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**Indian Economic Reforms: A
Stocktaking**

by

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Introduction

Indian economic reforms of 1991 represent a radical shift from the dysfunctional development strategy of the previous four decades. The pre-reform strategy pursued import-substituting industrialization, with the state playing the dominant role in the economy. Its foundations were laid prior to independence and attracted wide support across the political spectrum. As such, there was no significant political support for reforms until 1991, when a serious macroeconomic and balance of payments crisis forced a rethinking of the development strategy.

Until the early eighties India's macroeconomic policies were conservative. Current revenues of the Central Government exceeded current expenditures so that there was a surplus available to finance in part the deficit in capital account. In the early eighties, because of lax fiscal policies, current revenue surpluses turned into deficits, so that the government had to borrow at home and abroad, not only to finance its investment, but also its current consumption.

External borrowing was largely on concessional terms from multilateral lending institutions and from bilateral, government to government external aid until the eighties. As the eighties wore on, the government also resorted to borrowing from abroad on commercial terms both from the capital market and non-resident Indians (NRIs). In 1983-84, out of \$22.8 billion of public and publicly guaranteed external debt, roughly 17% was owed to private creditors. On the eve of the macroeconomic crisis in 1990-91, external debt had tripled to \$69.3 billion, of which around 30% were owed to private creditors. Thus debt to private creditors grew five-fold in seven years. Since the gross fiscal deficit was too large to be financed entirely by drawing on savings (domestic and external) part of it was monetized.

Although fiscal expansionism was unsustainable, with some liberalization in the form of delicensing of some industries and permitting flexible use of capacity in others through changes in product-mix within the licensed capacity under so-called “broad banding”, and relaxation of some import restrictions, it did generate growth. The average annual rate of growth of real GDP in the sixth and seventh plans, which covered the eighties, was 5.5% and 5.8% respectively, much higher than the so-called Hindu rate of growth of 3.5% of the earlier three decades.

By 1990-91, the gross fiscal deficit had grown to about 10% of GDP. If one includes the losses of non-financial public sector enterprises, the consolidated public sector deficit stood at around 10.9% of GDP in 1990-91, of which nearly 4.3 percent of GDP was for interest payments on domestic and external debt. An analysis by Willem Buiter and Urjit Patel (1992) showed that unless corrective steps were taken, India faced fiscal insolvency.

The rising fiscal deficits, and the steep rise in oil prices during the Gulf crisis of 1990, put pressure on prices and the exchange rate, fueling expectations about imminent devaluation of the currency. Political instability in 1990, as reflected in two changes of prime ministers within a year, led to a lack of confidence of non-resident Indians (NRIs) in the government's ability to manage the economy. The expectation of a devaluation of the rupee and the fall in confidence, led to the withdrawal of their deposits in Indian banks by NRIs and withdrawal of capital by other external investors. Foreign exchange reserves dwindled to a level that was less than the cost of two weeks worth of imports. The specter of default on short-term external loans loomed and led to a downgrading of India's credit rating. The government approached the World Bank and the International Monetary Fund for assistance and also undertook systemic reforms.

The major thrusts of the reforms of 1991 related to measures to address the macroeconomic and balance of payments crisis through fiscal consolidation and limited tax reforms, removal of

controls on industrial investment and on imports (other than consumer goods initially), reduction in import tariffs, creation of a less unfavorable environment for attracting foreign capital, prudent management of movements in the exchange rate while allowing market forces to play a major role in its determination, making the rupee convertible for current account transactions and finally, opening energy and telecommunication sectors for private investment (domestic and foreign).

1. Achievement and Shortfalls

1.1 Fiscal Consolidation and Reforms

Measured by the ratio of gross fiscal deficits of the centre and state governments, the objective of fiscal consolidation has not been achieved at all. The Central Government's fiscal deficit, having fallen from 6.6% of GDP in 1990-91 to a low of 4.1% in 1996, rose steadily to 6.1% in 2001-02. The revised estimate for 2002-03 is 5.9%, and the budget estimate for 2003-04 is 5.6% (GOI, 2003, Table 2.1; p. 15). The gross fiscal deficit of state governments, after falling from 3.3% of GDP in 1990-91 to 2.4% in 1993-94, has since risen to 4.6% in 2001-02 (revised estimate). The deficit for 2002-03 is estimated at 4.4% in the budget. The consolidated gross fiscal deficit of centre and states together rose from 9.4% of GDP in 1990-91 to 10.0% in 2001-02 (revised estimate) (GOI, 2003, Tables 2.10 and 2.11). Government of India sources do not provide estimates of consolidated deficit of the public sector as a whole. The International Monetary Fund (2002) reports the consolidated deficits of centre, state and central public sector enterprises rose from 8.7% of GDP in 1996-97 to 11.3% in 2000-01. No matter which indicator of fiscal performance one uses, the utter failure to achieve a significant reduction in the fiscal deficit relative to the pre-reform year 1990-91 is striking.

Two task forces, one each on direct and indirect taxes, both chaired by Vijay Kelkar, recommended measures for simplification and rationalization of the tax system. The main recommendations in their report, submitted in December 2002, included raising the exemption limit of personal income tax, rationalization of exemptions, abolition of concessional treatment of long-term capital gains and of the wealth tax, widening the indirect tax base, removal of exemptions, and expansion in the average service tax, etc. The Finance Minister virtually ignored the two reports in his budget for 2003-04. The long-awaited move to a value added tax in the states, which was to have begun on April 1, 2003, has once again been postponed.

Explicit subsidies by the centre alone, mainly accounted for by food and fertilizer subsidies, have been rising and amounted to 1.8% of GDP in 2002-03 (revised estimate). It has been estimated that non-merit subsidies (explicit and implicit) have accounted for 11% of GDP, 4% for central and 7% for state governments. The Fifth Pay Commission had recommended in 1977 a reduction in the size of government by a third. The Expenditure Reforms Commission, which reported in 2000, had scaled back this target to a 10% reduction in size (relative to January 1, 2000) by 2004-05 and a freeze in the creation of new positions for two years. However, there has been no significant reduction of the size of government at any level. More important, no serious consideration has been given to restructuring expenditures at all levels of government taking into account their social rationale and their effectiveness. Few attempts have been made to impose user charges for the publicly provided goods and services. Finance Ministers have proposed, but had to scale back because of political opposition, reductions in fertilizer subsidies. Reduction in food subsidies would require a major reform of the public distribution system and the

operations of the Food Corporation of India. Except for attempts to target the food subsidies better at poor households, the reforms thus far have been very modest.

