PLANNING STRATEGY AND THE POLICY FRAMEWORK : SOME ISSUES FOR THE EIGHTH FIVE YEAR PLAN

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1. Introduction :

The Seventh Five Year Plan is about three years old. With just about two years to go before its completion, the formulation of the Eighth Five Year Plan would be soon under way. Discussions have already been initiated on a wide range of issues relating to the Eighth Plan. The Prime Minister himself has, in recent times, expressed his anxiety to re-orient the process of planning so as to make it more effective in attaining the basic goals of amelioration of poverty and raising the standard of living in the country. This, therefore, is an opportune time to identify the changes in the broad strategy of planning as well as the policy design which are required for this process of re-orientation. This paper addresses some of the issues relating to this re-orientation process.

Broadly speaking, a development plan has three distinct components : first, the basic objectives; second, the broad strategy to achieve these objectives; and finally, the policy design which operationalises the broad strategies into concrete, down-to-earth action plans. Though this classificatory scheme for categorising the components of a plan is not based on any hard and fast rules, it does provide a reasonably good filing system to organise ones thoughts regarding the re-orientation of the planning process. Since the basic principle used for the classificatory scheme is the level of abstraction involved,

it can be said that the objectives of a plan are generally more abstract than the stratigies and strategies more abstract than the set of polcies. In some sense, therefore, the strategies help to bring the somewhat abstract objectives one step nearer to reality and a set of policies actually implement or operationalise strategies in practice. With this classificatory scheme, one could fruitfully ask which of these three components of planning in India ultimately require re-orientation the most.

Cut to its essentials, the basic objectives of Indian planning were : amelioration of poverty and a sustained increase in the standard of living in the country along with a reasonably equitable distribution of this increase in the standard of living. People of all persuations would, in general, agree that these are highly desirable objectives. Therefore, there does not appear to be any need to re-orient these basic objective of planning in India. The same cannot, however, be said about the overall strategies and the specific policy design adopted to achieve these objectives. Without overstating the case, it can be maintained that both the broad strategy and the attendant policy framework which were adopted to achieve the objectives of planning require re-orientation. The rest of the paper substantiates this basic contention.

The agrument that the strategy and the policy framework underlying planning needs re-orientation should not be construed to mean that we need to "dismantle" planning and that everything should be left to be

determined by the "free market". On the contrary, it simply makes out a case for re-orientation or modification of the strategies and policies of planning so as to make the planning process more effective in realising the basic objectives.

2. Development Strategy and the Policy Design : A Brief Review.

The Indian Five Year Plans, atleast the recent ones, contemplate two broad ways of achieving the objectives of amelioration of poverty and a sustained increase in the standard of living in the country. One is through a sustained growth of national income and employment and the other through certain "direct" anti-poverty programmes. Thus, essentially the approach to achieving the basic objectives of poverty all eviation and equitable growth was a combination of the "trickle-down" theory of growth proliferation, and the "pull-up" theory emphasising the importance of "direct" anti-poverty programmes. Such a basic approach to achieving the objectives of planning does not appear to be inherently defective, although different people would assign different weights to the trickle-down effect in comparison with the pull-up effect. In fact, it is even possible to argue that given the "mixed economy" framwork of Indian planning, such an approach to achieving the objectives of planning was but natural. The basic approach of Indian plans that growth would impact on poverty and that this when supplemented by direct anti-poverty programmes would help ameliorate poverty, thus, appears to be highly sensible.

The adequacy and the apropriateness of the strategies adopted to achieve faster growth as well as the policy design which was evolved to operationalise the growth strategy, have, however, been a matter of controversy in recent

years.

Professor Sukhamoy Chakravarty's recent book on development planning in India provides an extremely lucid account of the main features of the growth strategy underlying the Five Year Plans. Though some aspects of this growth strategy have undergone changes form one Plan to the other, it is possible to discern that part of the strategy which has more or less remained the same in the last few Plans. As Professor Chakravarty shows, the growth strategy followed in the Indian plans was, in turn, largely dependent on the planners' perception of the dominant constraints on economic growth.

