and a 4 to 5 per cent increase in the per capita income at constant prices;
- increased employment to absorb a part of the existing unemployed and additions to the labour force;
- rescue a larger number of persons from sinking below the poverty line.

What are the long run options that one has, to achieve these objectives? Can we really achieve a 7 to 8 per cent rate of growth? In the past, in no year did we achieve an annual growth rate in GNP of this magnitude. While in the First Plan we achieved a growth rate of 3.6 per cent on an average, in the Second Plan it increased to 4.1 per cent, but subsequently declined except for particular years of bumper agricultural harvests. On an average, however, during the seventies, the country has been growing at 2.8 per cent. What justification is there to assume a 7 to 8 per cent rate of growth in the long run and what are the resources we have that would enable us to achieve this?

One basic factor to be taken note of is the change in the capital output ratios over the years. From around 3 at the beginning of the planning era, it has now gone up to over 5. Even assuming that it would be restricted to 5 through efficient use of investment already created and being created, to achieve an average 7 per cent rate of growth would require a 35 per cent investment. It may appear difficult to achieve this rate of investment. No doubt sectoral capital ratios vary widely. For example, in agriculture generally it has been around 2 to 2.5, in manufactures it has been steadily increasing from about 4 to 8 and in electricity from about 17 to 25. To put it in the words of my colleague Fredie Mehta: In 1963-64 one Rupee of increase in fixed capital secured an increase in value added of 46 paise; by 1966-67, the increase in value added had come down sharply to less than 30 paise; by 1973-74 it further came down to 23 paise; and by 1976-77 it came down to 19 paise. (Currently, it is believed to be 16 paise a guesstimate.)

Given the nature of investment, and the sectoral allocations likely to take place in the Plan, achieving a high rate of investment is not impracticable, with our remarkably high rate of saving at around 20 per cent and our capacity to raise funds in the international markets. India's creditworthiness is such that we can raise quite substantial loans in the international money markets. What is essential is the political will to take decisions in this crucial area and have a package of investment proposals which can be financed therefrom.

In this context it is relevant to refer to our inability to utilise fully the foreign aid that we are getting year after year. Our rate of utilisation of foreign aid of twenty per cent is rather low. This poor utilisation is partly due to our inability to raise domestic resources. But we could do well by earmarking aid for particular projects and resort to the importation of complete plant and equipment on a turn-key basis to augment domestic capacity in various sectors, for example in the field of fertilisers or steel. In the same way, we can import telecommunication equipments to augment telephone and communication services, or augment the rolling stock of the railways. The country could also purchase aircrafts for both domestic and international services and for the purchase of ships to augment the fleet using such foreign exchange resources.

ROLE OF PLANNING

It is widely assumed without much thought that the growth aspirations of the economy can be achieved only through a system of economic planning, associated with which is extensive governmental intervention in the economy and the curtailment of freedom of choice. The supporters of this planning mechanism have further spread the canard that people who advocate the use of the price mechanism and monetary incentives are base and grasping people who do not deserve to be treated even as citizens. They are contrasted with others who believe that the economy can be run by appeals to patriotism and cooperation with the government which knows best what is in the public interest. Our demands, as supporters of the market economy, for reduction in high rates of personal taxation, removal of restriction on issue of licences to the publicly financed sector and dependence upon market forces for allocation of resources, are considered as manifestations of a mortal sin.

While accepting the mythology of planning as a tool for orderly development, one has to be rather cautious in delineating clearly the duties and responsibilities of the Planning Commission. While the Planning Commission as an expert advisory body has no power for implementation, its negative role is substantial. A project cleared by the Planning Commission may not fructify but if the Planning Commission delays clearing the project, the project has no chance of coming up. There is, in my view, a case for arguing that the Planning Commission should not sit in judgment on every project and second guess the decision of the Government of India.

Having stated earlier that the immediate need is to improve the performance of the infrastructure within the existing capacities, there is no denying the fact that we would soon reach optimum levels of utilisation and that new investments would be essential at that point. The short-run period must therefore be utilised to lay the foundations for the long-run growth which is to follow. An enormous amount of development work will have to be done to achieve the higher rates of growth which I have envisaged in my long-run perspective. I suggest that we draw up a long-term plan, say fifteen-year plan, for power, transport, coal, steel and aluminium sectors. This long-term plan, being a perspective plan, should provide the development possibilities and potentials in the coming three five-year periods. The initial steps necessary to achieve this plan must be taken now.

Further investment in the infrastructure should be based on long-term demand conditions. We whole-heartedly welcome the Prime Minister's statement that power generation should be consistently ahead of power demand. The same can be said of transport, coal and other basic inputs like steel and aluminium. But where resources are scarce already, how can we plan for further excess capacity on the basis that our utilisation will always remain below acceptable levels.