A Fiscal Responsibility and Budget Management Bill was introduced in Parliament in 2000 but is yet to be passed. The State of Karnataka has enacted a Fiscal Responsibility Bill, Maharashtra and Punjab have introduced a similar bill in their legislatures and Kerala is proposing to introduce one. It is too soon to tell whether such legislative measures would, in fact, be enforced.

The Central Government has set up a monitorable fiscal reforms facility for a five-year period from 2000-01. States which draw up a medium-term fiscal reform plan are entitled to receive resources from the facility. Sixteen out of twenty-eight states have availed of this until the end of December 2002. Another reform-linked assistance programme under various schemes such as Accelerated Power Development and Reform Programmes and others, as well as lump sum transfers for implementation of policy reform in sectors constraining growth and development, had been proposed in the union budget for 2002-03. Once again, it is too soon to tell how effective these attempts would be in reforming the state fiscal system.

There have been some significant changes in the tax rates, notably, a significant reduction in personal and corporate taxes. Of course, there were major reductions in customs duties. Interestingly, the share of direct taxes (essentially personal and corporate income taxes) doubled from 1.9% of GDP in 1990-91 to 3.7% (budget estimates) in 2002-03, total tax revenue increased only marginally from 15.4% of GDP in 1990-91 to 15.8% in the budget estimates for 2002-03, after falling to a low of 13.4% in 1998-99 (GOI 2003, Table 2.11). The difference in direct tax revenues has been largely offset by a fall in

indirect tax revenues, particularly customs revenues. At around 16% of GDP, tax revenue in India is not high compared to other developing countries. It is clear that fiscal consolidation and significant reforms of tax and expenditure systems are yet to be achieved. It is also clear that the continuing high fiscal deficit has adversely affected the ability of the government to finance essential public investment in infrastructure, physical and human.

1.2 External Sector Reforms

Import licensing was abolished. Tariff rates were brought down substantially from a weighted average rate of 72.5% in 1991-92 to 24.6% in 1996-97. Since then they have risen to 35.1% in 2001-02. Part of this increase was in response to the abolition of most quantitative restrictions (QRs) in 2000-01. India renegotiated some agricultural tariffs that had earlier been bound at low (even zero) levels at the time of removing QRs. Although successive Finance Ministers have promised to bring Indian tariffs down to East Asian levels, in the year 2000 China's weighted average tariff was 14.7%, Indonesia's 5.2%, Malaysia's 6.0%, Philippines' 3.8%, and Thailand's 10.1% (RBI 2003, Tables 7.1 and 7.1). Clearly, there is still a large gap between Indian and East Asian tariff rates. Some QRs (actually bans of some imports) are still in place, though these happen to be permitted under Articles XX and XXI of GATT for national security, environment and moral conduct reasons. Reserve Bank notes that "while removing QRs, the Government has taken several safeguard measures (adjustment of tariffs, imposition of temporary QRs, safeguard duties, anti-dumping duties and restricting imports of certain agricultural products) in order to guard against any surge in imports on account of dumping. A high-powered Standing Group functions as a watchdog on a war footing for tracking, collating and analyzing data on 300 sensitive items of importance to the public" (RBI 2003, p. VII) It is evident that

these actions are not exactly those that a government intent on removing trade barriers would take! Ironically, there was no surge in imports as feared in most of the 300 sensitive items.

India has taken the dubious distinction away from the US and EU as having initiated the largest number of anti-dumping investigations for two years in a row (2001 and 2002). What is more, that consumers of products allegedly dumped would gain from low prices and that their interests should figure in deciding anti-dumping actions seems anathema to the authorities: “To begin with there was no specific provision in the Act to take into account the interests of consumers. Secondly, there were logistic problems in contacting the so-called representatives of consumer interest as the sheer numbers could be staggering. While it was easy to consider consumer interest in the case of an intermediate good or raw material, it could become unwieldy when the concept of consumer good came up in a situation when the end users were not interested in anti-dumping and were only too happy with the cheaper product” (DGADAD, 2003, p. 92). There is no doubt whether it is whining by the US steel industry or by Indian industry against Chinese imports, the basic issue is almost always lack of competitiveness of the domestic industry rather than dumping by foreign producers. Alas, in the Doha negotiations for clarifying Article VI of GATT/WTO on anti-dumping actions, India has chosen to propose restrictions on their use rather than banning them altogether.

On export promotion, India is trying to emulate China by creating Special Economic Zones (SEZs) “in order to promote export production in a hassle-free atmosphere” (RBI 2003, Box VII.2). In fact, India had created an Export Processing Zone (EPZ) in Kandla long before China’s opening to the world economy in 1978. Yet, except

for providing duty-free access to imported products, not much else (particularly good infrastructure) distinguished Kandla from the rest of India. It is no surprise that Kandla as an EPZ did not take off. The lesson from Kandla is that it is not enough to remove bureaucratic hassles; if the necessary infrastructure (physical and human) that would ensure international competitiveness is absent, EPZs and SEZs are unlikely to succeed. In any case, if trade is truly liberalized, and infrastructure in the economy as a whole is improved, there would be no need for SEZs.

India's service exports have grown rapidly, from \$4.6 billion in 1990-91 to \$20.3 billion in 2001-02, driven in large part by the spectacular performance of software exports. Software exports increased from \$0.3 billion in 1993-94 to \$7.2 billion in 2001-02, with its share rising from 2.9% to 20.1% of total invisible receipts during the same period. Except for liberalization of foreign direct investment (FDI) and the abolition of QRs on computers and peripherals in 1992, it is hard to identify other elements of reform that could have contributed to the growth of the software industry and exports.

Certainly, measured by the share of trade (exports plus imports) in GDP, there has been a significant opening: the share increased from 14.6% in 1990-91 to 21.4% in 2001-02 (GOI 2003, Table 6.3). However, although India's share of world exports did increase from a minuscule 0.6% in 1993 (and even smaller 0.5% in 1983) to 0.7% in 2002, this increase is dwarfed by the phenomenal performance of China, whose share doubled from 1.2% in 1983 to 2.5% in 1993 and doubled again to 5.1% in 2002 (WTO 2002, 2003). Another indicator of India's relatively poor export performance compared to China is seen from the trend in shares in North American and European markets of eight labour-intensive commodities in which both countries could be expected to have a

comparative advantage. My calculations based on UN's COMTRADE data show that China's share in North American imports rose from 12% in 1990 to a peak of 27% during 1997-1999 and averaged at 22% for the decade of 1990-2000. India's share, on the other hand, fluctuated around an average of 1% with no trend. China's share, as well as ours, in the imports of the European Economic Community fluctuated, around an average of 3% in the case of China and 0.8% in our case. India's shallower integration and failure due to lack of domestic policy reform to avail of the opportunities in the world market limited not only the growth enhancing impact of trade reform but also, more importantly, its poverty reducing effect.