Stripped to its bare essentials, the broad strategy of growth adopted in the Five Year plans were based on the planners' perception that:

(1) the key constraint on growth is the volume of investment and that the major constraint on investment is savings, mainly domestic savings- a predominantly supply-side view of the basic constraints on growth,

(11) the market mechainsm cannot be relied upon to perform efficient allocation of resources in a large number of areas of economic activity- the inherent tendency to look upon the public sector as the engine of growth, and

(111) foreign trade does not provide a viable option for reaping the benefits of comparative advantage (or minimising the costs of comparative disdvantage) and hence as a major source of growth - the genesis of import-substituting foreign trade regime.

The first of these perceived constraints led the planners to put a strong emphasis on raising the savings rate in the economy. The second perception of the planners, when coupled with the first, led to an inbuilt public sector bias in the growth strategy. At the minimum, this invariably led the planners to think that a better plan is always the one with larger public sector outlay: to break the investment constraint on growth, planners almost always attempted to step up public sector outlay. To finance the increased outlay, more and more resources had to be transferred from the household sector to the public sector. Thus, given their perception of the dominant constraints on growth, it was a short step for the planners to move from a strategy which called for raising the overall investment and the saving rate in the economy to one which argued for higher public sector outlay and larger resource transfers to the public sector. The third perception of the planners on growth possibilities through foreign trade, based primarily on the familiar export-pessimism argument, added another dimension to the growth strategy- an inward oriented import-substituting, foreign trade regime.

Thus, the basic growth strategy of our Five Year

Plans had three basic components: an atempt to raise the saving rate in the economy, an emphasis on higher public sector outlay and larger resource transfers to the public sector and an inward-oriented foreign trade regime.

A given development strategy can more often than not be operationalised by more than one set of policies. Hence, there is a need to select a particular policy framwork to operationalise a given strategy. For example, to operationalise the strategy of large scale resource transfers to the public sector, one could either use the instrument of taxation(and within this various forms of taxation) or the instrument of public borrowings (once again, this could be done either through the interest rate mechanism, or through the statutory restrictions on the financial system). Similarly, the strategy of import substitution could be operationalised either through the tariff policy or through a scheme of quotas and direct controls on imports. Therefore, to operationalise a development strategy there is a need for a policy framework.

The specific policy framework which the government evolved over the years to operationalise the development strategy has three distinct features :

(1) reliance on direct controls on output, prices and investment in the various domestic sectors through such instruments as industrial licensing, price controls, capital issues control and credit rationing.

(11) resort to quota restrictions and direct import controls rather than to tariffs to implement the import-substitution strategy, and

(111) dependence on taxation,(mainly commodity taxation) and statutory restrictions on the uses of funds of the financial system as the mojor instruments to transfer resources to the public sector.

Thus, a growth strategy with a pronounced bias in fovour of public sector investment on the domestic front and import substitution on the foreign trade front was to be operationalised by a policy framework which relied more on direct, physical controls rather than on a scheme of incentives and disincentives as instruments for both resource mobilisation and resource allocation.

It is tempting to ask whether and to what extent the growth stategy and the attendant policy framework has succeeded in achieving the objective of faster growth. So much has been written on this issue that it is difficult to give a cut and dried, consensus view on it.

The growth strategy and the policy framework have been highly successful in raising the overall savings rate in the economy. The domestic savings rate which was about 9 percent in the early '50s has more than doubled by the mid-seventies and more or less remained at this high level since then. In its own right, this is a significant achievement. Hand in hand with this increase in the savings rate, the

domestic investment rate has also increased correspondingly. Except for a slow-down in the second half of the '60s, the rate of public sector investment has also gone up substantially. Public sector investment as a proportion of gross domestic product has increased from about 3 per cent in the early '50s to about 13 percent in the '80s. This has also been accompanied by a substantial increase in the tax-to-GDP ratio as well as in the ratio of government borrowings to GDP. The tax-to-GDP ratio has consistently gone up from about 8 percent in the early '50s to about 18 percent in the '80s. Net domestic borrowings by the government formed about one percent of GDP in the early '50s, currently, it is about 8 per cent. As for reducing the import content of domestic production through import substitution polices, results are somewhat mixed. There are industries in which the import content has gone down substantially side by side with industries in which it has either remained the same or has even increased over time.

