ECONOMIC REFORMS, POVERTY ERADICATION, SELF-RELIANCE AND ETHICAL VALUES

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I

INTRODUCTION

1. I am very grateful to my esteemed friend Professor S. Ramaseshan for inviting me to deliver the Gandhi Memorial Lecture. I deem it a great honour particularly since this lecture used to be delivered by the late Sir C.V. Raman while he was alive.

2. In 1991-92, India had to face a severe economic crisis. Our foreign exchange reserves had been nearly exhausted. International credits had dried up. We had to mortgage official gold to raise a small loan in foreign exchange. The country was on the verge of bankruptcy. The resulting import squeeze threatened to bring about a sharp reduction in production and employment. The annual rate of inflation went up to 18 per cent in August 1991 and it was feared that inflation would further accelerate.

3. The Government of India responded to this crisis by launching a multifaceted programme of economic reforms. Its short term objective was to

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restore a measure of macro economic stability so as to control inflation and balance of payments deficit. Its longer term objective was to create an economic environment conducive to more rapid growth of productivity and output than in the past.

4. I think most objective observers of the Indian economic scene will agree that there has been a dramatic improvement in India's economic fortunes since 1991-92. Indeed, there are very few developing countries which experienced such a sharp recovery in such a short period of time as was the case with India. The economy grew at an average annual rate of 6.5 per cent from 1992-93 to 1996-97 as against the 8th Plan target of 5.6 per cent. The reform of the external trading and external payments systems has helped to reduce the deficit in the balance of payments on current account from the unsustainable level of 3.2 per cent of GDP in 1990-91 to about one per cent of GDP in the last five years. The country's foreign exchange reserves which had declined to one billion US dollars in July 1991 now exceed 25 billion US dollars, providing a comfortable cover for imports for nearly seven months. The opening up of the Indian economy and increased competition from imports have not led to a flood gate of unwanted imports. On the other hand,

though export growth slowed down in 1996-97, in the preceding three years this growth averaged 20 per cent in dollar terms. The external debt of India has been managed prudently and there has been a very modest growth in it after 1990-91. This debt as a proportion of our GDP has declined from 35.3 per cent in 1990-91 to 25.9 per cent in 1996-97. The debt service expressed as a proportion of total current receipts has fallen from 35.3 per cent in 1990-91 to 25.4 per cent in 1996-97. Rates of domestic savings and investment rates for 1995-96 - the latest year for which figures are available - reached an all time high. The country is now able to attract annually foreign private investment (direct and portfolio) of about 5 billion US dollars as against less than 150 million dollars in 1990-91. The fiscal deficit of the Central Government has declined from 8.3 per cent of GDP in 1990-91 to 5.1 per cent in 1996-97. The inflation rate - measured in terms of both wholesale and retail prices has shown a declining trend since 1995-96.

5. The reform agenda is far from being fully implemented. There is still a large unfinished business. The fiscal deficit is still far too high. The restructuring of the public sector - making it more productive and profitable - has not received the

attention it deserves. The infrastructure sectors such as power continue to be mismanaged and these sectors are not attracting the investments we need to sustain the growth momentum. Fiscal reforms and restructuring were intended to release more resources for social sectors such as education, health, agriculture and rural development. This readjustment is not taking place at the pace we need. Limited progress has been made to establish viable social safety nets to protect the more vulnerable sections of population during the phase of transition to a more dynamic economy. Of late, there is a visible weakening of political will to push ahead with the unfinished task of reform which does not augur well for the future of our economy. In this respect, we can learn a great deal from the experience of China whose leadership's firm commitment to economic reforms has made it possible for China to grow at an annual rate of over 10 per cent for the last 10-12 years.

6. Despite the progress made by the Indian economy as a result of liberalisation and opening up of the economy since 1991-92, there are some people who continue to be sceptical abut the favourable impact of reforms. In today's lecture, I shall deal with three issues which still figure prominently in the debate on

the future of reforms. The first issue relates to the role of economic reforms in reducing poverty. The second issue deals with the possible impact of liberalisation and opening up of the Indian economy on our ability to pursue a self-reliant path of economic development. The third issue concerns the impact of economic reforms on corruption in public life.