India's negotiating stance in the ongoing Doha round of multilateral trade negotiations does not appear to be that of a country that places high value on a rule-based liberal multilateral trading system. Let me cite just two examples. India is insisting on Special and Differential treatment (S and D) of developing countries, rather than asking for a longer phase-in time for a set of common rules applicable to all members of the WTO. The most extreme version of S and D treatment is India's proposal for a "Food Security Box" which includes the following measures:

- All measures taken by the developing countries for poverty alleviation, rural development, rural employment and diversification of agriculture should be exempted from any form of reduction commitments;
- Appropriate level of tariff bindings to be allowed to be maintained by developing countries as a special and differential measure, keeping in mind their developmental needs and high distortions prevalent in the international markets so as to protect the livelihood of their very large percentage of population dependent on agriculture. The appropriate levels of tariff bindings will have to necessarily relate to the trade distortions in the areas of market access, domestic support and export competition being practiced by the developed countries;
- Developing country members should be exempt from any obligation to provide any minimum market access.

The second example relates to Anti-Dumping Measures (ADMs). Instead of asking, albeit unrealistically, for the removal of ADMs as permissible trade policy measures, India as the most frequent user in the last two years, is merely asking for restricting their use.

2.2.2 Exchange Rate, Balance of Payments, External Debt and Reserves

The exchange rate was unified and a system of managed float was introduced in 1992-93. The rupee was made convertible for current account transactions in 1994. Whether, and if so under what circumstances, the Indian rupee should be made convertible for capital account transactions as well was examined by the Tarapore Committee in 1997. RBI (2003, p. VII-21-23) describes India's approach to capital account liberalization as gradualist and cites a survey by Edison et al (2002) for inconclusive empirical evidence on the effects of financial capital flows on growth. On the other hand, it could be argued that freeing capital flows would be beneficial once the distortions in the domestic financial sector are removed. The pressure to remove distortions would be much more intense if a firm commitment to move to freeing capital movements at a specified date in the not too distant future is announced. With reserves exceeding \$79 billion at the end of May 2003, such an announcement could be made now without running into serious risk of triggering unmanageable capital outflows in the short run.

External debt was particularly well managed, with short-term debt reduced substantially from 1.9% of GDP in 1991 to 0.6% of a much larger GDP in 2002. Total external debt to GDP fell from 28.7% of GDP to 20.9% of GDP during the same period. Debt service ratio fell from 35.3% of exports of goods and services, 14.1% of

GDP during the same period. Current account balance, which was deficit at 3.1% of GDP in 1990-91 was in surplus at 0.3% of GDP in 2001-02 (RBI 2003, Tables 7.13 and 7.14). By any standard, these are remarkable achievements.

Foreign exchange reserves, which had fallen to a dangerously low level of less than \$1 billion, and not enough to cover two weeks worth of imports at the height of the macroeconomic crisis in 1991, is estimated at \$79 billion, enough to cover nearly 18 months of imports at the end of May 2003. I will come back later to the question of whether this high a level of reserves and the current account surplus should be viewed as symptoms of good health of the economy. The notorious Foreign Exchange Regulation Act has been replaced by Foreign Exchange Management Act in 2000.

2.2.3 Foreign Capital Inflows

In 1991, several liberalization measures were introduced: automatic approval of up to 51% of equity in high priority industries and trading companies engaged in exporting was allowed; 100% equity was allowed in export-oriented units subject to some conditions; and NRIs and overseas corporate bodies (OCBs) were allowed to invest up to 100% equity in high priority industries. In 1996-97 further liberalization by including 13 more sectors under the 51% equity automatic approval route, extending up to 50% equity participation in three new areas relating to mining, and enhancing the equity limit to 75% for automatic approval in nine priority areas and reconstitution of the Foreign Investment Promotion Board (FPIB) were announced. In the next year, FDI in financial services was allowed through the FPIB route and fifteen non-banking financial services for FDI were identified. The automatic route for FDI approval in certain infrastructural activities was simplified. Further liberalization of

FDI was announced in each subsequent year, including permitting up to 26% foreign equity participation in domestic insurance companies in 1999, and in 2000, placing of investment in all sectors except a small negative list under automatic route for FDI approvals. Foreign portfolio investment was liberalized in 1995-96, permitting NRIs, OCBs and Foreign Institutional Investors (FIIs) to invest up to 24% equity in Indian companies. This limit was raised to 30% in 1998-99. FIIs were permitted to invest in the Indian Government's dated securities from March 1997 and in Treasury Bills from April 1998. A number of steps liberalizing the access to Indian companies of foreign capital through Global Depository Receipts and American Depository Receipts were announced every year since 1995. External Commercial Borrowing rules and procedures were liberalized as well since 1995.

Although restrictions on foreign capital inflows of all types (FDI, portfolio and debt) have been substantially relaxed, still India is not a favourite destination for foreign capital. A large share (from 24% to 34%) of FDI—the dominant and relatively most stable component in long-term resource flows to developing countries—went to China in the 1990s. The peak Indian share was just 2% in 1995 and again in 1997. India's share of the more fluctuating private portfolio investment was, interestingly, higher than its share of FDI, but even in this component, except for four years during 1990-2000, China's share has been higher. The same holds true for official flows. India fared better only in private debt flows. Not only China, but also even smaller Southeast Asian economies like Indonesia, Malaysia, and Thailand often managed to attract more in all the categories of long-term resource flows than India until they were

hit by the recent East Asian currency crisis. In fact, even since its crisis of 1997, Thailand has continued to attract more FDI than India.

India's limited success in long-term capital inflows, particularly FDI, despite its declared intentions in this regard, might be attributed to three factors. First, heavy regulations have not completely gone after liberalization. Second, there is resistance to FDI by domestic industry in competing areas. Third, inadequacies in physical and legal infrastructure limit India's absorptive capacity, and hence its attractiveness to private foreign investors.