Thus, on a balance of considerations, it can be said that the growth strategy and the policy framework underlying the Five Year Plans have succeeded in achieving the somewhat intermediate targets of raising the domestic investment and savings rates, a fairly high rate of public investment financed by large scale resource transfers though taxatin and domestic borrowings and a fall in the import content of certain sectors too. The end result of all these in terms of growth has, however, been fairly negligible.

In spite of the substantial increase in the savings and the investment rates, the trend growth rate of real GNP has more or less remained at about 4 per cent per annum during the last three and half decades. This phenomenon has been variously symptomised as slow down in productivity, rising capital-output ratio, high cost economy, increasing inefficiency, etc. In sum, all these more or less say the same thing : stagnant growth rate in spite of rising savings and investment rates. Because of the low and stagnant growth rate, the Plans have not been able to make any significant dent on the problem of unemployment too. First, the much spoken about transfer of surplus labour from agriculture/rural sector to the modern, industrial sector has not taken place. The percentage of population dependent on agriculture for employment has more or less remained constant over the last three and half decades. Consequently, the unemployment and underemployment rates are exceptionally high even after three and half decades of planning. A part of the blame for this less than satisfactory growth performance could certainly be attributed to the growth strategy and the policy framework evolved to operationalise this strategy. To appreciate this point, one need not necessarily go through an intercountry comparison of the growth performance of India with that of Taiwan, Korea or China.

There is, therefore, a need to examine the adequacy of the conventional growth strategy and the policy framework, especially in the context of the changed economic

situation of recent years. Such a stock-taking exercise would help a great deal in formulating strategies and policies for the Eighth Five Year Plan.

3. Re-orientation of the Growth Strategy :

Howsoever relevant and useful the conventional growth strategy may have been in the '50s and the early '60s, a large part of it has simply outlived its usefulness. The growth strategy, therefore, needs re-orientation.

First, the planner's perception that the savings rate is the major constraint on growth was perhaps highly relevant in the '50s and the '60s. This argument should not, however, be carried too far. One cannot avoid the conclusion that the impressive increase in the domestic savings rate over the years has simply not given us commensurately higher growth rates. The main emphasis of the growth strategy in the Eighth plan should, therefore, be on achieving a higher rate of growth of GDP (and employment) from the current savings rate rather than attempting to step up the savings rate itself; even if a still higher savings rate is considered imperative, this should mainly come from a higher rate of public sector savings. In that sense, the Eighth Plan period should be viewed as a period for consolidating the potential gains of the fairly high savings rate that the earlier plans have helped us to achieve.

This brings us to the important question of raising the productivity of investment. Often, this is viewed purely as a technological question. In the last few years, therefore, considerable emphasis has been placed on the upgradation of technology both in the public and the private sectors. Certainly, this is a move in the right directin and needs to be given top priority in the Eighth plan. Side by

side with this, there is a strong need to concentrate on using the upgraded technology efficiently.

Even if all the sectors in the economy are technologically upgraded, there is still no guarantee that the upgraded technology would be used efficiently. A common way in which such inefficiency would show up is in the form of substaintial under-utilisation of capicity in the economy. This would result in low productivity of investment in spite of technological upgradation. Thus, besides concentrating on the upgradation of technology, the strategy for raising the productivety of investment should seriously consider the whole question of using the technology efficiently. Plan-related isssues which seem to of be crucial importance in this context are:

(i) a fresh look at the nature and scope of public sector investment;

(ii) grater emphasis on developing a healthy environment for the efficient functioning of the domestic market mechanism; and

(iii) exploration of the possibilities of using "foreign trade" as a source of increasing productivity and growth.

3.1 Nature and Scope of Public Investment :

In recent years, a large number of experts, irrespective of their ideological leanings, have argued that one of the major reasons for the inefficient use of the national savings and hence the low productivity of

investment in the economy is the low productivity of public investment. This low productivity has manifested in ways more than one. A common way in which it has manifested in recent years is in the form of a substantial increase in the capital-output-ratios. It is true that capital output rtios have generally gone up in the economy in the last two decades. However, the rise in capital-output ratios is particularly prominent in the industries belonging to the public sector, and in industries where both the public and private sectors coexist, being larger in the former than in the latter.

