THE ECONOMIC SCENE TODAY

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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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I

Pragmatic changes in Development Policy Needed.

By

Minoo H. Mody*

The economy, as it stands today, presents a varying picture of prosperity and crisis. After the decline in GNP by more than 3 per cent during the last year, the trend is likely to be reversed this year. The main contributing factor is the bumper agricultural harvest. Except for a few pockets, the monsoon has been satisfactory and the kharif crop is expected to yield 80 million tonnes surpassing the peak of 78 million tonnes in the year 1978-79. A similar bumper harvest is expected for the rabi crop. The commercial crops (sugarcane, cotton and oil-seeds) are doing well. Agricultural production on an average can be expected to be up by over 10 per cent. We still depend on the monsoon for our foodgrains, which makes a 10-15 million tonnes difference in production.

If one looks at the industrial scene, the situation becomes more disconcerting. There are positive pointers in

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* From the presidential address of Mr. Mody at the workshop organised by the Associated Chambers of Commerce and Industry of India at New Delhi on 5th Dec. 1981.

the shape of policy declarations — the liberalisation of the Industrial Policy, modification of convertibility guidelines, regularisation of excess capacity, automatic increase in capacity and policies towards export promotion. We should not under-rate the importance of these from a long-term stand point. But these have not been reflected in industrial production which during the first half of the year declined by 1.8 per cent. Major industries like steel and cement have recorded absolute declines in production. Capacity utilisation all round has declined, particularly in cement, steel, aluminium and electric motors to mention a few. On the other hand, during 1980, in the first seven months upto July, the total mandays lost were only 7.8 million, as compared to 32 million during the same period in 1979. 1979 recorded the largest number of mandays lost since Independence (44 million). If this data for 1980 is taken at face value, labour unrest has ceased to be a major problem hampering industrial production. This view is certainly not in accord with operating experience, which reflects continuing industrial relations problems in many areas.

Normally, if demand exists, capacity utilisation depends on raw material inputs and infrastructure. But in India it looks as if this is also both a management problem and a technical one. Age of the equipment has much to do with efficiency. In a number of industries the machinery and the technology are old and obsolete. The capacity that exists on paper cannot be fructified. The declining trend in the output of the public sector steel units is also a management problem, as an inefficient management fails to use capacity fully and does not keep the manufacturing plant in a good state of repair.

The basic problem of industrial growth is the investment famine of the "seventies". Beginning with bank nationalisation and passing of the Monopolies and Restrictive Trade Practices Act, the seventies saw a reversal of the

Government's policy underlining the concept of a mixed economy and inter-dependence of the public and private sectors. The private sector was looked upon with suspicion and distrust. The new Industrial Policy enunciated by the Minister for Industry, no doubt, rectifies some of the restrictions of the seventies. Still much needs to be done. The best option would be to cut the Gordian's knot, once and for all, and free the economy from the shackles of controls and licensing completely. For some reason Government has not been bold enough to deal with this problem except by tinkering with the licensing system.

I have previously suggested — the idea of an open season — that licensing and other controls could at the very least be kept suspended totally for a period of five years, in the first half of eighties, at least in the areas determined by Government as constituting the core sector. After thirty years of licensing and control, the time has come to try out a period of liberalisation and see how it works.

The priority industries do not include wage goods industries. We still continue to follow the concept of industrialisation enunciated by Prof. Mahalanobis with an accent on heavy industries. Stagnation in the seventies to some extent was due to this absence of growth in the consumer goods sector. The large investment in the heavy industries sector has not generated the surpluses which would have financed further growth. The new industrial policy that has relaxed the restrictions on growth has practically limited them to industries other than wage goods industries. The relaxations, if they are to be effective, should cover all industries.

The time has also come to have a look at the performance of the sectors already under the control of Government. There is a continuous new investment in existing state undertakings and new undertakings are being formed. At the same time the politicians and administrators continue to bewail the fact that surpluses are not being generated by the state sector. The time has come for some of the activities reserved for the state sector to be thrown open to the private sector. The private sector should also be associated with the management of state sector units.