A basic problem in the context of stepping up investment is the escalating capital costs. To quote an example, for the Fifth Plan, the planners estimated the creation of an additional 16,000 MW electricity generation capacity with an investment of Rs. 7000 crores, but the Plan, which is now defunct, for the period 1978-79 estimated addition to the generation capacity at 18,000 MW (just 2,000 MW more than that estimated for the Fifth Plan) with an investment of Rs. 16,000 crores. This clearly reveals that the per KV investment has more than doubled during a short period of six years. The new plan is likely to reveal sharper increases in the cost of creating capacity for electricity generation.

It is not merely the total investment that influences growth. As I said earlier, the sectoral investments too have their roles to play. Additional irrigation to the tune of 2.5 million hectares per year, adding to the area under high yielding seeds, and larger consumption of fertilisers—all these will result in a lower capital output ratio in the agricultural sector.

In order to restrict the demand-pull inflation, there is also a need to augment substantially the capacity for wage goods industries. In this field my only suggestion would be that there should not be any undue restrictions on large-scale sector in the production of wage goods, based on ideological considerations. I strongly feel that if wage goods prices are to be stabilised then they should be mass produced, and the large-scale sector alone could effect such a mass production.

EMPLOYMENT

Figures of unemployed vary widely, but it is generally accepted that unemployment—both direct and disguised—is substantial in India. The now defunct Sixth Plan estimated that it would create 49,261 million man-years of work spread over all sectors of the economy, nearly fifty per cent of which would be in agriculture. I would only venture to suggest that if the forthcoming plan is also going to estimate employment in the country, based on employment-capital ratios, it would be interesting to compare the employment created with that visualised in the Plans.

However, it looks as if in the coming decade, agriculture, specially intensive agriculture, would provide employment in large numbers to the rural unemployed and those who are below the poverty line. In addition, concentrated efforts should be made to create employment through both public works programme and food for work programme. A million tonnes of foodgrains per year would create at least 4-5 million employment potential, even if it is for 300 days in a year. My suggestion is that both food for work programme and the rural works programme should be intensified. We should set apart 2 million tonnes of foodgrains from buffer stocks and create 10 million employment in the short run per year. No doubt this would involve the necessity of developing blueprints for economically viable schemes for creating community assets. The minimum needs programme could cover important aspects like elementary education, rural health, rural water supply, rural roads and housing programmes.

LABOUR RELATIONS

Another problem that is attracting increasing attention is the deteriorating labour relations. In 1979 we lost 44 million man-days in strikes and lockouts. There is need for an industrial truce to enable the economy to be put back on the rails.

An important element in the industrial relations picture in India is the psychology of confrontation between trade unions and the employers. One of the unfortunate legacies which we inherited from our British rulers has been this form of trade union movement where there is no recognition by the unions of the important contribution which the productive enterprises make to the national economy and the importance which they must attach to the health of the industry in which they work if it is to provide them with continuous opportunities for growth in employment and improvement in earnings. A strong politically motivated trade union movement, the absence of an incomes policy and the confrontational attitude, both on the part of the employers and the trade unions, have contributed to the souring of industrial relations in this country with its attendant problems of violence, strikes and lockouts. A developing country, such as ours, can ill-afford the luxury of continuous battling between employers and employees at the cost of the national economy.

The traditional view that workers are being exploited by being made to work at a low level of wages is no longer true of the great portion of organised industrial labour. Trade union activity now takes the form of extracting more and more wages and benefits from the employers which in many cases the employers are happy to do, so long as they are able to add the cost to the price of the final product. The result has been that the industrial working class in the organised sector has now become the true aristocracy of the country enjoying high levels of wages, substantial perquisites and security which are quite disproportionate to the general level of wages and benefits enjoyed by workers or self-employed persons in the rest of the economy.

In order to unite the interest of the working classes with the need of the productive enterprise, we need to look more closely at the genuine fears of our work people. If the price of winning acceptance for dismantling the present disruptive trade union movement, while retaining collective bargaining arrangements, is more worker participation in the running of industry, or what has been called the creation of a "property right in jobs", I am all for experimentation in this direction. The real problem is how to devise a system of worker participation in industry which is compatible with the rights of shareholders and the survival of business enterprise under competitive conditions.

INFLATION

During the seventies, except for a short period of stability, inflation was rampant perhaps not only in India but all over the world. In India, inflation has become a continuing feature of our lives. In recent periods due to a variety of factors like increase in indirect taxes (such as excise, sales tax and customs), increasing cost of inputs and infrastructural facilities (all of which come from the state sector) and increasing wages, production costs are increasing, and also prices as a consequence. In such a situation, prices will go up even in the absence of a demand-pull factor. The question arises as to what should we do? Should we concentrate on stabilising prices or should we go ahead and develop and pay the price of inflation?