Not all of this low productivity of the public sector enterprises is due to technological reasons. This can be seen from the widespread under-utilisation of capacities in the public sector industries. Capacity utilisations are extremely low for electricity generation which is almost entirely in the public sector, and in other key sectors like basic metals including steel, non-electrical machinery and transport equipment, which are all dominated by public enterprises. What is even more important is that in sectors where public and private ownership coexist, capacity utilisation is often lower in the former by 15 to 20 percentage points. In 1985-86 the latest year for which we have the data, of the 189 commodity producing units in the public sector under the Central Government, 93 of them (i.e. about 50 per cent) reported capacity utilisation below 75 per cent; roughly half of these 93 units had capacity utilisation of less than even 50 per cent. To be sure, this

phenomenon of substantial under-utilisation of capacity is not specific to just 1985-86 but has been common for atleast the last 10 years. The problem of capacity utilisation is even worse in the case of enterprises under the State Governments.

Recent studies on comparative productivity trends in the public and the private sectors also show that labour productivity, i.e., output per labour, of public sector enterprises in the manufacturing sector has fallen consistently during the period 1970-71 to 1983-84, whereas it has increased by about 64 per cent in the private sector during the same period. This sharp fall in labour productivity has, however, not prevented the average real emoluments of public sector employees from rising over time. During the last decade or so, per capita real emoluments of public sector employees, (i.e., nominal per capita emoluments deflated by the consumer price index) has increased by about 70 per cent.

These are just illustrative of the lower productivity of public sector investment; one can fairly easily multiply such examples. But that is not important; suffice it to mention at this stage that the end result of all these inefficiences in the public sector enterprises is a dismally low rate of return on a large chunk (of just under 50%) of the nation's yearly investments. Just to give a macro picture and to indicate the seriousness of the problem, as on March, 1987, an outstanding investment of about Rs.57,402

crores in the Central Government commercial enterprises yielded a paltry sum of Rs.1769 crores of profit - a return of just about 3.1 per cent. Even this was made possible by the Rs.2142 crores profit earned by the petroleum units. The enterprises in the non-oil sector had a loss of about Rs.373 crores on an outstanding investment of Rs.52,297 crores.

Some might argue that the low recorded rate of return on public sector investment should not be held against public investment because the comparable implicit social rate of return on these investments could be higher than these recorded rates of return - the familiar but mostly overstated externality argument. The widespread under-utilisation of capacity in the public sector enterprises, however, substantially weakens the force of such a defence of public investment. Further, even if for the sake of argument one agrees with the externality argument for public investment, it is almost impossible to justify public sector investments in the production of consumer goods such as tea, bread, footwear, leather goods, films, lens, newsprint, paper, vegetable oils, contraceptives, textiles, cars, scooters, bycycles and television sets and intermediate goods such as, pumps, compressors, brakes, valves, cables, picture tubes, and tyres; nor does public sector investment highly justifiable in the area of trading and marketing or in the provision of road transport services. Yet, the investment of Central Government public enterprises alone in these areas outstanding as on March, 1987 amounted to

approximately Rs.10,000 crores yielding a net loss of about Rs.350 crores. A lot more such loss making investments have been made by the State Governments too. For example, in 1985-86 the State Road Transport Corporations incurred a loss of Rs.226 crores on a block capital of Rs.1882 crores. Public investments in such areas of economic activity not only constitute a major drag on the budgetary resources but also has an adverse effect on efficiency in private sector enterprises too. To the extent private sector enterprises need to complete with only inefficient public sector units, they do not have much incentives to increase their own efficiency substantially.

The Eighth Plan should, therefore, take a fresh look at both the size and the pattern of public investment. First, the scope of public investment should be limited to areas where the social rate of return could be substantially higher than the private rate of return and sectors where there is a case for natural monopoly. Broadly, this would iclude infrastructural investments in irrigation and flood control, energy (power, coal and oil), railways, construction of roads, communication, science and technology and certain social services like education, health and family planning. To this list, one may add investments under the special anti-poverty programmes, although the specific schemes themselves need to be modified and re-oriented. In all other areas where public sector has already invested, there should be a freeze on further

investments, followed by a properly phased out process of gradual privatisation.