In spite of the marginal improvements that one sees in the infrastructural performance, much has to be done. Solutions are not unknown. During the past one year the air is thick with suggestions and counter-suggestions for improving the infrastructure. But one would like to know what has been done. Do we have the will power to implement suggestions for putting the infrastructure economy back on the rails? There is a feeling in some quarters that one reason for a decline in the railway traffic and in the increase in the turn-around time is that the cream of railway personnel has been deputed to work abroad. Of course, it is difficult to substantiate, but I would like to mention this viewpoint.

There is another aspect of this phenomenon, namely the diversion of technical managerial resources which are scarce, to undertake work internationally when there is an acute national shortage in the same sphere of activity. Every one of us is familiar with the appalling conditions of the airports in our country and yet the International Airports Authority is constructing airports abroad. We are familiar with the shortage of telephone facilities and yet the communication industry is engaged in supplying and installing telephones overseas. One possible reason for this may be that our state sector managers have now got so fed up with regulatory mechanism under which they have to work in India that they seek every opportunity for personal satisfaction in working abroad under less restrictive conditions.

With regard to the financing of industry, there are two alternate proposals for generating funds within the private sector through a change in the tax structure. First is to discontinue the tax deduction on interest provisions and the second alternative is a one per cent tax on total capital. The idea that interest being allowed as a deduction for tax purposes results in inefficient use of capital is totally inconsistent with personal experience and facts. Current rates of interest charged by the banking industry are high enough. Many borrowers indeed pay yet higher rates because of restrictions imposed in one form or another by the Government. Company deposits are already subject to a penalty in the form of disallowance of a part of the interest paid for tax purposes. There are physical limitations on the capacity of industry to borrow following upon the restrictive credit policy. It would therefore be ridiculous to argue that money is being utilised recklessly. Non-availability and high interest are sufficient penalties to ensure efficient use of monetary resources.

The suggestion for a one per cent tax on capital employed is of course a variation of what was recommended by the Wanchoo Committee. When industry is burdened with heavy taxation, the time is inappropriate for making any such suggestion. The Wanchoo Committee's own suggestions were coupled with certain other changes in the tax system, including reduction in corporate rates of taxation. The danger of making such suggestions is that one out of a series of suggestions is picked up by the Government and is implemented, while other suggestions which involve reduction in the burden of tax are brushed aside as not being relevant. If such ideas are accepted, instead of leaving more funds for expansion, it will have a contrary effect. These proposals would add to the burden of industry and to the price that the consumer pays.

There is a feeling in some quarters that in spite of an 8 per cent increase in credit to the commercial sector last year, the production has gone down. There is nothing surprising about this. During the last year prices have gone up all round by nearly 20 per cent and the increased credit intake has not fully compensated for the requirements of credit for raw materials, inventories, transport and wages.

One of the sad consequences of the foreign exchange crisis which is engulfing the Indian economy is that some of the sound economic policies which have been adopted such as liberalised imports are likely to be abandoned. This will, in the long run, be a retrograde step. As a country which is trying to sell its products internationally we should have a vested interest in freer trade. This involves an obligation to keep our markets reasonably open to competition and not to create restrictive trading conditions. International competition also ensures that our trade and industry has access to improvements in technology as well as the benefits of price competition. The foreign exchange shortage will have the following results: (1) import substitution will again become one of the major dogmas of our economic policy makers; (2) this will require some investment in new equipment and plant which will have to be imported; (3) this in its turn will require substantial Rupee resources to be made available for meeting the requirements of the new projects.

With the present tight money policy which is being followed with fanatical zeal by the Reserve Bank, the situation of trade and commerce for meeting its financial requirements will become acute and in fact a situation of crisis proportions will arise. This crisis can only be met if we are prepared to raise Euro Dollar loans or international loans to supplement these resources. There is considerable hesitation in the minds of the Government about the advisability of borrowing money internationally.