II

ECONOMIC REFORMS AND POVERTY ERADICATION

7. The central problem of India is the eradication of mass poverty, ignorance and disease which still afflict a large number of our people. Since Independence a good deal has been achieved in softening the harsh edges of extreme poverty. Even then, it is a fact that the overall pace of social and economic progress has fallen far short of the aspiration of our people as well as of the objective potential of our economy. Moreover, the speed and depth of the process of poverty removal in India compare unfavourably with many countries of East and South East Asia. The

experience of these countries demonstrates that given sound economic and social policies, significant progress can be registered on the poverty front in the time span of a single generation.

8. The international experience suggests that strong, sustained and labour intensive economic growth provides the most favourable framework for a speedy removal of mass poverty. The quality and structure of growth have also an important bearing on the profile of poverty. In a predominantly agrarian economy, the development of agriculture and labour intensive manufactured exports, help to increase the labour intensity of the process of development and thereby help to expand employment opportunities. The role of social development is also important. The access to basic social services such as elementary education and paimary health care to all citizens regardless of their income status promotes equality of opportunity and wider sharing of the fruits of development. Historical experience of many countries also supports the view that strong emphasis on social development, laying particular stress on the social and economic status of women, can also be a powerful factor in controlling the rate of population growth.

9. The rate of growth of India's national income until about 1979 averaged 3.5 per cent, falling far short of the targets laid down in the successive five year plans. In the meanwhile, the population of India continued to grow at an annual rate exceeding 2 per cent. With per capita income growing at no more than 1.5 per cent per annum, it is not surprising that there was no significant decline in the proportion of people living below the poverty line. In the 1980s, India did manage to improve its growth performance very significantly, the average being close to 5.5 per cent per annum. This improvement in the growth performance was an important factor in the significant reduction in the proportion of people living below the poverty line between 1977-78 and 1987-88.

10. However, as the decade progressed, the sustainability of the growth process became doubtful because of an unsustainable increase in the country's balance of payments deficit and the fiscal deficits of the Government. The economic crisis of 1991-92 was precipitated largely by an unsustainable increase in the two deficits. A principal purpose of economic reforms introduced in 1991-92 was to correct these imbalances which threatened to disrupt the rhythm of economic progress. At the same time, reforms also

sought to reduce the bias in favour of excessive capital intensive processes and products built into our trade and industrial licensing policies, exchange rates and interest rates policies. A gradual reduction in protection for industry and exchange rate reforms, it was hoped, would also improve agriculture's terms of trade and thereby attract more investment into this vital sector. Furthermore, it was expected that fiscal restructuring and reform of the public sector would release larger resources for deployment in social sectors such as education, health and rural development. Thus the expectation was that new economic policies would help to accelerate the process of poverty reduction.

11. What has been the actual outcome ? Unfortunately, the latest data on estimates of poverty prepared by the Planning Commission on the basis of NSS data do not go beyond 1993-94. Compared with the previous estimates of 1987-88, the data for 1993-94 do show a decline in the proportion of people living below the poverty line. The decline is not very large to boast about. But the data do not substantiate the claims of those who assert that the reforms were anti-poor. In any case, a five year period, of which two were spent in crisis management, is not long enough

period to draw firm conclusions about the impact on poverty. In analysing the available data, one has to remember that 1993-94 represented the early phase of reforms and during this period we had to take many unpleasant decisions involving cuts in expenditure, including subsidies. Moreover, the agricultural performance in 1991-92 and 1992-93 was not too good and as a result food prices rose sharply. The import squeeze of 1991-92 and 1992-93 also accentuated inflationary pressures. In this background, one should not be surprised if after the crisis of 1991-92, the reforms did not have much to show by way of improved poverty performance in 1993-94. Since 1994-95, the overall growth rate of the economy has gone up substantially. Agricultural growth rate has also turned out to be better than initially estimated. The improved performance of the real economy has also led to moderation of inflationary pressures since 1995-96. Since 1994-95, the expenditure on social services and rural development has also gone up though not by as much as is needed to make a dent on social deprivation. I therefore believe that despite the imperfect implementation of economic reforms, the data for later years, say for 1995-96, when they become available, would reveal a more favourable picture. I further believe that if we can sustain the momentum of economic growth at 6-7 per cent per annum and pay more adequate attention to agriculture, physical infrastructure and basic social services, there would be a progressive decline in the incidence of poverty in years to come. The improvement will be faster if we can further reduce the remaining bias against agriculture still built into our industry and trade policies. Liberalisation has thus far made a limited impact on agriculture though the terms of trade have moved marginally in favour of agriculture in recent years. The impact on poverty will be sharper if we are successful in restructuring public finances, in improving the buoyancy of tax revenues, targetting subsidies more purposefully, secure higher returns from public sector enterprises and thereby acquire the capacity to spend more on investment in physical infrastructure and social development.