Secondly, even with regard to public investment in the infrastructural sectors mentioned above, emphasis should first be on making fuller use of the existing capacities before new projects of additional capacity creation are taken up. Only after the process of consolidation of the gains from past investments are completed, should there be a case for additional capacity creation through fresh investments. The whole strategy of public investment in the Eighth Plan should be one of limiting the scope to infrastructural investments, consolidating the gains of past investments in the infrastructural sectors and then and only then of expanding capacities. Limit, consolidate and then only expand should, therefore, be the key public investment strategy.

An important caveat on the coverage of infrastructural investment needs to be entered here. More conventional planners of the old vintage might treat public investment in steel, fertilizers and even heavy engineering as infrastructural investments on the ground that these involve lumpy investments which if left to the private sector would not be forthcoming on a desired scale. This argument needs to be closely examined rather than faithfully acepted. However, even if it is conclusively shown that the private sector would not be able to invest in these sectors in the foreseeable future, it would be extremely useful to implement the concept of public ownership but private

management in these sectors. This would impart the much needed efficiency in these sectors.

3.2 Market Mechanism and Indicative Planning :

Once the scope of public investment is limited basically to infrastructral sectors, only these sectors would need detailed quantitative planning. There would thus be more scope for indicative planning, especially for the other sectors in the economy. As opposed to direct controls on sectoral output, prices and investment, indicative planning would rely more on a properly framed scheme of incentives and disincentives which would work its way on output, prices and investment through the market mechanism. The success of indicative planning would, therefore, depend both on the scheme of incentives and disincentives that are evolved and the efficiency of the market mechanism.

The greater reliance on indicative planning should not be constructed to mean that the growth strategy is one of leaving everything to the free market. Rather, it argues for a re-orientation of the conventional strategy in which the planners put excessive emphasis on controlling the market mechanism to such an extent that, more often than not, it defeated the very purpose of the controls. The conventional strategy, as we have already seen, was based on an utter lack of faith in the market mechanism. It had a rather naive assumption, which development economics as such shared during the early '50s, that the Economic Man or the invisible hand cannot work in less developed economies like

India. At times, this perception got manifested in arguments of the following type : if price incentive were offerd, farmers would not respond with more production, they might even produce less; given higher wages, Indians supplied less labour, not more; a higher interest rate would make savers to save less and not a larger proportion of their income; nor would it induce firms to economise on the use of capital, etc. Even if one argues that some of these perceptions have a semblence of relevance even today, what is important is to realise that this is essentially due to the imperfections and rigidities that prevail in the various markets themselves and not due to the inherent irrationality of the Indian people per se. More importantly, it is common knowledge today that many of these imperfections and rigidities could be attributed to the highly interventionist economic policy itself. One should, therefore, attempt to remove these imperfections and rigidities so as to make the process of indicative planning more effective.

The new strategy should, therefore, concentrate on promoting a more efficient functioning of the market mechanism by minimising market imperfections, evolving institutions and a legal framework to see that the basic "ground rules" are properly framed and effectively enforced. Such an attempt is essential not only in the commodity or the goods markets but also in the labour and the financial markets.

3.3 Export Pessimism and Foreign Trade :

A third ingredient of the new strategy is a re-

orientation of the inward-looking, import substituting foreign trade regime. This strategy has led to excessive protection to domestic industries, whether in the public or the private sector. No doubt, this has helped to reduce the import content of some sectors (like chemical and chemical products, metals and metal products, machinery and transport equipment, leather and paper and paper products). This reduction in the import content is, however, bought at a phenomenal cost in terms of efficiency; protection has reduced efficiency both by directly limiting competition and by biasing the choice of technology towards capial intensity. It is true that India now produces virtually everything from pins to all kinds of machinery and transport equipment but at exhorbitantly high cost. By raising the domestic cost of production and limiting international competitiveness of our products, import-substitution strategies have also affected exports adversely.