The second solution is to utilise deferred credits which are freely available. European and American industry is facing a severe recession and is therefore prepared to offer shorter delivery periods and very competitive prices, as well as low interest credits. In fact, they would be prepared to dump their equipment on us. For once, we should welcome this as providing an opportunity to add to the productive resources of the economy. The dogma of self-reliance will however stand in the way of this. The state sector units will also play a major role in seeking restriction on imports in order to sell the products of their high-cost factories. They bring pressure on the Government to get orders for them even where international prices are lower and delivery schedules shorter. Such instances have been found in the case of heavy electrical plants, heavy engineering, cryo plants and compressor plants.

The present recession in international industry must, therefore, be utilised for a major forward thrust of new investment in capital plant and equipment, particularly, if they are available on shorter delivery schedules and which will enable us to improve our capital-output ratios and add to the productive capacity of the economy which is now a major constraint.

After 19 months of continuing inflation, there is some respite in the price situation. 1979-80 saw a 19 per cent price increase and until October during the current financial year, the price increase was more than 13.5 per cent. However, there has been a drop in the prices in November and the price rise between April and now is just around 12 per cent. With the bumper harvest this year, there is a possibility that the price rise during this current financial year will be contained.

One important aspect which needs to be looked at is the inflationary potential which is being built up in the economy. There are three inflationary factors at work at the present moment. One is external to the economy, i.e. inflationary factors arising out of the increase in the price of oil and its products which is outside the direct control of the authorities. The second inflationary factor in operation is the all round increase in costs imposed upon the economy by bad management of the infrastructure and the inefficient use of resources by the state sector. The third factor, to which not enough attention is being paid, is the segmental pressures which are developing in the economy. The agricultural sector is no longer a passive element in the economy with prices tumbling with a glut and rising with scarcity. Through continuous pressure, support prices have been raised for agricultural products. The recommendations of the Agricultural Prices Commission have been repeatedly set aside. Every State Government has denounced the APC. Hidden subsidies, and direct subsidies in the form of lower prices for fertilizers, lower prices for electricity and other agricultural inputs have been obtained. Business circles have been lulled into complacency in the belief that, with the eclipse of Mr. Charan Singh and his Government, the pressure of the agricultural lobby has abated. The successor Government has continued to follow policies which are a continuation of the policies of the previous Government. As a result of this, the terms of trade between urban and rural sector are likely to change in a very significant manner over the coming years.

Hitherto, cost increases in the industrial sector have been more or less irreversible because of the basic rigidities of the cost structure and lack of improvement in productivity. We are now entering a phase where the agricultural sector will also show similar trends of inelasticity in costs and constant upward movement in prices. We have seen in recent weeks two phenomena, arising out of these forces—the present farmers' agitation in Maharashtra, which is tending to spread, for higher support prices. There has also been a successful agitation by agricultural workers, particularly those employed in the support of sugar co-operatives in Maharashtra in order to get higher wages for the workers. The political leaders have come to realise that this represents a gigantic vote bank. Many of these pressures are aggravated by caste and ethnic considerations. Unless there is, therefore, a substantial productivity gain in the agricultural sector, we are likely to enter into a prolonged phase of increase in agricultural prices which is bound to have an effect upon the terms of trade between the two major segments of the economy. In the long run this may well be of benefit to industry as providing the markets which will enable industry to expand its production to achieve economies of scale and to improve its profitability. But in short run, it represents a very significant trend which is likely to add to the inflationary pressures in the economy.

As regards the prospects of foreign trade in the current year. The trade deficit would be around Rs. 4,000 crores taking into account the huge oil bill on one hand and our inability to increase our exports substantially on the other. The major problems in exports are internal and that, as advocated by the Tandon Committee, it is the growth of our industrial production and removal of constraints in coal, steel, electricity, the shipping bottlenecks, that would enable us to improve our export performance. Government have recently announced a number of steps to boost our exports, even for dominant undertakings. The decision to accord free trade zone facilities to 100 *per cent* export-oriented units is also likely to boost export performance, though not immediately.