12. Thus if we are serious about poverty reduction, the challenge ahead is not to go back on reforms but to deepen the fiscal reforms, create an environment in which the public and private sectors can spend more on infrastructure development and social services. We need to deepen the process of reform of the financial system so as to augment resource flows for long term investments in infrastructure and reduce the cost of

raising funds for investment. Additionally, we should build credible social safety nets, such as a nationwide scheme of employment guarantee for a minimum period of 100-150 days in rural areas, mid-day meal programme for school children, and increased allocations and improved delivery systems for elementary education and primary health care and promotional measures in support of micro enterprises in rural areas and in the urban informal sector. When we consider these issues in the holistic manner, it emerges that annual growth rate of 7-8 per cent is a must to generate the needed savings and public revenues for programmes of social development and poverty eradication. In addition, determined efforts are necessary to ensure that the quality and structure of growth are sufficiently pro-poor. The State has an important role to play to improve the capabilities of the poor.

III

REFORMS, SWADESHI AND SELF-RELIANCE

13. In some recent discussions of reforms, questions have been raised about the impact of reforms on our sovereignty and some people have expressed a fear that we may become excessively dependent on foreigners to sustain the momentum of growth.

Sometimes, a distinction is drawn between internal liberalisation and external liberalisation. While the former is welcomed, doubts are expressed that external liberalisation, involving liberalisation of imports and capital inflows from abroad, may lead to Indian enterprise being destroyed by competition from imports and inflow of foreign investment in our country. Some people pose this issue in emotive terms: as a choice between Swadeshi and Videshi.

14. In some ways, these issues are not new issues. They have been discussed earlier also in the post-Independence period. Indian planners have recognised that autarky is inefficient and ineffective instrument for realising our development objectives. Import needs invariably increase in the process of successful development and have to be financed either by an increase in exports or capital inflows. Indeed, for most of the post-Independence period since 1957, our imports have invariably exceeded our exports and we have relied on external assistance equal to about 2-3 per cent of our GDP to bridge the resulting gap between imports and exports. Currently, the climate for concessional aid is highly unfavourable and if we do not find alternative means of bridging the import-export gap, we must be prepared to pursue a more

aggressive export promotion policy or compress our imports. In the short run, there are limits to which exports can be increased. Thus a cut in external assistance must inevitably lead to a cut in imports. The bulk of our imports consist of raw materials and capital goods and a cut thereof will have an adverse effect on our economy. Most people do not realise that on a per capita basis India is not well endowed with natural resources and we have to be a major trading nation if our development is not to be constrained by shortage of natural resources, particularly commercial energy.

15. The economic reforms have sought to substitute concessional aid flows by private foreign investment. So far they have not increased the overall dependence of our economy on the rest of the world. Indeed, in some ways, we are less dependent on foreigners now than in the past. During the greater part of the post-Independence period, we have relied on external aid flows equal to 2-3 per cent of our GDP. By contrast, the reliance on external inflow as measured by the deficit in the balance of payments on current account has averaged only 1 per cent of our GDP in the last five years.

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16. Way back in the early 60s, the Planning Commission while formulating the 3rd Five Year Plan had come to the conclusion that in the real world it would be impossible for any country to be wholly self-sufficient in everything. Thus, in an increasingly interdependent world that we live in, the Planning Commission recognised that to give practical shape to the spirit of Swadeshi, our national objective had to be not autarky but self-reliance. And how did they define self reliance ? Not by elimination of commercial capital inflows which were considered to be normal feature of any well functioning economy but by aiming at a progressive reduction and ultimate elimination of concessional aid flows which are capable of being influenced by political considerations. By this criterion, India is more self reliant today than ever before. Today, we get only small quantities of external aid and when we take into account repayment of principal and interest on past loans, the net transfer is negative. In the 1980s, India's exports financed about 60-65 per cent of our imports. In the last five year, 85-90 per cent of imports were financed by exports. Thus those who argue that reform have made India more dependent on the outside world have got their facts wrong. As I stated earlier, we are basically substituting aid by