The basis for opting for an import-substituting, inward oriented trade strategy in Indian planning was to be found in the "export pessimism" that characterised development economics in the early '50s. Once again, howsoever relevant the "export pessimism" argument was in the early '50s, it has lost ground since then. Without necessarily taking recourse to the examples of Taiwan's, Korea's or China's export performance, it can now be seriously maintained that for a wide gamut of Indian exports, the relative price elasticity is fairly high. In

this context, it is worth mentioning here that in a study of aggregate export demand elasticities for 15 developing countries, in 1974, Moshin Khan had found that Indian exports had the highest price elasticity of 1.7. More disaggregated studies of Indian exports in recent years also help us to identify commodity-wise price elasticities of Indian exports. In a recent study on Indian exports of 18 manufactured commodities/commodity groups, R.E.B. Lucas found that as many as 13 commodities have price elasticities of above unity and as many as 6 commodities have price elasticities above 2. These commodity/commodity groups with their relative price elasticities in paranthesis are : non-ferrous metals (13.3), railway equipment (6.2); cycles (3.8), sugar (3.1), steel (2.6), motor vehicles(2.5), essential oils (1.8), wool products (1.6), electric equipment (1.4), oil cakes (1.3), miscellaneous food products (1.2), leather products (1.1). Besides these, both non-electric machinery and paints and dyes have price elasticities very close to unity. A recent study on cotton textile exports finds that the price elasticity of Indian exports of cotton textile fabrics is about 4.

Once again, these are just illustrations to show that the export pessimism argument of the '50s have very little relevance in the more recent years. On a more fundamental level, the case can be made that notwithstanding the protective tendencies in the developed market economics there is a fairly good chance for Indian exports to succeed in the international market if only we reduce the cost and

improve the quality of our products. For this, along with a relaxation of the avoidable government interventions in the domestic front, there is a need to follow a trade strategy which does not discriminate between production for the domestic market and exports on the one hand and between purchase of domestic goods and foreign goods on the other - what is characterised as an outward oriented trade regime.

4. Reorientation of the Policy Framework :

For operationalising the new strategy of growth, there is a need to re-orient the policy framework. It is beyond the scope of this paper to spell out the nitty gritties of the plan of action which are required for this re-orientation of the policies. Therefore, what is attempted here is to indicate the broad contours of action that are required for this reorientation process.

The strategy of fruitfully limiting the scope of direct public sector investment to only infrastructural activities would call for : first, working out a set of measures to increase the efficiency of the existing public sector units in the infrastructural sector and secondly, identifying those public sector units in the non-infrastructural sectors which can be privatised over a reasonable period of time.

The first set of issues would call for evolving a policy framework in which the management of these public sector units could have more autonomy in day-to-day functioning and responsibility for the ultimate performance and more streamlined labour laws to help a better involvement and participation of labour in the affairs of the company. Broadly, this set of measures are required to emphasise the "enterprise" dimension of these public enterprises. A number of committees (for example the Jha Commission on Administrative Reforms, the Sengupta Committee on public enterprises and the Economic Advisory Council) have examined various aspects of this set of issues over the last three to four years. Some of the recommendations of

these committees have been implemented by the government. This is a step in the right direction in that it gives the proper signal. However, for more effectiveness of the government's efforts, a lot more than just providing signals needs to be done.

Besides emphasising the "enterprise" dimension, the issue of increasing the efficiency of public sector units also involves the whole question of modernising the existing public sector units in the infrastructural sector. Policies relating to how to finance the modernisation schemes, whether it should be financed by budgetary support (and if yes, to what extent) or whether funds have to be raised from the capital market etc. needs to be addressed.

On the strategy of privatising the public sector units in the non-infrastructural sectors, a list of public sector units to be privatised over a reasonable period of time should be drawn up. Then the time-phasing of privatisation of these units should be decided upon. This is the question of which units to be privatised when. Some broad criteria can easily be worked out for this. Extent of losses as also the number of consecutive years for which the unit has incurred losses could be some of the guiding principles for this time-phasing. Finally, the exact technique of privatisation across broad sectors of economic activity in which these units are currently operating needs to be worked out. Generally, three methods or techniques of privatisation may be considered : (i) liquidation, which

involves closing down the unit under consideration and selling the assets of the unit; (ii) privatisation of ownership, in which the public sector unit is not closed down but sold as an operating unit to private sector, and (iii) privatisation of management through leasing and management contracts - the concept of public ownership but private management.