In the case of imports, some changes in the Government's approach to inputs are visible, perhaps due to foreign exchange difficulties. There is a view that we must examine whether machinery imports affect domestic capital goods industry. I feel that the entrepreneurs are going for imports of plant and equipment only because the domestic producers are not able to deliver the goods on time and at competitive prices. There is need for a balance in our approach towards import substitution in capital plant required by industries. For example, if import of plant and equipment can save foreign exchange for import of cement or fertilizers, we should go in for imports.

The well-known economist, Dr. M. Adiseshiah, has rightly observed: "And this whole control and exemption system, dealing with some Rs. 40,000 crores of industrial activity, is entrusted to our officers, who, from the peon to the top man, are paid such a low salary that it is a standing invitation to bribery, nepotism and corruption. The controls are the main generator of black money and the parallel economy. In case all this is regarded as some kind of Indian way to socialism, we need to look at the end result of the whole system, which should be people's well-being and sense of justice."

In spite of 30 years' planned development, still 40 per cent of our population live below the poverty line. We are one of the lowest fifteen nations in the world, ranked by the World Bank. To reverse this situation, pragmatic changes are essential in our philosophy of development without unduly getting attached to ideological considerations.

II

ECONOMIC RATIONALE OF FARMERS' AGITATION

Dr. A. C. Chhatrapati*

People in cities are used to agitations by organised labour, government employees, teachers and even officers of public sector undertakings for higher wages. However, the sudden massive agitations by farmers in several states, led by non-politicians, for higher prices of their produce or lower costs of their inputs is a new phenomenon taking all by surprise.

For centuries, the Indian farmer is known to have suffered patiently exploitation from invaders or rulers. Even during the British rule, the zamindari system permitted heavy exploitation of the farmer. With a deep religious belief in the theory of *karma*, that his fate is regulated by the Invisible Hand, the farmer has been accustomed to accept whatever comes his way as the fruit of his labour. With regular ravages of floods and famines, his belief in fate has been his prime base of survival. Farming to him has been a way of life and means of sustenance, not an enterprise.

The farmer's interests have received attention since Independence. In the democratic policy, he as a voter has

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* Based on a lecture delivered under the auspices of the Forum of Free Enterprise in Bombay on 22nd January 1981. The author is the Secretary General of the Vanaspati Manufacturers' Association of India.

exercised considerable influence. Since members of legislatures from rural areas who are themselves farmers are in majority, they have been successfully demanding concessions, particularly in matters of taxes, subsidies on inputs etc.

Efforts to increase agricultural production in the last 30 years have brought about a dramatic transformation in the attitude of a large part of farmers. With education, formal and informal, the farmer has begun to look to agriculture as an industry in which investment in inputs and better technology helps him to improve his output and, therefore, income and lifestyle. This may be called adoption of capitalistic farming as in developed countries.

In periods of inflation, all sections find that their costs are rising but not their incomes at the same rate. They use their collective economic power to achieve a larger and larger share of the national economic cake, or Gross National Product. The sudden upsurge among farmers demanding higher prices for their output and cheaper cost of input, purely economic issues, is the first manifestation of their exercise of economic power.

Let us examine what has caused farmers to agitate so massively and so suddenly for economic gains.

We do not have in this country indices of harvest prices which determine the income of the farmer. We have only a general wholesale price index which reflects prices in major markets throughout the year. The current series with 1970-71 = 100 shows that the price index of agricultural products has been rising with the rise in general price index but always at a lower rate. In advanced countries in order to protect the income of the farmer support prices are announced on a basis of parity with the prices of manufactured goods the farmer has to use either as input or for his own consumption. "Economic Survey" published by the Finance Ministry usually gives a comparative picture of the prices of manufactured products and agricultural products. From this it is observed that generally upto 1978-79 manufactured products were showing an annual increase of about 3 to 10 *per cent* more than the prices of the agricultural products. The difference was not very much. However, in 1979-80 the difference widened to 14 *per cent*. What is more, the monthly indices of last quarter of 1980 onwards showed that the prices of manufactured products have been rising at a rate as much as 30 *per cent* higher than those of the agricultural products.