1.3 Industrial Reforms

Industrial licensing, irrespective of the level of investment, was abolished in July 1991 for all except 18 industries. In 1998-99, 12 of these have been removed from licensing requirements. The number of industries reserved for development exclusively by the public sector has been reduced from 17 in 1991-92 to 3 by 2000-01. These two are major reforms. The draconian Monopolies and Restrictive Trade Practices (MRTP) Act of 1969 was amended in 1991-92, removing the threshold limits of assets in respect of application of MRTP and of dominant undertakings. The Competition Bill incorporating a modern competitive law was introduced in Parliament in 2001.

On the abolition of reservation of products for production by small-scale industries (SSI), progress has been glacial. Two committees appointed by the government to study the issue seem to have come to diametrically opposite conclusions. The Abid Hussain Committee of 1997 recommended the abolition of reservation on all of the 800-odd products then reserved exclusively for SSI units. A new study group appointed by the Planning Commission in May 1999 is apparently in favour of retention of reservation for

many products. Thus far, from 1997 until May 2002, in all only 88 products have been de-reserved. De-reservation of 75 more has been announced by the Finance Minister in his budget speech in 2002-03. Rakesh Mohan's (2002) paper for the first Indian Reforms Conference at Stanford documented the cost of the SSI reservation policy. The Reserve Bank (2003, p. VIII-4) is merely stating the obvious when it describes the policy as an anomaly, now that products manufactured elsewhere by large scale units could be freely imported. The policy merely excludes Indian large firms from entering the market. Clearly, if there are scale economies, international competitiveness of these reserved items with high export potential (of which there are many) is adversely affected. The sooner the Hussain Committee's recommendation to abolish all reservation is implemented, the better.

Abolition of industrial licensing and relaxation of restrictions on FDI have substantially eliminated barriers of entry into industry. However, the exit of unviable and uncompetitive units is still significantly constrained by the Sick Industrial Companies Act (SICA) of 1985; labour legislation, particularly the Contract Labour Act of 1970; the Industrial Disputes Act of 1948; and bankruptcy provisions of the Companies Act (CA) of 1956. A bill to repeal SICA was introduced in Parliament in 2001 and is yet to be passed. Bills amending CA have been introduced in 2001-02. Although former Finance Minister Yashwant Sinha had proposed raising the limit to 1,000 from 100 of the size of employment in a firm for it to require government permission to close down, this proposal has not been enacted.

Manufacturing production recovered rapidly from negative growth of -0.8% in the crisis year of 1991-92 to a peak of around 14.1% in 1995-96. It has since declined rapidly to 2.9% in 2001-02 (RBI 2003, Table 3.18). The share of industry in GDP has hardly

changed, from 24% in 1990 to 25% in 2000 (RBI 2003, Table 3.15). The share of manufacturing industry in GDP has also stagnated at 17% during the 1990s. Growth of employment in manufacturing was negative at -2.1% in the latter half of the nineties (RBI 2003, p. III-27).

RBI (2003, Table 3.25) summarizes the available empirical estimates of total factor productivity growth (TFPG) in Indian industry. Given the well-known methodological problems in estimating TFPG and also the measurement errors and biases in the data on inputs, outputs and prices, it is not surprising that the estimates differ widely. This being the case, one cannot be definitive about the contribution of reforms to productivity growth. Nonetheless, RBI categorically states that, “The productivity growth in the manufacturing sector seems to have declined during the 1990s and more so, in the latter phase of the reform period, primarily as a sequel to the faltering pace of structural reforms, the binding infrastructure constraints and the lack of required industrial restructuring—all impinging on the competitiveness of Indian industry” (RBI 2003, p. III-40). Since RBI has not specified its analytical framework and the mechanisms through which the various factors (structural reforms, infrastructure constraints and restructuring) contribute to competitiveness, it is hard to judge the validity of this categorical assertion.

I would argue that the primary mechanism of productivity gain, namely increased competition allowing more efficient firms to enter and less efficient firms to exit, has not been that much evident in India. First of all, although abolition of import licensing and reduction of tariffs allowed greater import competition, the devaluation of the rupee in 1991 cushioned this effect to some extent. Also, the removal of quantitative restrictions on imports did not take place until 2001. Exit continues to be difficult for various reasons

explained earlier. As such, a priori, one would not have expected dramatic gains in productivity during the first decade of reforms. In sum, not much by the way of acceleration of growth of industrial output and improvement in efficiency has happened yet and will not happen unless the reform process is extended and deepened.

2.3.1 Disinvestment and Privatization

Disinvestment of equity in Public Sector Units (PSUs) was started in December 1991 and a Disinvestment Commission was set up during 1991-92 for identifying PSUs for equity disinvestment and for suggesting modalities of disinvestment. A Department of Disinvestment, later made into a Ministry was created. The pace of disinvestment was extremely disappointing during the first decade of reforms, with realized revenues from sale of public equity being modest (roughly 35% of the target of Rs. 78,300 crores were realized in the period 1991-92 to 2002-03 (GOI 2003, Table 7.22)) and with only one enterprise, a bakery having been fully privatized. The successful privatization of BALCO, particularly its affirmation by the Supreme Court after it was challenged, changed the climate for privatization for the better. However, an initial postponement of disinvestment in two petroleum enterprises (BPCL and HPCL) primarily due to disagreements within the cabinet on the wisdom of disinvestment, as well as the abandonment of proposals for disinvestment of Air India and Indian Airlines suggest that political economy considerations are still unfavourable to large scale disinvestment, even though concerns about likely retrenchment of workers after privatization seem to have been exaggerated. The government has made a suo-motu statement in both houses of Parliament in December 2002, laying out the objectives of disinvestment as “to put

national resources and assets to optimal use and in particular unleash the productive potential inherent in our public enterprises” (GOI 2003, p. 150).

However, there does not seem to be any interest in a thorough examination of the social rationale for existing enterprises to continue to be in the public sector. Those for which there is no such compelling rationale should be privatized, regardless of whether they are making profits. The policy of disinvestment—consisting for a long time of a sale of a part of the equity in an enterprise (not necessarily to private agents)—has not been a meaningful substitute for a well-thought-out policy of privatization. The percentage of disinvested equity has typically not been enough to give buyers control over operations and management and thus has not brought in market incentives.

Political support for privatization is unlikely, however, until the labour laws are reformed and workers that would be likely to be laid off from overstuffed Public Sector Units (PSUs) after privatization are reasonably confident that they can secure alternative and equally remunerative employment in a rapidly growing economy. The successful privatization of BALCO, and the sale of significant share of equity in Videsh Sanchar Nigam Limited as well as Maruti Udyog Limited and other firms to private investors, appears to have significantly changed the climate for privatization. As a recent observer notes: “Long a source of controversy, privatization is rapidly becoming a matter of routine. Since the start of the year, India has sold more government-run firms than it did in the previous decade. No fewer than 17 companies—some large, some small—have moved from public to private hands, bringing the government an expected \$2 billion” (J. Slater, “Privatization Is Routine in Once Socialist India,” *Wall Street Journal*, July 5, 2002).