It is understood that since 1982 more than 40 developing countries have persued reforms of their public enterprises through various schemes of privatisation. Experiences of these countries as also of some of the developed countries like U.K. in the recent process of privatisation can be fruitfully drawn upon in working out the techniques of privatisation as well as its time-phasing.

The success of the growth strategy which limits the scope of direct public investment to only infrastructural sectors and leaves the investment and output decisions in the other sectors to indicative planning would depend upon the efficient functioning of the market mechanism, not just in the commodity market but in the labour and the financial markets too. Promoting market efficiency should, therefore, be the second major concern of the policy. For this, there is a need for "streamlining" the gorernment's regulatory framework guiding private sector economic activity. Note that what is required is a streamlining of the regulatory framework which need not necessarily be synonymous with "deregulation". For, not all regulations on private economic activity ecessarily impede market efficiency.

There are some government regulations which impede market efficiency and others which not only promote it but are essential for rendering "exchanges" in the market (be it in commodity, labour or financial markets) to be fair to the parties concerned. It is at times argued that India has too much of the efficiency impeding regulations and too little of the efficiency promoting regulations; even when the latter type of regulations formally exist on paper, they are not effectively enforced in practice. Streamlining the regulatory framework, therefore, requires policy reforms aimed at removing the efficiency impeding regulations along with strengthening the efficiency promoting regulations either by introducing fresh ones and/or by a better enforcement of the existing ones.

Broadly speaking, the efficiency impeding regulations range from the detailed and cumbersome licensing requirements for industrial investments, reservation of industries for small scale units, administered import allocations through quota restrictions, administered commodity price ceilings, and a set of rent control and tenancy eviction rules in the commodity and real estate markets to equally cumbersome statutory restrictions on portfolio allocation of the funds of financial institutions and artificially maintained interest rate ceilings in the financial market. In contrast, a set of properly framed rules and regulations aimed at consumer protection (against unfair trade practices such as marketing of adulterated and

impure goods which are hazardous to life, selling goods of poor quality, selling "duplicate" goods under the guise of certain well established and popular brand names and cheating through under-weighting etc) are either conspicuous by their absence or are not effectively enforced. The picture is even worse in the financial market; the regulatory framework for investor protection against malpractices such as kerb and insider trading in shares, inadequate and misleading disclosures by companies in their prospectus for public issues of shares and debentures and artificial manipulation of share prices in the Stock Exchanges, is in its infancy, to say the least. Neither are fines and deterrants against a whole range of economic offences ranging from tax evasion to smuggling very severe; nor are these effectively enforced.

In recent years, the government has made a beginning in streamlining the regulatory framework. In 1986, the government passed the Consumer Protection Act. This Act provides for setting up of Consumer Protection Councils both at the Centre and the States. The objective is to make the Councils' services easily accessible to consumers to protect them against various unfair trade and business practices. To provide protection to investors in the capital market, the government is currently in the process of setting up a Securities Industry Board on more or less the same lines as the Securities and Exchange Commission in the U.S. The Board when finally set up through a statute, would work as a watchdog over the functioning of the capital market with

investor protection as its basic responsibility. In addition, the Planning Commission has recently set up a Working Group on the development of the capital market to recommend the major policy initiatives required for the efficient functioning and healthy development of the capital market. Also, in the 1985-86 Budget along with a reduction in the income tax rates, emphasis was laid on a stricter enforcement of the tax laws.

In the sphere of removing what we have called efficiency impeding regulations too, the government has initiated a number of measures in recent years. Delicensing of certain industries, allowing broad-banding of production in selected industries, introduction of a scheme of liberal endorsement of capacity, raising the MRTP limit from Rs.20 crores to Rs.100 crores and shifting certain items of imports from the more restricted to the OGL list are some of the policy initiatives in this direction. More recently, the government is reported to be considering a proposal to raise the minimum limit for licensing requirements from the current Rs.5 crores to Rs.25 crores. Available evidence on industrial growth as well as overall capacity utilisation in the manufacturing sector indicates that these policy initiatives have yielded positive results. Note that even the worst drought-year of 1987-88 is most likely to end up with a manufacturing output growth of 8 to 9 per cent.

