UNIT 28 ECONOMIC REFORMS AND SOCIAL JUSTICE

Structure

28.0 OBJECTIVES

After going through this unit, you will be able to answer the following:

- What were the most serious problems facing the Indian economy since the beginning of 1990s;
- How did the new government, which assumed office in June 1991, perceive the immediate task;
- What was the rationale behind change in the direction of economic policy;
- What is the content of new economic policy package;
- What has been the relative importance attached to the different aspects of policy;
- What has been the pace and progress of reform process; and
- Are the economic reform measures more responsive towards social justice.

28.1 INTRODUCTION

There is a feeling that the Nehruvian development model was wrong. Socialism has failed because it could not generate wealth on a sustained basis. Yet, basic socialist concerns about poverty and inequalities have still not disappeared. India's basic objectives have not changed but the need to change the strategy of growth has been increasingly accepted.

There is a passive consensus in favour of the strategic shift in the development strategy. So the real question in the process of environment reforms is not the "*sterile debate*" between "*the state and a pure market*" but the question of "how to manage the transition (i) from excessive to reduced state intervention; (ii) from intervention in the wrong areas to those in previously neglected important ones; and (iii) from one form of reliance on quantity controls to another form (reliance on prices) of policy".

The strategy of self-reliance based on import substitution followed so far has to be combined with the strategy of export promotion. The first phase of rapid industrial growth, from the 1950s till about 1965, was characterised by government stimulus in the form of public investment. The boom of the 80s was supported by public consumption in the form of government expenditure. This was not sustainable and resulted in the government slipping into a fiscal crisis and the economy suffering from balance of payments problems. But the basic point is that all the expansionary phases have so far been either based on public investment or public expenditure. The economic reforms and policy changes in India have focussed on two methods of increasing the aggregate demand:

i) private investment-led, and
ii) private consumption – led expansion, including exports.

There has been a lot of debate on the behaviour of private investment- domestic and foreign – in the context of reforms. Economic reforms reflect *a review of the role of Government, or more general of the State vis-à-vis the market.* By early 'nineties' most, if not all, economies have launched on a policy of redefining and reducing overall the role of the State. This phenomenon clearly signifies the new trade-off between *'State failures' and 'market failures'* or what may be termed as the new realities in the relationship between the State and the market.

28.2 PROBLEMS FACED BY THE ECONOMY IN 1990

Before considering the various steps for restructuring the economy, it is important to be clear as to what were the most serious problems facing the Indian economy in 1990. Consider the following:

1) A large *fiscal deficit*, the underlying cause of which is *expenditure outpacing revenues*.

2) A huge *foreign debt*, with a high debt-service ratio, and debt-exports ratio, which caused a downgrading of the country's credit rating and serious repayment problems.

3) *Low levels of efficiency economy-wide*, which result in huge wastage of resources.

4) More contemporaneously, *a recessionary situation in the industrial sector,* stagnant agricultural output and poor growth prospects in the economy as a whole, coupled with a *serious inflationary problem*.

The situation that the nation and the economy had to face in mid-1991 was grim. The balance of payments situation had deteriorated so sharply and the foreign exchange reserves had fallen so low that the possibility of default in payment was imminent. On the domestic side while the Indian economy had done extremely well in terms of real growth between 1985 and 1990, the fiscal situation had also deteriorated sharply. The *budget deficit* as well as the overall *fiscal deficit* had sharply increased contributing on the one hand to large increase in money supply and on the other, to sharp increase in interest payments. Fiscal deficit of the centre and the states taken together, which was about 7.5 per cent of the GDP in the late 70s, had increased to about 11 per cent by 1991. The fiscal deficit of the Central Government alone which was below 6.0 per cent in the late '70s had increased to 8.5 per cent by 1991. Consequently, interest payments in the Central Government's budget had become the single largest expenditure item rising from 2 per cent of GDP in 1980-81 to nearly 4 per cent of GDP in 1990-91. The country thus entered during the '90s with a fiscal deficit that was simply unsustainable.

28.2.1 Need for Economic Reforms

The reforms were imperative for the following reasons:

1) The *downgrading of India's* credit rating made commercial loans difficult.

2) *Funds flow from west Asia dried up* following the Kuwait crisis, there were large withdrawals of NRI deposits during the early part of 1991, and foreign direct investment was low.