These price indices of annual averages are misleading because agricultural prices show marked seasonal trends and when the farmer brings his produce to the market the prices are generally the lowest. This would imply that the farmer has been getting prices for his produce which are much lower than the averages and hence not reasonable when compared to the prices of manufactured goods. As "Time" has put pithily in a recent article, the American farmer is grieved that he has to buy his inputs at retail prices but sell his produce at wholesale prices and has to pay for freight both ways. The position of the Indian farmer is much worse.

There is a system of announcing support prices for major agricultural commodities like grains, cotton, some oilseeds, sugarcane and jute. This can provide effective protection to the farmer if the support prices are fair and the Government has an agency to purchase produce in the market at harvest time to ensure that the farmer realises the price declared. While the Food Corporation purchases rice and wheat and Cotton Corporation buys some cotton, there is no agency to protect the farmer in respect of other crops even where support prices are announced. There is also another aspect, namely, whether the support price announced by the Government is reasonable. The Agricultural Prices Commission is the statutory body to fix the prices. It recommends support prices on the basis of the estimated cost of production of the farmer. It does not take into account the risk of production fluctuations from season to season which invariably occur for rainfed crops. In other words, over a number of years, if the farmer gets only the support price, he cannot recover his cost fully. Some of the support prices announced by Government for 1980 as compared to 1977-78 show an increase of only about 10 *per cent* whereas the general price index has shown a rise of 40 *per cent.* It is thus obvious that the support price mechanism has not helped farmers to protect their incomes effectively.

In an inflationary situation the Government in its attempt to regulate prices should ensure that there are no sectoral imbalances. In other words, if agricultural prices are kept down in order to check inflation but the prices of manufactured products are allowed to rise it will only amount to transfer of income from agriculture to industry and urban areas. This in the long run may rebound in the form of stagnation in agricultural output.

One aspect of agricultural marketing deserves serious attention. We regularly hear reports of farmers having to sell onions, potatoes and vegetable at the rate of 5 to 10 kg per Rupee. In urban areas the consumer continues to pay much higher prices. This anomaly can be corrected only by providing orderly marketing facilities through improved transportation, and better methods of processing and storage of such produce. Similarly, it is very important that even for non-perishable produce, farmers should be given an assurance of a support price through effective intervention of some Government agency when prices tend to decline to unreasonable levels. Here again, better organised regulated markets, storage facilities and guidance to farmers on correct storage of the produce and credit against such produce to enable him market it over a period of time can go a long way to ensure that he gets a fair share from what the consumer pays.

The Planning Commission refers to the importance of post-harvest technology as an important requisite of increasing agricultural production. But so far precious little has been done. Hence we find wide disparities in prices realised by farmers and what the consumer pays or the prices at harvest time and in the lean season.

The fact is that the farmer is today as much an entrepreneur as the small or large industrialist. The farmer's venture, however, is far more risky than that of the manufacturer. The farmer has to face every season the high risk of weather turning out unfavourably and drowning his investment in inputs. We have yet no device of insuring the farmer's investment through crop insurance. This high risk factor is consistently ignored in Government measures like support prices. Famine relief only keeps him alive. It does not give him resources to make full investment required for normal output next season. One-time populist gimmicks like debt relief or *ad hoc* concessions are not the answer for an enduring solution to the risky venture that is agriculture in India.

With access to radio, newspapers and political meetings, the farmer has awakened to his rights and has begun to protest against the unfair deal he has received in the form of unduly low prices for his produce or the sudden large increases in rates of power, irrigation, fertilisers which he has to pay. Thus in the battle of containing inflation Government will now have to reckon with the claims of still another and the largest sector of our economy.

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**

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