2.4 Infrastructure

2.4.1 Power

This is one of the crucial infrastructural sectors. Yet it is also the sector in which the reforms are yet to have any significant impact. At the beginning of reforms, electricity generation, transmission and distribution were all parts of fully-integrated public sector monopolies. Although there are some generating plants run by the Central Government (including all nuclear power plants) accounting for a quarter of the nation's generating capacity, a much larger share is owned by State Electricity Boards (SEBs). The sale of electricity by SEBs to agricultural and non-commercial users has been heavily subsidized. Theft of electricity (euphemistically called part of transmission and distribution losses) has been significant as well. The average recovery of cost of generation, transmission and distribution through tariffs has fallen steadily from 82.2% in 1992-93 to 68.6% in 2001-02 (GOI 2003, Table 9.5). The rate of return on investment in the state power sector was an appalling -35.4% in 2002-03 (GOI 2003, Table 9.4). The failure of power sector reforms is in large part due to the failure to reform the functioning of SEBs.

In October 1991, the relevant legislation was amended to permit private enterprises to enter power generation. A scheme to attract domestic and foreign investors into eight "fast track" projects was formulated in 1994-95 which included the provision of counter-guarantees by the Central Government of payments to private generators for their sale of electricity to SEBs in case they failed to pay and their owners, the state governments, also failed to pay. The most infamous of the fast track projects is the massive Dabhol power plant in Maharashtra of ENRON which is

currently completely idle! The saga of ENRON and the withdrawal of several other foreign investors in power generation is well known.

Briefly stated, except for privatization of distribution in Delhi and Orissa, not much else has been privatized. Even after a decade of opening up of power generation to the private sector, only 10% of the generating capacity is in private hands. Several states have unbundled generation, transmission and distribution into distinct entities. A Central Electricity Regulatory Commission and several state electricity regulatory commissions have been established. The Central Government has been signing memoranda of agreement with states to undertake reforms in a time-bound manner. The Central Government also (in effect) bailed out SEBs of their dues to Central PSUs. An accelerated power development program has been launched to assist states in the reform of distribution. An Electricity Bill has been introduced in 2001 in Parliament to provide a legal framework for enabling reforms and restructuring of the power sector.

It is too soon to tell whether the basic issues of pricing power appropriately and reducing the extent of cross-subsidization will be squarely faced by the regulatory agencies and state governments. According to RBI, the state electricity regulatory commissions have already identified “governance as the primary issue. The governance issue arises because of the complicated structure, inadequate information flows to the field offices to the management, lack of action by the senior management against the non-performing executives and staff, undefined role of the political executive, absence of guidelines and norms for personnel policies, lack of transparency and finally, outdated work processes that are not in tune with the commercial status of the Electricity Corporations” (RBI 2003, III-35, Box III.5).

The outlook for major reforms of governance in the near future is uncertain at best. As long as the power sector remains a drag on the economy, the prospects for accelerating aggregate rate of growth of GDP to 8% per year or above, as targeted in the Tenth Five-Year Plan, are uncertain as well.

2.4.2 Telecommunications

Reforms have been spectacularly successful in this sector. Value added services were opened to private sector in 1992, followed by the enunciation of the National Telecom Policy in 1994-95 which opened up basic telecom services to competition. Foreign equity participation up to 49% was permitted in case of a joint venture between an Indian and a foreign firm. The Telecom Regulatory Authority of India (TRAI) was established in 1997. In order to separate the service-providing function of publicly owned telecom enterprises and policy-making function, both of which were initially with the Department of Telecommunications, a separate Department of Telecom Services was set up in 1999-2000. Also, the jurisdiction for settlement of disputes was taken away from TRAI and entrusted to a separate agency called Telecom Dispute Settlement and Appellate Tribunal in the same year. The two public sector service providers were corporatised in 2000-01. International long-distance business, which was a public sector monopoly, was opened to unrestricted entry in 2002-03. A bill called the “Convergence Bill” was introduced in Parliament in 2001 which, inter alia, envisages the setting up of a regulatory and licensing authority to be known as the Communications Commission of India. Parliament’s Standing Committee on Communication and Information Technology reported on the bill in November 2002. The Universal Service Support Policy came into effect in April 1, 2002, under which an

universal service levy (USL) at 5% of adjusted gross revenue of all telecom carriers (except pure value added service providers) has been fixed. The Universal Service Fund, financed by the levy, will subsidize access to public and community phones in villages as well as individual household phones in net high cost rural/remote areas.

The two basic goals of reforms are: delivering low-cost voice telephony to the largest possible number of individuals, and delivering low-cost high-speed computer networking to the largest number of firms. Achievements thus far, while commendable, yet lag those in other developing countries such as China. Teledensity in India, although it more than quadrupled from 1.1% to 4.89% between 1995 and the end of 2002, is still less than a third of that in China (GOI 2003, Table 9.7). Public sector accounts for 80% of basic telephone connections, while 75% of cell phone connections are in private hands. In part because of this, rebalancing tariffs between local and long-distance telephony has become a politically charged issue, and TRAI has been put under great pressure from this perspective. If the political masters could be persuaded that tariff rebalancing will hardly affect the poor and to refrain from interfering in the decisions of the regulatory agency, prospects for further progress in the telecom sector are very bright. It is not in the national interest to let enterprises go bankrupt, as has happened in other countries, because of poor regulatory decisions under pressure.

2.4.3 Roads, Ports, Railways and Airports

Roads sector is another bright spot in infrastructure reforms. A key reform was the creation of a major new source of funding for national, state and rural road construction, called the Central Road Fund (CRF) under the Central Road Fund Act of 2000. The resources for the fund are raised through an additional excise duty on petrol

and high-speed digital (HSD). Clearly, given the close relationship between the damage to roads created by a vehicle and its fuel consumption, this is a well-designed user tax. The 50% of the duty collected from HSD is earmarked for development of rural roads. The remaining 50% from HSD levy and the entire amount from petrol levy is allocated as follows: 57.5% for development and maintenance of national highways, 12.5% for road bridges and railway-related roadwork, and 30% for development and maintenance of state roads other than rural roads. The National Highway Development Project financed by the CRF is one of the largest single highway projects in the world. It includes the nearly 6,000km of Golden Quadrilateral (GQ) connecting the four metropolitan cities of Chennai, Delhi, Kolkata and Mumbai and 7,300km of North-South and East-West Corridor. The GQ would be substantially completed by the end of this year and fully by 2004. The corridor would be undertaken during 2003-07.

