THE HINDU

OPINION » COMMENT

Published: July 27, 2016 00:51 IST | Updated: July 27, 2016 01:33 IST July 27, 2016

Reforms are here to stay

- C. Rangarajan

— Photo: Reuters
Bridging the gap: "While poverty is coming down, the poverty ratio is still high and India is lagging behind in meeting the Millennium Development Goals on several dimensions." A pavement dweller in Kolkata.

The overwhelming evidence on view since 1991 is that reforms have to be an integral part of any programme aimed at accelerating growth

Mid-1991 saw a new dawn in the economic history of India. The country then faced a severe economic crisis, triggered largely by an acute balance of payments problem. The response to the crisis was to put in place a set of policies aimed at stabilisation and structural reform. While the stabilisation polices were aimed at correcting weaknesses that had developed on the fiscal and balance of payment fronts, the structural reforms were meant to remove rigidities that had entered various segments of the Indian economy and to make the system more competitive and efficient. Thus the crisis was turned into an opportunity to effect some fundamental changes in the content and approach to economic policy.

Break with the past

The break with the past came in three important directions. The first was to dismantle the complex regime of licences, permits and controls that dictated almost every facet of production and distribution. Barriers to entry and growth were dismantled. The second change in direction was to reverse the strong bias towards state ownership of means of production and proliferation of public sector enterprises in almost every sphere of economic activity. Areas once reserved exclusively for the state were thrown open to private enterprise. The third change in direction was to abandon the inward-looking trade policy. By embracing international trade, India signalled it was boldly abandoning its export pessimism and was accepting the challenge and opportunity of integrating into the world economy.

The genesis of reforms

On the genesis of reforms, some interesting questions have been raised. First, several people have been curious to know the role of P.V. Narasimha Rao in the reform process. Was he an ardent advocate or a reluctant reformer? Second, were the reforms of 1991 a continuation of a process that had already begun in the 1980s or did they truly constitute a break? Third, since the leaders and bureaucrats involved in the reform process were themselves part of the earlier control regime, what compelled them to change their approach? How much of the change was influenced by the International Monetary Fund (IMF) and other multilateral institutions?

Manmohan Singh as Finance Minister spearheaded the new policy. He articulated the need for change and provided not only the broad framework but also the details of the reforms. It was, however, Rao as Prime Minister who provided the valuable political support and shield which were very much needed. It must be noted that as Prime Minister, he also held the Industry portfolio which was directly responsible for initiating changes that led to the dismantling of various types of controls and licences relating to the industrial sector. This was indeed a key element of the reform programme.

The Eighth Five Year Plan, in the writing of which I had a role, spelt out in some detail the rationale for reforms. Rao, as Chairman of the Planning Commission, had read the draft and approved it fully. However, as a matter of strategy, he couched the reforms in a language which would appeal to the 'old guard' of his own party. There is no doubt that reforms could not have moved forward without his solid support and conviction.

The 1980s saw some important changes in economic policy. A number of committees were set up which recommended changes for improving the functioning of the economy. But most of these recommendations were still within the framework of an overall system of controls. What was attempted was only a relaxation of controls such as raising the threshold for licensing. They were largely incremental in nature. On the other hand, the reforms of 1991 moved away from the control regime and offered a consistent set of measures covering various segments of the economy in line with the new approach.

What changed the mindset of the people who initiated the reforms was the enormity of the crisis of 1991. India's foreign exchange resources had fallen to a level equivalent to only three weeks of imports. The possibility of 'default' loomed large. It became obvious that 'business as usual' would no longer work. We had to move fast and make fundamental changes in our economic policy. It was true that at the time we were negotiating with the IMF and other multilateral institutions. Obviously they had their own bias. They were in favour of a competitive economy with minimal controls. But the decision we took to introduce reforms was entirely our own. The credit goes fully to our leadership.

Questions on the reform process

In the first three years after reforms were launched, there was a flurry of activity. Reforms covered all key sectors such as industries, external trade, foreign investment, exchange rate system, banking, capital market and fiscal and monetary policies. The impact was quick. Growth started picking up. The balance of payments situation improved and confidence in the economy was restored. It was good that successive governments have adhered to the reform path. The pace of reform has, however, varied over time. Nevertheless, what stands out is that growth since the reforms has been faster. Between 2005-06 and 2010-11, the average annual growth rate was 8.8 per cent. While the decline in growth rate seen in the last few years needs careful analysis, reforms have to be an integral part of any programme aimed at accelerating growth.

On the progress of reforms itself, two questions from two opposite angles have been raised. First, how far have we come in fulfilling the original goal of liberalisation? How much more needs to be done? The second question is, how much of the benefit of growth has gone to the lower deciles of the population? Has there been a perceptible impact on the vulnerable and weaker groups?

As reforms progressed, more and more sectors of the economy were brought within the ambit of liberalisation. However, there are still some segments which are subject to controls reminiscent of the pre-1991 period. A good example is the sugar industry. Agriculture too as a sector needs special attention. Reforms of the agricultural marketing system are overdue. The country is yet to emerge as a single market. Administrative reforms need to be pursued with urgency. Thus the scope for future reforms is still wide.

Despite faster growth, India still ranks low in the Human Development Index even though the country is classified as a medium human development country. There is, however, evidence that poverty is coming down. Whatever level of private consumption expenditure is used as the cut-off, the poverty ratio is falling. Having said this, one must recognise that the poverty ratio is still high and we are lagging behind in meeting the Millennium Development Goals on several dimensions. Growth does help in reducing poverty because of both the percolation effect and the ability to raise more resources on the part of the government to provide for increased social sector expenditures. Therefore, a twofold strategy is needed: letting the economy grow fast, and focussing on targeted programmes to help the poor and disadvantaged.

Thus the emphasis on efficiency does not mean ignoring concerns relating to equity. As the role of government as a producer of marketable goods and services goes down, its role as a regulator and provider of public goods and services increases. In fact, even in the provision of public goods, different combinations are possible. Public-private participation can combine the efficiency of the private sector with larger public policy concerns.

Reforms have come to stay. There is a fair measure of agreement across political parties on the need for reforms. However, individual measures may run into problems. This is inevitable in a democracy when conflicting political pressures are at play. Persuasion and consensus-building are qualities which political parties in power must nurture and cultivate. Reforms are the first important step towards raising the growth rate. But as our experience over the last few years shows, reforms alone are not enough. They must be supplemented by a proactive government which is focused on development and not distracted by other considerations.

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Printable version | Jul 28, 2016 11:33:00 AM | http://www.thehindu.com/opinion/op-ed/c-rangarajan-writes-reforms-are-here-to-stay/article8902538.ece