OBSTACLES TO LIBERALISATION AND MARKET ECONOMY

MANU SHROFF

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

OBSTACLES TO LIBERALISATION AND MARKET ECONOMY

By

Manu Shroff*

If I have to speak on the theme of the seminar — viz. Obstacles to liberalisation, there could not be an easier task set for me. This is because there is, sadly, no dearth of obstacles to liberalisation and no elaborate search is necessary. The social, political, economic and administrative environment in our country has been bedevilled by feudal attitudes which are totally at variance with individualism and enterprise. Status rather than contract, by and large, determines human relations in our society. And this has been so as much in the traditional society ridden with the divisions of caste as in the modern educated segment which has inherited quite a bit of the British-style hierarchy deriving from lineage, school and civil service status.

** The author, an eminent economist, is a former Editor of "Economic Times" and presently Adviser to the Unit Trust of India. The text is based on the Keynote address delivered at a seminar on the subject organised by the Project for Economic Education at Bangalore on 7th November 1992. The text is reproduced with kind permission of the Project for a wider audience.

When we sought to bring about economic change, it was almost natural for us then to choose the path of a paternalistic government taking on the major responsibility for setting the pace and direction of economic development. In the name of socialism, we ignored individual enterprise and looked to the state to provide the impetus for growth and removal of poverty. The result was comprehensive central planning backed by an ever expanding bureaucracy which undertook to direct economic activity in its minutest detail.

From one economic crisis to another, we learnt from experience, but ever so slowly, preferring at every stage to believe that the path chosen by us was wrong, only the implementation went awry, as if the distortions which the licensing system created were not the inevitable consequence of the system but resulted from its corruption; as if the poor performance of public sector was not a consequence of the inherent weaknesses of extensive public ownership of means of production, but was caused only by the corruption of the political and administrative system; as if the very corruption did not have its roots in the design of central planning and extensive government intervention. May I draw your attention at this stage to the late Dr. Sukhumoy Chakravarty's little book entitled "Development Planning" which typified the attitudes I have just described and which I had occasion to point out in my review of that book entitled "Learning by learning" published in the Economic Times dated 11th January 1988. We never learn from experience. We try to learn only from our own previous learning! Such a Brahminical mind-set has been the major obstacle to liberalisation and I am constrained to say that we have not yet managed to get rid of it.

Those who thought that after July 1991, it would take but a short space of time to move to free enterprise and market economy probably understated the strength of the attitudes I have just described. And it is a change in these attitudes which is far more important than specific policy reforms if we are to move to a market economy in a meaningful way. The hope is that deregulation and competition will help bring about such a change. And they well may, if the society is able to absorb the harsh shocks of competition without political turmoil.

Let me turn now to the specific policy intiatives taken in the past few years and the obstacles they have encountered. It is hardly necessary for me to recount to a distinguished and experienced audience like this the various policy reforms that have been introduced. As is well known, they have straddled the areas of fiscal and monetary policies, industrial licensing, price controls, foreign trade and foreign investment. Fiscal policy, in a way, is at the centre of the reform package. Without stabilisation, structural reforms do not work. The defined objective is to reduce the fiscal deficit to 5% of GDP this year, having already brought about a reduction from 8.6% to 6.5% last year. The major instruments have been reduction in government expenditure, in particular, subsidies and privatisation. As you all know, the task has not been easy. The agricultural lobby has stalled the progress on cutting subsidies, forcing the government to adopt a gradualist approach — and push forward much of the burden of cuts in fertiliser subsidies from wealthy farmers to the general tax payer and the less-well-to-do consumers of food. As fertiliser subsidies have been reduced, the procurement prices of foodgrains have been raised necessitating partly an increase in issue price of foodgrains to some extent and partly an increase in food subsidies. The general reduction in government expenditure is also moving at a slow pace. Although industrial licensing is virtually abolished and import controls greatly reduced, not a single government department has been closed down. Retrenchment is next to impossible; even redeployment encounters stubborn resistance. There are numerous activities which scores of government departments have got into which can be easily dispensed with or contracted out. But the pull of vested interests is strong. Privatisation moves have aroused suspicion and anger among left politicians and the employees of public enterprises — the former unable to shed the ideological baggage of the past, the latter reluctant to part with the cosy comforts provided by the so-called model employers. The result is that instead of privatisation, all that the government is able to do is divestment of a part of its holdings in public enterprises to raise resources. The techniques of divestment have not been without criticism. Is the government underselling its assets? Is it 'forcing' publicly owned investment institutions to overbid? Who is exploiting whom is not specified, and no one seems to care, so long as some "exploitation" is shown to have occurred. Auction means competition. But we seem to be averse to accepting the reality of competition. After the latest auction which was a bit of a flop, there seems to be an impasse.