Although new institutional arrangements (including private ownership of ports) have improved performance considerably, it still lags behind ports in nearby countries such as Colombo and Singapore.

Indian Railways (IR) is one of the largest railway systems in the world. Ostensibly to serve larger social interests, IR has been undertaking “certain uneconomical operations . . . so as to provide affordable transport facilities to the common man, and to carry certain essential commodities of mass consumption at low freight rates. During 2001-02 losses incurred on this account . . . constituted approximately 9 percent of total earnings . . . losses incurred on passenger services are cross-subsidized by profits earned through freight services and also earnings from higher classes of passenger travel. In addition, cross-subsidization exists within freight

services” (GOI 2003, p. 198). Given the relatively high cost of freight and poor quality of service, even long-distance cargo traffic has been competed away by road transport operators. Although Railways have undertaken several reforms to improve their functioning and to augment their resources, such as involving state governments to participate in the financing of railway projects and creation of the so-called Special Purpose Vehicles (i.e., a firm embodying a financial contract with no management or employees), until the issue of cross-subsidization is tackled, these reforms and a new non-budgetary initiative for the development of railways are unlikely to prove adequate.

The government has approved restructuring of four metro airports (Chennai, Delhi, Kolkata and Mumbai) “to make them world class . . . approval in principle has been granted for setting up new international airports in Bangalore, Hyderabad and Goa with private sector participation” (GOI 2003, p. 202).

The problem of upgrading urban infrastructure in metropolitan cities and towns is massive. Few states have devolved powers to cities and towns for planning and managing municipal services. FDI for development of integrated township, permitted since 2001, has not materialized.

To sum up, except for telecommunications and roads, the reform process in infrastructure is yet to take hold and yield fruits.

2.5 Financial Sector

Commercial banks were nationalized in 1969, insurance companies had been nationalized earlier. On the eve of reforms in 1991, the financial sector (other than stock markets) was dominated by the public sector. The financial system was repressed, with controls on deposit and lending rates, selective credit controls and the acquisition of a large

part of the resources of the banks by the government through cash reserve ratios, statutory liquidity ratios and so on. I can do no better than cite RBI (2003, Chapter VI) on the pre-reform situation thrust of various reforms and their overall assessment.

Until the early 1990s, the role of the financial system in India was primarily restricted to the function of channeling resources from the surplus to deficit sectors . . . Financial markets were characterized by control over pricing of financial assets, barriers to entry, high transaction costs and restrictions on movement of funds/participants between the market segments. This apart from inhibiting the development of the markets also affected their efficiency.

The main thrust of reforms in the financial sector was on the creation of efficient and stable financial institutions and markets. Reforms in respect of the banking as well as non-banking financial institutions focused on creating a deregulated environment and enabling free play of market forces while at the same time strengthening the prudential norms and the supervisory system. In the banking sector, the particular focus was on imparting operational flexibility and functional autonomy with a view to enhancing efficiency, productivity and profitability, imparting strength to the system and ensuring financial soundness.

Reforms in financial markets focused on removal of structural bottlenecks, introduction of new players/instruments, free pricing of financial assets, relaxation of quantitative restrictions, improvement in trading, clearing and settlement practices, more transparency, etc.

After a comprehensive examination of the evidence, RBI assesses the reforms as follows:

The most significant achievement of financial sector reforms has been a marked improvement in the financial health of the commercial banking sector, which constitutes the most important segment of the Indian financial system. Asset quality of commercial banks, which before the initiation of reforms was at a very precarious level, improved significantly even as the norms were tightened over the years and the economy slowed down.

The empirical evidence suggests that public ownership impinged on the efficiency of the banking sector as old private sector banks and those PSBs [Public Sector Banks], which divested their equity recently, outperformed fully Government-owned banks. However, significant improvement was observed in the performance of fully Government-owned banks in the recent years and their performance tended to converge with that of other bank groups.

While commercial banking sector showed significant improvement, the impact was not so evident in respect of other financial intermediaries operating in the system. Co-operative banking sector as a group did not show any improvement in either that stability or efficiency parameters. . . . DFIs [Development Finance Institutions], which traditionally played an important role in financing investment activity, find themselves at the crossroad. . . . On the whole, they have not been able to sufficiently reposition themselves in the changed operating environment. While all DFIs are able to maintain adequate CRAR [Capital to Risk Weighted Assets Ratio], the profitability and asset quality of some of them are becoming a cause of concern.

NBFCs [Non-Banking Financial Companies] have been witnessing significant changes. While the capital adequacy position of most of the NBFCs improved in the recent years, their profitability was adversely affected due mainly to rise in the cost of funds.

Reforms have been able to create competition in the insurance sector and give customers a wide choice not only in the matter of insurance companies but also in terms of insurance products. However, impact of increased competition is yet to be felt on the insurance penetration.

Thus, insofar as intermediaries are concerned, reforms have had a mixed impact. Improvement in the stability and efficiency parameters of the commercial banks has been the major achievement of the reform process. Reforms have also been able to enhance stability of other intermediaries, in general . . . Reforms have, however, not been so successful in bringing improvement in the efficiency as profitability of some intermediaries such as co-operative banks, NBFCs and DFIs declined in recent years due to various sector-specific reasons.

The 1990s saw the significant development of various segments of the financial market. At the short end of the spectrum, the money market saw the emergence of a number of new instruments . . . The process of financial market development was buttressed by the evolution of an active government securities market after the Government borrowing programme was put through the auction process in 1992-93. . . . The foreign exchange market deepened with the opening up of the economy and the institution of a market-based exchange rate regime in the early 1990s. Although there were occasional episodes of volatility in the foreign exchange market, these were swiftly controlled by appropriate policy measures. The capital market also deepened during the 1990s. While the sharp increase in resource mobilization through equity in the mid-1990s could not be sustained, there was a steady increase in the turnover in the secondary market. In terms of trading and settlement practices, risk management and infrastructure, capital market in India is now comparable to the developed markets.

. . . increasing integration of various segments of financial markets, the distinctions between banks and other financial intermediaries are also getting increasingly blurred.