3) *Aid for poorer countries was getting scarce* because of larger claims by the former Soviet states and increased demands in the United States for domestic spending. Compulsions of efficient use of aid made the case for reforms stronger.

4) Following the collapse of old attitudes worldwide and the emergence of a global market, India had no *other alternative but to initiate economy policy reforms.*

However, reforms cannot be wholly attributed to these economic compulsions. The necessity for macro-economic reforms had been steadily gaining credence in the 1980s. The control system under the *'permit raj'* had become unpopular. The timing was, therefore, ripe for an assault on the system and would be greeted with a sense of relief. It is well known that structural adjustment involves hard choices. The choices are described as being hard because they often have implications that find disfavour with the populace at large, at least in the short run.

For the Indian economy, 1991 was an *epoch-making year*. Bold measures were taken to resurrect the economy from the brink of a fiscal and balance of payments crisis. Sweeping market-oriented reforms in industry, foreign trade and investment were introduced to liberalise the economy from the shackle that were binding it for decades. The crucial test for its success is : *does it create conditions for durable growth*? The crisis underlined the need to set in motion *a series of structural changes in trade, industry and finance sectors* so as to provide the necessary springboard for the economy to take off for self-sustaining growth.

28.2.2 Objectives of Economic Reforms

When the Congress government headed by Mr. P.V. Narsimha Rao assumed office in June, 1991 the task before it was two fold:

1) to restore macro-economic stability by reducing fiscal and balance of payments deficits, and

2) to complete the process of economic reforms, i.e., structural adjustment which have for the preceding ten years been conducted on a partial basis, gradually and intermittently.

The announced aims of the current economic reforms strike a revolutionary note. Reforms intended to achieve the following:

1) *stabilisation and macro-economic balance* through fiscal, monetary and exchange rate policies;

2) *a liberalised trade regime with no import* licensing and tariff rates comparable to other industrialising developing countries;

3) an *exchange rate system* which makes the rupee convertible, at least for current account transactions of the balance of payments;

4) a *competitive financial system* with sound regulations;

5) an *industrial sector free of many controls*; and

6) an *autonomous, competitive and streamlined* public enterprise sectors.

There is a common thread running through all these measures. The objective is simple and that is to improve the efficiency of the system. The regulation mechanism involving multitude of controls has fragmented capacity and reduced competition even in the public sector. The thrust of the economic reforms or *New Economic Policy (NEP)* was towards *creating a more competitive environment in the economy as a* means to improving the productivity and efficiency of the system. This is to be achieved by removing the barriers to entry and the restrictions on the growth of firms.

28.3 THE ECONOMIC REFORMS PACKAGE

It is important to understand clearly what the economic reforms package was and equally important what it was not. Economic reforms can be briefly summed up as a package consisting of three separate sets of policies: (Arun Ghosh, 1992)

i) The *stabilisation of economy* meaning thereby, bringing into balance the aggregate demand and supply, the imbalance being in the main caused by large and endemic deficits in the Central Government's budget during the 80s, which got reflected in the spiral of inflation at home and deficit in external payments abroad. The policies adopted in this context relate to budgetary and credit policies.

ii) A *restructuring* of the Indian economy with a view to making Indian industry internationally competitive. The policies adopted in this context range from industrial and foreign trade policies to issues like the lending policies of financial institutions (including banks), the pattern of government expenditure and public investment, including the policy relating to the public sector, and the approach on sick units and in regard to *subsidies generally and the subsidisation of small business and farms in particular.*

iii) *The globalisation of the Indian economy*, throwing open, in stages, the import of all commodities including consumer goods, reducing the customs tariffs, allowing free inflow of foreign capital (including short-term capital), opening up the service sector to foreign capital, especially in the matter of banking, insurance and shipping and full convertibility of the rupee.

28.3.1 Implications of Reforms

According to Dr. Arun Ghosh the three pronged approach has major implications for the functioning of the economy and its future direction. They imply a complete and a sudden break from the past, and several issues arise relating to:

a) the *desirability of the pattern* of development sought;

b) the *timing of the various policies* and, more importantly, their sequencing (and in fact the wisdom of the frequent changes in policy which has the effect of creating uncertainties in the Indian economy);

c) the relative importance attached to the different aspects of policy, in as much as domestic *priorities relating to the* provision of education, health and employment, globalisation of the economy; and

d) the likely impact *of the package of policies* .

