

# New Year Resolutions



C Rangarajan

**Reforms by themselves do not result in growth. They only create the necessary environment**

Rating agencies blame the slowdown in reforms as the cause of decline in the growth rate. Many other analysts also hold the same view. If reforms are essential to accelerate growth, three questions arise. First, in the present context, what are the kinds of reforms that are needed? Second, what are the priorities and what should be the sequence? And third, are reforms the only prerequisite for growth? The basic objective underlying all the measures introduced since July 1991 has been to improve the productivity and efficiency of the economy by injecting greater competition. It's this principle that should be extended to all sectors. There are still some segments of the economy where barriers to entry and growth exist. A typical example is the sugar industry .

## Auction Natural Resources

Regulators are needed only in those sectors where competition is weak, or where security and stability considerations are important. Where competition is not possible, transparent mechanisms for fixing the price must be followed. In the case of natural resources, which are a government monopoly , auction is the best method of allocation and pricing.

In the realm of matters coming directly under the government, there are two areas that require attention. First is fiscal policy . In fact, reforms in the early 1990s started with this area. One major proposal under discussion is the introduction of the goods and services tax (GST). Much time has been spent on discussing this reform measure. The time has come to take the final jump.

Obviously , the 1% tax on interstate transactions is inconsistent with the spirit of GST. This should go. But on other issues, all sides should show flexibility . States that are already apprehensive may not agree to any rigid formulation. Too much expectation from the GST in terms of its impact on growth is also not warranted.

Leaving aside fiscal reforms, the other area that demands attention, and that'll have a big pay-off immediately , is improvement in the administrative structure. The government's delivery system reform not only in terms of the distribution of subsidies but also regarding all other services will have the most immediate impact. Cumbersome rules and procedures must be done away with.

Administrative reforms have been talked about for long. The implementation of the Seventh Pay Commission recommendations should be accompanied by some responsibility and accountability measures.

Sequencing of reforms is equally important. It is often argued that factor markets have largely remained untouched by reforms. People have particularly the labour market in mind. Flexible labour markets always help in generating faster growth. For example, in the post-2008 crisis period, the US has done better than Europe because of the more flexible labour markets in that country .

Nevertheless, the time for modifying labour markets is when the economy is booming -that is, when the economy will be able to absorb easily the disruptions, if any , caused in the labour market. Labour will then realise that it stands to gain more by a fast-growing economy than by legislative constraints.

It is only in a growing economy that new entrants join the labour force in a big way . It avoids the trap of the employed becoming the enemy of the unemployed. Thus, while some reforms of the labour market are necessary , they should wait till the economy gathers momentum and moves on to a stronger growth path.

#### Reforms, Present Continuous

The low-hanging fruits are clearly in the area of administrative reforms.

In fact, closely related to them is the improvement in the functioning of various public enterprises. The infrastructure is still dominated by the public sector. If the capital expenditures in public sector enterprises promised in the Budget are fulfilled, that itself will act as a great stimulus for growth. That will require drive combined with reforms.

For sustained high growth, reforms must remain part of a continuing agenda. But reforms by themselves do not result in growth. They only create the necessary environment.

There has to be a proper response to reforms from the private and public sectors. For example, the policy framework was similar between the periods 2005-06 and 2007-08, and post-2011. But the growth rates were strikingly different. Maybe some of the constraints in the early high growth phase that were non-binding became binding later.

The key to growth lies in building a proper investment environment. This is dependent on both economic and non-economic factors. Reforms are only an important first step.

Reforms are not ends in themselves. Even growth is not an end in itself. Ultimately , growth triggered by reforms must benefit all segments of society. Equity and efficiency should not be posed as opposing considerations. They must be weaved together to

provide an acceptable pattern of development. Equity will remain only a dream, if it is not accompanied by growth and reforms.

The writer is former governor, Reserve Bank of India



**Creating the right atmosphere is just the beginning**

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