In India, while the banking system continues to play a predominant role, it is significant to note that, as a result of various reform measures, the relative significance of financial markets has increased.

RBI rightly notes that despite substantial improvements brought about by reforms, many issues remain to be addressed: (i) Is the public sector character of the banking sector affecting its performance adversely? (ii) Would dilution of the government stake have a positive impact on the efficiency of the banking sector? (iii) Have DFIs lost their relevance? (iv) Are various components of the financial markets still largely segmented? (v) Does the erosion of boundaries between providers of various financial services call for a rethinking of the regulatory framework for the financial sector? In particular, should the existing system of a separate regulator for each segment of the sector continue, albeit with appropriate coordination among various regulators, or should there be a single regulator for the entire financial system as in the United Kingdom?

2.6 Agriculture

In agriculture, in contrast to industry, public sector did not engage in production. Also in the constitutional separation of powers, agriculture is in the domain of states whereas both central and state governments have jurisdiction over industry. However, state intervention in the sector was massive, though not always effective in all cases. Mandated ceilings applied to land ownership. Certain forms of land tenancy were outlawed, and the state stipulated some of the terms in other forms of tenancy. Inputs such as water from public irrigation systems, electricity and other fuel for pumping groundwater, and chemical fertilizers are subsidized. Government purchased (at specified prices) certain commodities such as foodgrains and sugar for the public distribution system. In principle, the

government set several prices for the same commodity such as wheat or rice: a minimum support price at which the government stood ready to purchase any amount offered for sale by farmers, a higher procurement price at which it bought specified amounts for the public distribution system, an even higher issue price at which government sold foodgrains to purchasers through the public distribution system. Finally, there was the open market price at which commodities were bought and sold outside of the public distribution system. Over time, particularly after the onset of the green revolution and the emergence of a powerful farm lobby, the distinction between support and procurement prices disappeared and procurement prices were set at ever increasing levels in response to pressure from farm lobby. Subsidies became entrenched. However, since the subsistence component of foodgrain agriculture is significant in a poor country such as India, quite a large share of output was consumed by the farmers themselves and not sold to the government or in the market. Of course, as the economy grows, the subsistence component would decline.

The purchase, transport, storage and distribution of grains for the public distribution system was in the hands of an inefficient public enterprise, the Food Corporation of India. Foreign trade in agricultural commodities (raw and processed) until very recently was canalized, that is, exports and imports were handled by state trading companies. Under the Essential Commodities Act, governments of states were free to restrict movement of agricultural commodities on private account to other states as well as within their states across districts. Also, state governments procured grain at prices which included a premium over the procurement prices set by the Central Government. There are other state interventions in agriculture, particularly provision of subsidized credit (in fact, with the lax treatment of overdues and loan forgiveness during droughts, loans in effect have become

grants!), crop insurance, and agricultural research and extension. In short, Indian agriculture was largely insulated from world markets and riddled with a number of state interventions, many of which are distortionary. It is not easy to quantify the net incentive effect of all the distortions and insulation together; Gulati and Mullen provide some estimates in their paper for the conference. Since assessment policy reform is the theme of the paper, I will not attempt it here, except to say that I do not believe that reforms have made substantial progress towards making Indian agriculture distortion free.

2.7 Social Sector

The overarching objective of Indian development has always been the eradication of mass poverty and the attainment of a socio-economic-political-legal system in which every Indian has the freedom and opportunity to live a full life according to his or her own lights. An undoubtedly important achievement is that India continues to be a vibrant democracy. The intrinsic and instrumental values of democracy for India's plural society cannot be exaggerated, notwithstanding pompous critiques such as that of Fareed Zakaria (2003).

Ever since independence, there have been a number of poverty alleviation and employment generation programmes: Government of India (2003, Box 10.3) lists twelve major programmes currently in force. Yet until growth accelerated in the 1980s, there was no perceptible decline in poverty. There can be no doubt, therefore, that accelerating average annual rate of aggregate GDP growth to at least 8%-10% and sustaining it at that level for a sufficiently long period is a necessary condition for achieving the objective within a reasonably short time horizon. While growth-oriented policies together with policies to ensure that benefits of growth are widely shared are necessary, they have to be supplemented by policies that are focused on providing opportunities to the poor to acquire

quality education and adequate health care. Significant progress has indeed been made in terms of increases of literacy, life expectancy and reductions in infant, child and maternal mortality.

A claim has been made that “the ongoing economic reforms have a human face and, in pursuance of the commitment towards development of human resources and enhancement of human well being, additional resources for the social services sector are being allocated by the Government. Suitable targets for the reduction of poverty, hunger, mortality and illiteracy have also been incorporated in the Tenth Five Year Plan (2002-07)” (GOI 2003, p. 211). Yet it is clear that many serious problems relating to social sectors in many parts of the country remain to be addressed. In particular, the potentially dire consequences if the spread of AIDS is not arrested fairly soon are yet to be fully understood both by policy makers and the public.

Although universal primary education has been mandated by a recent amendment to the Constitution, whether the elementary education system that “is besieged by numerous systemic problems such as inadequate school infrastructure, presence of single-teacher schools, high teacher absenteeism (specially in rural areas), large-scale teacher vacancies, inadequate equipment, etc.” (GOI 2003, p. 245) is capable of delivering it is an open question.

The system of primary health care is equally problem-plagued. It is recognized by the government that:

health sector reforms are a part of economic reforms. However, due care will have to be taken to ensure that the poorer segments of the population are able to access services they need. Data from the NSSO [National Sample Survey Organization] indicate that escalating health care costs is one of the reasons for indebtedness not only among the poor but also in the middle income group. It is therefore essential that appropriate mechanisms

by which costs of severe illnesses and hospitalization can be borne by the individual/organization/State are explored, and affordable/appropriate choices made. Since continuation of a universally free public health care system is unsustainable, strategies be evolved for levy and collection of user charges from people above the poverty line (GOI 2003, p. 245).

Given the utter political failure to contemplate levying user charges in other areas thus far, not much hope can be placed on implementing strategies in which levying user charges has a central role.

2. Conclusion

I will conclude with a few remarks on the contemporary macroeconomic scene, which I find paradoxical. As noted earlier, the consolidated fiscal deficit of central and state governments together was 10.0% of GDP in 2001-02 (revised estimate) and it is unlikely to be any less when the revised estimates for 2002-03 become available. On the other hand, our current account has turned into surplus, and foreign exchange reserves have crossed the \$79 billion mark. Foodgrain stocks with the government, at 50 million metric tons, are three to four times what would be required for the operational and buffer stock needs. It appears that commercial banks are holding more government securities than they are required to hold. Despite a serious drought, inflation is not an issue, and interest rates are falling. Taken together, these facts are paradoxical for a developing country such as India and suggest a rather unhealthy state of affairs.