It must be noted that while the *stabilisation policies* are intended to correct the lapses and put the house in order in the short term, *the structural reform* was intended to accelerate economic growth over the medium term. Structural reform policies cannot succeed unless a degree of stabilisation has been brought about. But stabilisation by itself will not be adequate unless structural reforms are undertaken to avoid the recurrence of the problems faced in the recent period. Structural reforms were broadly in the area of industrial licensing and regulation, foreign trade and investment, and financial sector. In relation to foreign trade policy, the aim was to liberalize the regime with respect to imports and try to bring about a closer link between exports and imports. Yet another objective is to reduce the tariff rates. As regards import duties, the policy has been gradual and the tariff rate in India has been progressively reduced in order to avoid a high cost economy. As regards foreign investment, the new policy measures certainly make a break with the past. Regarding exchange rate devaluation of the rupee, the Exim Scrip Scheme, partial convertibility scheme, unified exchange rate and the subsequent full convertibility on current account are essentially intended to ensure that the import growth is not out of tune with exports.

28.4 PROGRESS OF ECONOMIC REFORMS

What *has been the content of economic reforms*? We present below a list of major economic policy decisions announced so far since the programme initiated.

1) Devaluation of the Rupee: Approximately 19% in two quick stages.

2) Trade Policy Reforms: Export subsidy abolished. EXIM Scrip introduced but then replaced with a so called partial convertibility of the rupee on trade account (the 40:60 formula), unified exchange rate, and full convertibility of the rupee on current account since August, 1994.

3) Industrial licensing scrapped except for 6 industries primarily those of strategic importance, or producing hazardous goods.

4) The whole chapter in the Monopolies and Restrictive Trade Practices Act, which was ostensibly meant to curb the concentration of economic power, is scrapped.

5) The convertibility clause abolished. This clause hitherto enabled the term-lending financial institutions to convert industrial loans into equity at the price and time chosen by the lending institutions.

6) Substantial liberalisation of rules and procedures for foreign private investment. Foreign Exchange Regulations Act (FERA) liberalised to allow 50% equity participation in most industries; the FERA has now been to be replaced by Foreign Exchange Management Act (FEMA).

7) The exclusive domain of the public sector has been pruned. Only five industries are now reserved (i.e., Defence related industries, Atomic Energy, Mineral Oils, Mining) for public sector. But the private sector is welcome to apply even in respect of these. Besides, partial privatisation of some of the profit making public enterprises has been initiated. Thus, the steps taken regarding PSUs pertain to: (i) limiting public sector to strategic, high-tech and essential infrastructure; (ii) referring sick PSUs to Board of Industrial and Financial Reconstruction (BIFR), (iii) disinvesting a part of the shareholding of the PSUs, (iv) granting greater autonomy for PSUs through the instrument of Memorandum of Understanding (MOU); and (v) to develop a *safety net* for workers who are likely to be retrenched as a result of measures to close down sick units or rationalisation of the staffing pattern of PSUs.

8) The problem of *black money* started being attacked at the root; some measures adopted to curb the generation of new black money (the flow), some others to mop up the black money generated (stock) for productive purposes.

9) Fiscal policy reforms: (a) resolved to cut on government expenditure; (b) reduced

rate and simplification of individual income tax, corporate tax, excise and customs duties.

10) *Financial Sector Reforms* initiated so far are: (a) mutual funds allowed in the private sector; (b) foreign institutions like pension funds permitted portfolio investments in Indian companies; (c) deposit interest rates liberalised; (d) for the first time ever the SLR (the Statutory Liquidity Ratio) is reduced, and that too drastically; banking sector thrown open to private enterprise; insurance sector also opened to private enterprise.

11) Steel industry deregulated.

12) Policy announcement was made regarding small and tiny sector.

13) Reforms in Gold Policy was introduced; imports of gold allowed under baggage rules.

14) Substantial de-compression of imports, with only a short negative list to become shorter.

However, it must be noted that the process is by no means complete. The unfinished tasks are numerous, and can be divided into three broad categories. They are: (i) whatever has been done is only the start. The process needs to be carried further and consolidated in each of the above areas; (ii) *there are several areas, which have not been touched as yet,* and (iii) the introduction of reforms has brought to surface some relatively *unanticipated problems* that need to be considered and addressed.