Similar problems have been encountered in the progress of the reform of the financial sector. The extreme view would be denationalisation of the banking system in order to restore its health and viability. But even a compromise position that new private banks be allowed to set up in order to promote genuine competition has not so far been accepted. The Reserve Bank has issued guidelines for achieving capital adequacy norms, but there was little hint (until a few days ago) that at least a few of the banks which have strong balance sheets, would be allowed to raise capital from the market. And yet, the burden of providing adequate capital for banks can hardly be borne by the budget. The dilemma is acute and leads to inaction. But how long can we postpone facing the issues squarely?

True, the Government and the Reserve Bank have taken steps to gradually implement some of the Narasimham Committee's recommendations. The SLR has been reduced. Interest rates are freer than before. Accounting norms have been laid down. Capital issues control is abolished and SEBI clothed with statutory powers. But the securities scam has caused doubts about the future. The blame for the scandal is wrongly laid at the door of liberalisation. As I have argued elsewhere (ET 23rd June 1992), the scam was the result of incomplete liberalisation. The furious activity in the ready forward market was the inevitable consequence of the RBI controls on call money rates (since given up), on interest rates on deposits (which continue) and restrictions on leading to certain categories of borrowers which included brokers. Restraints on public sector units about where they can bank and the forms in which they can deploy their surplus funds, while at the same time imposing new norms of profitability on them, added fuel to fire. Had all interest rates been free, SLR reduced to reasonably low levels and bank financing of stock market transactions permitted and hence brought within the discipline of the RBI, the scam could not have occurred. And yet the mind-set I referred to earlier would derive the opposite conclusion from this experience and block all further reforms in this sector!

Let me now turn to domestic and foreign investment. Reforms in these areas have moved speedily and despite the continued doubts and apprehensions on the part of foreign investors, they represent a genuine break with the past. Industrial licensing and MRTP restrictions have been virtually given up. The rigour of import licensing has been greatly reduced and import duties brought down. There are hardly any price controls left. Several activities have been thrown open to private sector, the latest being steel. Direct foreign investment upto 51% is allowed as a matter of course in a large number of sectors and higher ratios considered for approval. Technology import has been freed to a great extent. Greater freedom has been given for Indian joint ventures abroad. Foreign institutional investors can buy and sell stock on the Indian stock markets without too many restraints. The Indian economy has been rapidly opened up and the stage set for Indian industry to achieve world-scale capacities, technology and competitive strength. But there are grave doubts if these policies will be allowed to reach their fruition. What the Finance Minister has called the East India Country syndrome or chauvinism for short, has been displayed by the opposition parties, who seem to be all agreed that while domestic liberalisation is all right, opening up to the world is anti-national. Such an attitude reduces the credibility of the steps already taken, endangers their success and slows down further moves in the same direction. Meanwhile, China, which has been regarded by most observers as our competitor in the development process, has gone ahead with unprecedented vigour attracting massive foreign investments, not all of which is from the overseas Chinese and has shown a remarkable *double digit growth rate.*

I do not want to make light of the burdens society has to bear during the initial period of reforms; nor do I want to belittle the importance of ensuring that these burdens do not fall on the poor. To a large extent this means a dogged determination on the part of government to control inflation. But how can anti-inflationary policies succeed if every section of society wants to pass on the burden of adjustment to the next section? The politically powerful generally succeed in doing so, and they are by no means poor. As the impact of liberalisation and competition begin to be felt the problem is likely to become more acute. An aspect of this is the so-called 'exit' policy.

It stands to reason that if 'entry' into an activity is free from controls, exit from it must also be possible without restraint. This is the law of competition. Winners survive; losers have to quit and do something else. But what happens to the labour force made redundant when an enterprise has to close down? We have no social security other than that provided by the family or traditional community. There is no unemployment insurance. Can we throw workers out on the street? Clearly, this is not feasible, whatever the logic of competition. Hence what is needed is a policy of redeployment and renewal of the potentially redundant labour force, be it in industry or the service sector, including government administration. And the government has rightly followed a cautious approach, developing a consensus before going ahead with the statutory and other reforms which are required. Slowly the idea is being accepted that poor productivity in loss-making activities is not wholly due to inefficiency of labour but a consequence of market forces or bad government policies in the past. Labour alone cannot be asked to bear the cost of these failures. Equally, therefore, redeployment of labour in more successful activities, with some retraining as necessary, should ensure improvement in productivity in general. The notion that employment has to be secured in the same firm, in the same occupation at the same site is clearly infeasible and detrimental to the long term interests of labour. However secure the workers may feel in their present employment, they just cannot ignore that change invariably means some dislocation and must further learn that the challenge such change offers can prove to be a strong stimulus to improvement in their productivity and hence welfare. Most of us have been displaced from our traditional milieu. As the villages move to towns and the towns to cities, there is dislocation and 'redeployment' all along the line. Such a process has not been allowed to take place for many years in the case of industry. The clearance of the accumulated problem thus assumes critical proportions and causes serious socio-political tensions. In almost all areas of economic reform, we are dealing with the neglect of decades. The task cannot be accomplished overnight. And yet it has to be done soon enough.