In other countries — both developed and developing — a part of the cost-push factor is absorbed by economies of scale, but in India due to both licensing policy and the MRTP, FERA and other regulations, economies of scale are difficult to obtain. While I would plead for a more realistic approach in regard to licensing and other aspects affecting large-scale industry, a growth addict like me would suggest that the country should plan to grow even in the face of inflation, as is happening in some Latin American countries. Nowhere in the world has the incompatibility of rapid growth and price stability been reconciled.

FOREIGN TRADE

In foreign trade, after a spectacular improvement in the early half of the 70s, the rate of acceleration started to decline. In recent years, exports have been increasing only by about 5 per cent as compared to imports which are increasing by more than 20 per cent. What is essential is to have a pragmatic policy for exports. A lot of discussion goes on regarding the usefulness or otherwise of export subsidies without understanding their true significance. These export subsidies only compensate for the indirect tax element on inputs which are not covered by drawbacks. The recent announcement by the Finance Minister of the creation of an export-import bank is a welcome step in this direction. I do hope that the private sector will be associated with this bank both in capital and management.

POPULATION EXPLOSION

The most crucial problem is however the population explosion. Population has been increasing steadily in India during the 70s, say by about 2.2 per cent per year. This has nullified even the effects of the tardy rates of growth that the economy achieved in the earlier years. This is an area where the government can intervene and, according to Robert McNamara, the World Bank President, there are two broad categories of interventions that the government can undertake—those designed to encourage couples to desire smaller families and those designed to provide the parents with the means to implement that desire. Much has been said on the population syndrome and I would only like to add that any effort at development should accord top priority to population control without which the fruits of development will not be distributed in the way desired.

DEVELOPMENT PSYCHOLOGY

It looks as if in our recent development history we have fallen willy-nilly to accept the development psychology of East European countries. Growth is inhibited by excessive state control and lack of incentives. There is much frustration amongst the people. The bureaucratic and political apparatus is smug and complacent. They have given up any attempt to achieve better results. They point to individual physical achievements—an atomic power plant built here or a space rocket shot off there both significant and laudable in themselves.

There was a time when the entrepreneur, once he got his industrial licence, was up and away. Today apart from the controls that the government exercises through licensing and other policies, the commanding heights are occupied, as I stated earlier, by the state sector; the infrastucture is with them — coal, steel, aluminium and the financial institutions. There is little freedom for the publicly financed sector to operate in the context of a mixed economy, the concept which India has adopted for development. The publicly financed sector must have sufficient freedom to operate within the sphere allotted to it and I feel that one option that could be exercised by the government forthwith is to reduce unnecessary controls. This by itself will have a salutary effect on the economy.

In the case of a large number of industries like steel, power, aluminium and heavy machinery, the publicly financed sector may not have sufficient resources to invest but they may be capable of managing them. Within the policy constraints, I suggest that the investments made in the state sector should be allowed to be run by the publicly financed sector on an experimental basis in selected public sector undertakings, specially in the area of power generation and coal production.

Given the overall tardy performance of the state sector, I have no doubt that the publicly financed sector will bring a new life and approach to the working of the state sector. Unless we have larger participation of the publicly financed sector in the management of the state sector enterprises, in the long run, we will be heavily investing in the state sector and will be financing their losses through taxation.

It is evident that India is slowly slipping backwards from the position of the tenth industrialised nation in the world. It is sufficiently evident that indigenous research will not be capable of meeting our total future technological requirements. Our efforts should be to purchase technology as much as possible from abroad through collaboration. A time has also come to recognise the fact that we are not as advanced technologically as some of us think we are. Our policies should be conducive to attracting foreign collaboration. Some changes in the royalty and taxation policies are necessary. We have to give up the notion that we are doing a favour to foreign companies by approving collaborations.

CONCLUSIONS

Thus, the imperatives are: to achieve reasonable rate of growth — both GNP and per capita income — create larger employment potential and lift as many as possible from below the poverty line. The short-run option should be: 'consolidation for growth'. Better utilisation of capacity and better management of the infrastructure would also provide a firmer base for development. In the long-run, I envisage that if the foundations are laid through developmental efforts in the first few years, a high rate of growth can be achieved through a high rate of savings coupled with extensive borrowings in the international markets.

All these efforts would depend on our political will to incorporate changes in our system that are of a fundamental nature. If we are not prepared to abandon the 'left luggage' of the socialists of the last generation, nothing serious will happen.

An eminent economist once said that the country has a natural growth rate of three per cent and it requires an extremely incompetent government to reduce it below that level. But only very efficient government can push it up above that level. We want such a government.

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

"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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