I say so because, for a poor developing country, it would be normal for the current account to be in deficit, being financed by a capital account surplus from sustainable foreign capital inflows. And again, it would be normal for the capital inflows to support domestic investment in growth-promoting capacity. Instead, we have a current account surplus, and capital inflows are reflected in the accumulation of reserves. In our regime of managed float, I do not wish to minimize the insurance role of reserves in smoothing shocks to terms of trade and in responding to the volatility

of short-term capital flows without inducing excessive volatility to the exchange rate. Still, our reserves are far higher than our short-term external debt. It is true that reserves (at least that part which is not gold and foreign currency) do earn a positive return. However, unless I am very mistaken, the overall marginal return from reserves, even taking into account the insurance aspect, would almost certainly be much less than the return from growth-enhancing investments in the economy were the situation to be normal. From this perspective, the use of reserves for prepaying “high cost” debt makes sense only if we give up on identifying and making such investments. RBI (2003, p. VII-33) has articulated its current thinking on reserves as follows:

The prevalent national security environment further underscores the need for strong reserves. We must continue to ensure that, leaving aside short-term variations in reserves level, the quantum of reserves in the long-run is in line with the growth of the economy, the size of risk-adjusted capital flows and national security requirements. This will provide us with greater security against unfavourable or unanticipated developments, which can occur quite suddenly” (RBI 2002, qtd. in RBI 2003, p. VII-33).

It also suggests a paradigm shift in India’s approach to reserve management away “from a single indicator to a menu or multiple indicators approach. Furthermore, the policy of reserve management is built upon a host of factors, some of which are not quantifiable, and in any case, weights attached to each of them do change from time to time” (RBI 2003, p. VII-34). A nice and appropriate set of words, but concretely what they add up to is hard to say! Part of the reason for reserve accumulation is that RBI continues to buy foreign exchange so that the rupee does not appreciate too much and hurt our exports. Even so, my point would be that had the situation been normal, appreciation would have been less likely, and RBI would not have had to intervene.

Looking at the situation from a different perspective, the high fiscal deficit apparently has not put pressure on the current account. It would have, if either an increase in the fiscal deficit

reflected higher public investment expenditure, such as on infrastructure, which in turn crowded in private investment so that aggregate investment exceeded domestic savings to a larger extent, or alternatively, private investment was rising regardless of the composition of public expenditures. The fact it has not, could mean either the deficits crowded out private investment so that an increase in the fiscal deficit was accommodated by a fall in private investment, given total domestic savings, or private investment was down for other reasons, and its fall enabled the government to run higher deficits. Had there been serious crowding out of private investment, I think we would not have seen a downward movement in interest rates. Also, the fact that banks are investing in government securities, rather than commercial paper, suggests that all is not well with private investment, though I do not wish to downplay the chilling effect on the investment decisions of public sector banks because of the prospect of the management being pilloried by members of Parliament and criticized by the Comptroller and Auditor General if investments do not pan out for reasons other than poor judgment of the management.

A careful empirical macroeconomic analysis that distinguishes exogenous shocks and endogenous responses to those shocks and allows for leads and lags is necessary for us to arrive at a sound explanation for our abnormal macroeconomic scene. Unfortunately, the abysmal state of macroeconomic statistics relating to savings investment and GDP precludes such an analysis. My look at the available data suggest that funds available for financing investment by the public and private non-household sector from financial savings and capital inflows exceed the estimated investment, the difference being attributed in official statistics to errors and omissions¹. These have been large in recent years. In any case, my bottom line is that our abnormal economic scene is a reflection of our poor investment climate. Real gross domestic capital formation

¹ I discuss the problems with our macroeconomic and other data in Srinivasan (2003) "India's Statistical System: Critiquing the Report of the National Statistical Commission," *Economic and Political Weekly*, January 25-31, 2003, pp.303-06.

(RGDCF) by the private corporate sector as a proportion of real GDP has been declining from its peak value of 9.9% in 1994-95 and is provisionally estimated at 4.9% in 2000-01, and quick estimates for 2001-02 put it at 4.8%. RGDCF in the public sector has declined to around 6.4% of GDP in 2000-01 from its peak of 8.7% in 1994-95. As we all know, our aggregate growth has declined from a peak of nearly 7.5%, reached in 1996-97—it touched a rock bottom of 4.4% in 2000-01. In my darkest moments, I feel that 5% to 5.5% per year represents the early twenty-first century version of the infamous “Hindu” rate of growth of 3.75% per year during 1950-80, adjusted for the much lower share now of agriculture in GDP and larger share of services. I am not entirely reassured by the expected growth of around 5.6% (quick estimates) this fiscal year (2002-03) and lower advance estimates of 4.4% for 2002-03. I cannot help feeling that without corrective action the economy might be converging to the revised “Hindu” rate of growth. Needless to say that just as the old “Hindu” rate of growth was woefully inadequate to make a dent in our massive poverty and did not, the new “Hindu” rate of growth will not either.

I do not want to be unduly pessimistic. I have no doubt that the Tenth Plan’s target rate of 8% growth per year is eminently feasible. First of all, India’s average annual growth rate was close to 6% since 1980, with a peak rate of 7.5% in 1996-97. An acceleration to 8% from this base is not a substantial jump. Second, our current macroeconomic scene is one of a subdued investment climate, which in turn means that once the climate is changed for the better (or to use Keynes’ colorful phrase, “animal spirits” are revived) the comfortable stock of foreign exchange and food reserves would enable higher investment rates to be sustained without fear of igniting inflation or running into unsustainable current account deficits. Third, a better domestic investment climate would also attract more foreign direct and portfolio investment.

The corrective actions needed to revive investment climate and to accelerate growth are well known and I have already alluded to them in the previous section. These are, not necessarily in order of importance: fiscal consolidation, including significant tax and expenditure reforms as well as rethinking of centre-state fiscal arrangements; further opening up of the economy to foreign trade and investment, including a credible commitment to capital account convertibility of the rupee at a specified date in a not too distant future; alleviating infrastructure constraints bringing in greater private sector involvement as well as public investment; rethinking of the involvement of the state in the production of goods and services, followed by privatization of activities which have no social rationale for being in the public sector; and finally, legal reforms including, most importantly, reform of labour and bankruptcy laws.

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