commercial inflows. Even then, the inflow of foreign investment is no more than 1.5 per cent of our GDP and it is too small to subvert our economy, or affect our sovereignty. On the contrary, it has helped us to free the economy of the psychology of acute scarcity of foreign exchange which prevailed during the greater part of the last 50 years and was used as a justification for rigid controls on investment, imports and use of foreign exchange. Those who want the inflow of foreign investment to be stopped, should then be prepared to go back to the old licensing of imports and investments. May be, this is what they want. While the country suffered a great deal under the regime of tight controls, some people prospered under the old regime of infinite protection. But I doubt if the ordinary people in India would like to go back to the old system where producers had no concern for cost or quality and consumers were being exploited all the time. Against India's annual flow of 5 billion dollars, China last year had capital inflow of 42 billion dollars and it is using external capital in a big way to modernise its economy so as to emerge as a super economic power. India has to acquire a similar attitude if it is to emerge as a global player on any significant scale.

17. Some people argue that foreign investment is welcome in high technology and infrastructure sectors but not in consumer goods. This is a reversal of the old argument that the commanding heights of the economy should be in the hands of Indians. Any way, if we wish to discourage foreign investment in consumer goods, we ought to modify our tariff and import control policies which by not allowing import of consumer goods confer infinite protection on producers of such goods in India and thereby encourage the inflow of investible funds into this sector. We need further liberalisation of external trade regime to reduce this artificial stimulus provided to investment in consumer goods. Moreover, the actual inflow of foreign investment into the consumer goods is far too small to hurt the domestic producers on any significant scale. The available data show that only a small proportion of foreign investment is going into consumer goods such as automobiles, agro-processing and some white goods. We should also not forget that countries like China by allowing foreign investment in consumer goods have built up massive exports of consumer goods in recent years. By contrast, our industrial and trade policies have been a major factor hurting the growth of our exports.

18. Since the 2nd Five Year Plan, India has pursued an inward looking restrictive import policy based on

the belief that our exports like textiles, leather goods and light engineering had no future. The experience of East Asia, South East Asia and China has been exactly opposite. They have not suffered from this sort of export pessimism and have taken full advantage of the world trading system to expand their exports of labour intensive products. In the process, they have created new job opportunities in industry, reduced the pressure of population on land and also dealt effectively with problems of poverty and social underdevelopment. By contrast, industrialisation in India behind highly protective walls has failed to bring about any significant reduction of the pressure of population on land. Those who wish to persist with the old policy framework of India must realise the tremendous social and economic cost they are asking the people of India to pay for their preferences. Moreover, it is no longer possible for India to sustain a trade regime in which we retain the authority to restrict imports while expecting the rest of the world not to impose restrictions on our exports to them. At the same time, there is no basis for the fear that removal of import controls will lead to a floodgate of imports. So long as we pursue sound macro economic policies, an intelligent use of tariffs and exchange rate mechanisms will provide a credible protection against an excessive inflow of imports. Moreover, we can always resort to anti-dumping import duties if there are valid reasons to believe that foreigners are dumping goods into India.

19. To argue for greater openness is not to argue that globalisation processes, involving liberalisation of trade and capital flows, do not pose risks. Competition can certainly hurt those who are not prepared for it. But a country like India, with its vast human and material resources, and with the ambition of becoming a major global economic player, cannot take such a defeatist view. We ought not to underestimate the capabilities of an India that can produce computer programmers for the Silicon valley. We must have a coherent strategy to come to term with globalisation, a process we cannot stop even if we do not like it. The challenge ahead is to prepare the Indian economy to take full advantage of the opportunities offered by globalisation to leap frog in the race for social and economic development and, at the same time, to minimise risks associated it. India needs a first class physical and social infrastructure and a modern financial system to enable our entrepreneurs to take full advantage of the new opportunities. The only valid meaning of the Indian

industry's demand for a level playing field is to create a top class physical infrastructure and a well functioning financial system which will help Indian industry to become internationally competitive. All this means a more forceful commitment to economic reforms and a more open economy and not an economy which sees its salvation in isolation from the rest of the world. Interdependence of nations is a fact of life. We cannot ignore it. The only practical choice is to negotiate an equitable management of this growing global interdependence. India needs a strong economy and fast expanding markets to negotiate from the position of relative strength for an equitable management of global interdependence. In the famous words of Gandhiji, we ought to build a house with windows open on all sides so that winds from all cultures of the world can freely flow in. But we ought to build a strong economy and polity so that we are not blown off our feet by any of these cross currents.