One of the reservations about liberalisation, especially of the external sector, is that it will push us even more heavily into foreign indebtedness. Even those who favour deregulation of economic activity generally are thus wary of excessive or speedy liberalisation of imports. Clearly, it would be wrong to permit import of luxury consumer goods and the recent gaffe of policy makers about special import licenses for exporters which would be valid for import of consumer electronics is a pointer to the temptations which arise. At the same time, it is next to impossible to insulate all export activity from domestic sales even when we go the route of export zones. Should we then give up the prospect of promoting export of consumer goods (which will require freer imports of capital goods and components required for their production) merely because some of these goods e.g. the so-called white goods — will be sold to domestic consumers, usually the relatively well-to-do? I think we fall prey to what the late Prof. Alan Whitehead called the "fallacy of misplaced concreteness" if we confuse the need to curb consumption generally with the notion that particular kinds of goods should not be produced or imported. A good tax policy should be able to take care of the distortions that may arise. To say this is not to imply that we do not need to worry about foreign debt. The economic reform is of no significance to the country if it does not aim at and succeed in bringing about improved allocation of resources which enhance productivity and exports, thus closing, over the next five years or so, the critical gap in our balance of payments. But this does not mean that we can close the gap and reduce our foreign indebtedness by import restrictions. Our own experience shows the futility of such policies.

Another reservation about liberalisation is that it will accentuate the duality in our society While the urban middle class forges ahead, borne on the dynamism of a market economy, the rural poor will be left behind. This assumes that the rich will look after themselves any way and that the urban poor being vocal will not lose out a lot. How will the reforms affect the rural poor? Is there anything in the package to *directly* address their problem? The answer is clearly in the negative. It is a paradox of our experience that while the failures in industry have been due to excessive government intervention, those in agriculture seems to be due to inadequate intervention. The introduction of market economy in agriculture, in the absence of land reforms, spell disaster for the poor farmers. And the massive transfers from the urban to the rural sector through pricing policies and subsidies of all kinds have only accentuated rural inequalities, reinforcing the acute caste-based inequalities which persist.

To ask for greater and more meaningful Government intervention in the rural sector is not a contradiction but an assertion that market forces cannot work without a strong frame work of laws and rules which ensure that markets are not distorted. This is true of industry and financial services as well. A level playing field is necessary for economic agents freely to compete. In the rural sector, this means meaningful land reforms, massive public or publicly induced investments in social and economic infrastructure — transport, power, irrigation, technology diffusion and policies which aim at direct attack on poverty and unemployment — e.g. employment guarantee schemes and enlarged and more meaningful public distribution system.

But what about existing inequalities of wealth and incomes? This is a legitimate question to which there are no easy answers. Other models of development which try to attack these inequalities through state action seem to have failed. What is being tried now is allowing freer play of market with safety nets for the weak, in the hope that the resulting gains will, in the end, benefit all. But this is not yet a proven case. I cannot assert that distribution of income and wealth has become more equal in developing countries which have followed the market-oriented pattern. But with growth, poverty has been reduced in most such societies. In this context, the Chinese experiment with "market socialism" will be watched with interest.

In sum, I have argued that but for the economic crisis, we may never have moved so far the direction of a liberal market economy, given the feudal attitudes and the ideological baggage of the past. Happily, the direction is set and as the Prime Minister has said more than once, the process of economic reform is irreversible. The old mind-set must, however, change, as it may under the impact of reforms, in order that we may move forward in the same direction.

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

— **Eugene Black**

555

HAVE YOU JOINED THE FORUM?

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. 50/-(entrance free Rs. 50/-) and Associate Membership fee Rs. 20/-(entrance fee Rs. 10/-). Graduate course students can get our booklets and leaflets by becoming Student Associates on payment of Rs. 5/- only. (No entrance fee).

Write for further particulars to the Secretary, Forum of Free Enterprise, 235, Dr. Dadabhai Naoroji Road, Post Box No. 209, Bombay 400001.

Published by M. R. PAI for the Forum of Free Enterprise, 235, Dr. D. N. Road, Bombay 400001, and Printed by S. V. Limaye at India Printing Works, 42 G. D. Ambekar Marg, India Printing House, Wadala, Bombay 400031.

14/Feb./1993