Altogether, the above package constitutes a sharp turn-around in policy thinking compared to the *license permit raj* built up during the 1960s and 1970s. Some measures were taken to relax controls during the late 1970s and 1980s but these moves were a pale shadow of what is underway now. Observers of the Indian scene were very impressed by the dispatch with which government issued one policy statement after another. This speed of taking decisions was indeed remarkable. If, however, relevant policy moves are assessed against what is required to be achieved under the fundamental aims of the reforms, then the record of policy decisions does not appear to be all that impressive. What has happened so far is surely a good start but it leaves many gaps to be filled up. The agenda of issues, which will have to be tackled, is very long indeed.

Check Your Progress 1

1) Write four problems faced by the Indian economy in June, 1990.

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2) What were the reasons for adopting economic reforms in India?

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3) What do you mean by economic reforms package?

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4) Examine the progress of economic reforms in India.

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28.5 ECONOMIC REFORMS AND SOCIAL JUSTICE

The important consideration is not whether the economic reforms measures are anti-poor or not, but whether they are in fact "*pro-poor*". In other words, is there an explicit "*equity*" dimension to the economic reforms or is the "humane face" merely an attempt to neutralise the negative impact that the reform measures would have on the extant structure of income and asset distribution? The very fact that the social sector spending policies, including the creation of the *National Renewal Fund (NRF)* for retrenched workers, is defined as a "*safety net*" such policies are meant to compensate for equity losses and would not necessarily improve the existing structure of incomes and asset inequality in the country.

There are areas in which government intervention is specifically required to ensure that apart from efficiency gains, the economic reform measures would have a positive impact on equity as well. These areas are: (i) employment, (ii) food security, (iii) health, (iv) education, (v) technology, and (vi) environment. While "*equity*" is not an explicit goal of the economic reforms measures, it is necessary that this is so and a clear definition of what equity should imply in the Indian context should be developed.

Another important consideration relates to the fact that while we are assessing the social impact of the reforms measures, a distinction be made between the direct "*transitional costs*" of reform measures in terms of equity losses, and the already pre-existing equity loss that occurs due to the inequitious nature of the extant economic regime. One should not confuse between the inegalitarian consequences of the existing social and economic order and what might be the specific product of the economic reform measures.

In measuring government's support for greater equity, it would not be correct to look only at budgetary allocation but one should also look at the efficiency of resource utilisation. Have the economic reform helped better utilisation of existing resources, even if fiscal stabilisation required a squeeze on total allocation?

The economic reform measures should not imply a retreat of government from all spheres of the economy and society. While in some areas there would have to be reduced governmental intervention/support, in others like health care, education and social welfare, they ought to be more purposive and better targeted in terms of equity intervention by the government.

The broad thrust relating to the education, health and the public distribution system is that public provisioning of these services is still important and there is inadequate attention being paid to improving the quality of these services in the public sector. On the other hand, the increasing privatisation of these services has created a dualistic structure in which *a high value, high quality private sector is growing while a low value low, quality public sector is stagnating*. Unless the government invests more money and improves the quality of the services rendered the retrogression in these sectors would have adverse social externalities resulting in a national loss.

If financial allocations are no measure of public support, there is no evidence either to suggest that the government be any more committed today than before to improving the efficiency of resource utilisation. The real challenge before the government today is, therefore, not *so much to reduce the role of the government in the social sectors but in fact to make government more responsive to the needs of the people*.

Indeed, *the popular base for economic reform can only be built when ordinary people perceive an improvement in the quality of life*. Deregulation, debureaucratisation, decontrol, disinvestment and so on are only ways to wind down the involvement of the government in the economic life of the people. While much of this is popular with the business community, most consumers of public services are desperately seeking a more efficient and humane government rather than just less government. For, less government is no substitute for good government (Sanjay Baru, 1993).