IV

REFORMS, CORRUPTION AND ETHICAL VALUES

20. I now deal with the argument that economic reforms, with their market orientation, have led to pursuit of excessive greed and consumerism and that

they have encouraged excessive materialism. Some people also feel that reforms have led to erosion of ethical values and increased the scope for corruption in our public life.

21. As regards the pursuit of consumerism, it is certainly true that the expansion of mass media, particularly the electronic media, has created new opportunities for advertising and for stimulating new wants among consumers. However, it is necessary not to exaggerate the significance of this phenomenon. Certainly, there is no evidence that this craze for consumerism has led to a decline in the domestic rate of savings which reached an all time high in 1995-96. Moreover, not all advertising is socially harmful or destructive. This is particularly so when new products appear on the scene and have to be introduced to the markets. I, however, agree that at the present stage of India's development, we cannot afford to copy the life styles of the affluent post-industrial societies of the West. Pursuit of these life styles will be disruptive of ecological stability and in any case the resource constraints will ensure that only a small minority will be able to enjoy these life styles. The elite groups in India need to set an example by adopting life styles which are affordable. The owners

of wealth have to recognise their responsibilities as trustees of society. At the present stage of development, India must make every effort to leap frog in the race for technological, scientific and managerial development but consumption levels and patterns must take into account the resource constraints and the need to step up the national saving rate for the sake of a faster pace of capital accumulation and economic growth. The mass media, in their operations, should not lose sight of this wider national perspective.

22. As regards corruption, the security scam of 1992 has been sometimes cited as a byproduct of liberalisation. However, it is worth recalling that this scam took place much before an attempt was made to liberalise the financial sector. In fact this scam was going on since 1986. As regards other scams at the Centre and the States, most of them took place in the process of handling public sector transactions and therefore bear no relation with liberalisation. In any comparative evaluation, one must not lose sight of the enormous scope for corruption which existed in a command and control type of economy. Gandhiji was one of first persons to recognise the evil influence of excessive economic controls in this regard. The dismantling of these controls in a well phased manner

should, therefore, reduce and not increase the scope for corruption in our public life. However, it is certainly true that ad-hoc, case by case liberalisation without a clear cut transparent set of rules and guidelines does create scope for corruption. The answer to this problem is to liberalise the economy in such a way that selection of potential new entrants and the tariff policies do not allow for arbitrary exercise of power. Every effort should be made to introduce a rule based and not a deal based system. Otherwise, 'crony capitalism' with attendant scope for corruption and misuse of power will become the norm.

23. As I see it, rule based liberalisation can be an important means of reducing the scope for corruption in our public life. Thus the removal of industrial licensing, price and distribution controls, import controls and controls on capital issues can help to create an environment whereby industrialists do not have to bribe public officials to secure a licence or the permission to undertake an activity. Import liberalisation and relaxation of exchange controls also help to reduce the scope for smuggling and Hawala type of transactions. Similarly, tax reforms, with their emphasis on moderate rates and minimum amount of discretion being given to tax officials can help to

promote a culture in which bribary and corruption do not flourish.

24. Thus as I see it, properly designed and implemented, economic reforms can be an important means of toning up the moral fibre of our society in which people will have adequate incentive to remain honest. However, in practice economic incentives by themselves may not suffice. We need to supplement them by electoral reforms as well as strong emphasis on value education in our schools and colleges as an integral part of the process of national reconstruction and development. Along with liberalisation in the framework of transparent rules of the game, we need to promote the growth of a value system which prizes creativity as well as integrity and ethical values. After all, the economy is not an end in itself. It exists to serve our people and to enable them to lead a life of dignity and self respect. It would require much more than mere economics to reconstruct our polity and society along the desired lines. Thus economic reforms need to be accompanied by a vigorous national movement laying emphasis on moral and spiritual regeneration of our people.