Prof. V.S. Vyas has cautioned the Central Government against resorting to *"unmindful cut in government expenditures"* on sectors like education and health, besides infrastructure and human resource development to reduce deficit. In our enthusiasm to reduce deficit we must not curtail the expenditure vital for development. Fiscal adjustment and economic reform is not simply a matter for the drawing room. In the period of transition, it imposes a burden of adjustment that is distributed in an asymmetric manner. Without correctives, the burden of adjustment is inevitably borne by the poor. Whatever we might say about social safety nets, we do not have the resources for this purpose. It cannot and will not suffice to assert that the burden of such adjustment would have to be borne by the affluent and the middle class, simply because the rich in our society have the incomes to immunise themselves from the burden of structural adjustment.

28.5.1 Need for Reforms with a Humane Face

There can be no adjustment without pain, but we must do everything possible to minimise the social costs of the transition, in particular the burden on the poor. Restructuring on the supply side, which follows structural reform, will inevitably impose a burden on wage-labour. The phrase '*adjustment with a humane face*' could then become hollow and deceptive (Deepak Nayyar, 1992).

In this context, one is inclined to agree with the view that "the agenda for sound macro-economic policies has to be harmonised with legitimate social objectives and the removal of longer-term constraints on growth. While no simple tune produces this harmony, there is no doubt that we need a radical departure in policies as well as popular attitudes and political behaviour. Indeed, all these are inextricably linked. (I.G. Patel,1991).

The policy makers should not ignore the fact that any experiment with India, no matter how well-intentioned, has to take into account the well-being of 1000 million people and not just the top 20 per cent, given that the creamy layer is attractive enough for the marketing needs of the Western World. Thus, even if high tech does come to the country, even if industrial systems are upgraded and even if exports pick up, unless reforms seek to wipe the tears off the face of the lowliest in the land, the bottom line will continue to suggest failure. *The concept of globalisation has no provision for the poor except for the safety nets.*

Assessing the humane face of structural adjustment and fiscal stabilisation in India, one may ask the question, what is the share of food subsidy in our gross domestic product? It would be over one per cent of GDP. Then, why bother about it when nearly 40 per cent of our population lives below the poverty line? Don't touch the food subsidy, but target it better. The public distribution system (PDS) should supply food at realistically affordable prices, especially because inflationary expectations seem to be strongly linked to PDS issue prices in India.

Dr. V.S. Vyas has highlighted the inconsistency of the Government's approach to the PDS. On the one hand, the government is of the view that it wants to target the PDS to the poor and on the other hand, it increases food prices. Dr. Vyas is concerned about the inflationary impact of the price hike and says, "a more courageous and desirable course would have been to reduce subsidies on inputs. In the quest for reducing fiscal deficits, the government is becoming unmindful of the social consequences". This goes against the government's desire to keep the rate of inflation within limits. The hike in food prices will serve some purpose if the government is really serious about fiscal discipline and can curb revenue expenditure sharply. If non-productive government spending does not come down, this can only have an inflationary impact. Food prices are very sensitive subjects and history reveals that stabilisation and adjustment programmes have been given a bad name by rising food prices.

By announcing that the grain distributed in tribal and some other backward areas will be sold at a cheaper price, the government has made an attempt to target the poor through PDS. It might also exclude better-off classes in urban areas, something more often recommended by economists but resisted by politicians of all hues. It remains to be seen whether such targeting succeeds, and does not fall a prey to leakages and corruption. The contents of the PDS basket need to be changed if the aim is to target the poor. There is no reason why superior foods like sugar and edible oil should be subsidised by the PDS. Coarse grains could form a good proportion of grains distributed in backward areas. Since inferior foods are disliked by better off sections leakages will be fewer. A better way of targeting the poor is to expand rural employment programmes at low wages, which will attract only the needy.

Fiscal adjustment, which sought to reduce the wide gap between the income and expenditure of the government, constituted the core of the macro-economic stabilisation programme. According to Professor Deepak Nayyar, the quality of adjustment leaves much to be desired. There are three reasons underlying this concern: (a) it cannot provide a sustainable solution to the fiscal crisis; (b) it is likely to constrain economic growth; and (c) it is disturbing the burden of adjustment in an unequal manner. In a period when we are imposing a substantial burden on the poor through expenditure adjustment, the equity principle demands that the rich and the better off share this burden through their contribution to direct taxes.

Thus, as has been pointed out by Professor Deepak Nayyar, it seems that the fiscal adjustment embodied in the budgets has lost sight of why the adjustment was necessary in the first place. The budget makers have been *concerned with form rather than substance and quantity rather than quality.* What is more, the adjustment has been regressive in its impact. The rich, who derived much of the benefit from the profligacy of the 1980's when the government and the country lived beyond their means, have been spared the burden of adjustment, while the cost is borne by the poor.

Professor A.M. Khusro is of the view that the new policy has so far impacted only the elite industrial and commercial society – the importers, the exporters, the traders, some manufactures and the NRIs. The logic of the policy is that once these elements are allowed freedom to perform and begin to produce competitively with improved efficiency, the output in various sectors will expand rapidly. The labour force required for expanded production would increase and improvement in production and supplies will restrain the rate of inflation and benefit the masses at large. In other words, if the policy does get implemented, the production and employment will trickle down of course, with a time lag. *Eventually, the masses will judge the policy through its effects on employment, prices, availability of output and a noticeable decline in the rate of inflation.* But all this will depend upon whether the first stage of implementation does or does not go through. That is why implementation is more important.

Check Your Progress 2

1) What do you mean by 'adjustment with a humane face'?

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2) What do you mean by a safety net?

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3) Mention the role of public distribution system in the on-going programme of economic reforms.

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28.6 LET US SUM UP

The task of reform is indeed a challenging one. The commitment to reform should go hand in hand with the concern for alleviation of poverty. A social safety net has been devised to take care of the consequences of the process of change. The imperatives of social policy as embedded in our social and economic framework mandate a concern for the poor and the deprived. The planning process should take care of this. *It is only appropriate that where markets distort the planning process, the State should take care of those who are disadvantaged. So long as one does not attempt to outguess the market but set right its distortions one can preserve the social goal of growth with equity. It is only on this basis that the process of reform can be sustained in an open society.*

With regard to economic reform with a humane face, the achievement seems to be far short of what was aimed at. After about ten years of liberalisation, large segments of the population have yet to share the benefits of progress of development. A clear assessment is not possible about the extent to which liberalisation objectives with regard to humane face have been attained. There are no quantified targets against which performance can be compared since what the economic reform measures indicate is a direction of movement, not a specific goal. *The pace of movement towa*Prof. S*rds achievement of humane face is much slower than what is acceptable. With the framework of the reform measures a greater degree of redistributive bias has to be built in.*

For long term strategy, we ought to focus national attention on seven issues: (i) a steep increase in the savings rate, especially the public and private corporate sector's savings rate, (ii) making rapid export growth a "national economic endeavor". (iii) to pay greater attention to exporting more; improve Indian industry's technological capability through greater attention being paid by firms to R&D, (iv) better tax compliance (v) greater concern for social justice, (vi) a greater concern for the environment – economic growth cannot continue without paying attention to the ecological costs of modernisation; and (vii) rural development which will take employment opportunities both in the agrarian and industrial sectors to rural areas so that there is rural enrichment and an end to urban crowding and decay.

28.7 KEY WORDS

Devaluation: A fall in the fixed exchange rate between one currency and others.

Depreciation: A situation where a currency falls in value against other currencies through changes in the forces of supply and/or demand.

Convertibility: An attribute of a currency, which is freely exchangeable for another currency, or for gold.

Terms of Trade: A relationship between the prices of exports and the prices of imports.

Deficits: A situation where outgoings exceed income, on an ongoing basis, or where liabilities exceed assets at a specific point in time.

28.8 SOME USEFUL BOOKS

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28.9 ANSWERS/HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Section 28.2
2) See Sub-section 28.2.1
3) See Section 28.3
4) See Section 28.4

Check Your Progress 2

1) See Section 28.5
2) See Section 28.5
3) See Section 28.5

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8

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BLOCK 8 ECONOMIC REFORMS IN INDIA

Introduction

Block 8 discusses the measures of economic reform introduced in India since 1991. In the background of the preceding policy regime that relied heavily on 'command and control' strategy of economic development, the present policy focuses on a path that is largely decided by the market forces. An attempt, therefore, is made to introducing the basic concepts of economic reform through Unit 25. The succeeding Unit 26 deals with privatisation moves in India and examines the privatisation of some of the economic activities hither to performed by the public sector. The basic thrust of ensuring the economic development in a competitive environment by India is discussed in Unit 27 under the title, Globalisation of Indian Economy. The concluding Unit 28 of the block deliberate upon the features of economic reform in India in the presence of social justice as an important objective.