The tempo of the policy reform towards streamlining the regulatory framework needs to be stepped up in the future

years. Four broad suggestions are in order in this context. First, the government should broaden the scope of delicensing of industries. Secondly, the reservation of products for small scale industries should be gradually discontinued. Thirdly, direct controls on commodity prices should be applied to as fewer a number of commodities as possible. Finally, once a proper policy environment is created for an efficient functioning of the commodity market, there is a need to streamline the various interest rate ceilings and statutory restrictions on the portfolios of intermediaries in the financial market.

The government's approach to delicensing has basically been one of drawing up a list of industries which are not required to be licensed. A much more positive and flexible scheme of delicensing would be one in which the government draws up a list of industries which require licensing and leave all other industries out of the ambit of licensing. This would certainly allow for more efficient inter-sectoral allocation of industrial investment than the present scheme of delicensing. Now that even the limited scheme of delicensing has yielded positive results, the government should seriously consider this alternative, more positive approach to delicensing. Along with this easing of entry barriers, there is also a need to formulate policies to facilitate exit barriers for firms which fail without depriving labour its justifiable claims.

Besides limiting entry through licensing requirement, the industrial policy reserves more than 800 products

to be produced exclusively by small firms, i.e., firms with a value of investment below a certain level. These firms also get cheaper credit from banks and other financial institutions, tax concessions and preferential treatment in government tenders, etc. As is well-known, these reservations as well as preferential treatment are provided mainly to encourage the spread of labour-intensive technology of production. However, a number of studies have shown that the technology of many of these products of small scale industries was clearly inferior in the sense of requiring "more of capital, labour and material inputs per unit of output" than its large scale counterpart. Resources which could have been saved by producing these products by larger firms have been wasted in the process. There should, therefore, be a gradual process of "de-reserving" these areas of production; that is, firms, irrespective of their size, should be allowed to produce these products.

Direct controls of commodity prices is generally an effective measure to combat inflation only for a very short period of time. Note that historically most direct price controls have been wartime legacies. Continued for long, such controls are well known to lead to market distortions, black marketing and the associated unproductive and inefficient use of the nation's resources. Keeping this in view, it is advisable to keep the number of commodities under direct price controls to as few as possible. The recent recommendation by the Chari Committee to decontrol

coal prices is a welcome step in this direction. And, whenever direct price controls are inevitable (one thinks mainly of public sector enterprises in the infrastructure sectors here), it is desirable that these prices are set on the normative long run marginal cost pricing principle, as has been suggested in the government's White Paper on Administered Price Policy.

Along with a streamlining of the regulations on the commodity market, attention should also be concentrated on streamlining the various regulations on the financial market. Two broad areas of reform here are : streamlining the statutory restrictions on the allocation of funds by the financial intermediaries like commercial banks, insurance companies and provident funds and rationalising the interest rate structure both on the lending and the borrowings of the financial intermediaries. Under the present system, roughly 40 per cent of the funds with the commercial banks are statutorily required to be held in cash and government and other approved securities at a fairly low average interest rate of 6 to 7 per cent per annum. Another 25 per cent of the funds are required to be lent under the priority sector lending scheme at an average interest rate of, say, 10 to 11 per cent. Of the remaining 35 per cent of the funds, a large proportion is lent at administered rates ranging from 10 to 15 per cent. On the whole, therefore, the average rate of return on commercial banks' funds would be in the vicinity of 10 per cent per annum. This rate of return, then, sets the limit on the interest rate that banks pay on

the deposits. Currently, banks pay an interest of 8 per cent per annum on a one year fixed deposit. Once inflation is taken into account, this would basically amount to almost zero real interest rate. Adherence to such a low interest rate policy would on the one hand affect financial savings adversely, and, on the other encourage more capital intensive technology of production. From the point of view of both encouraging larger financial savings by households and a more rational allocation of these savings, the statutory restrictions on portfolio allocation of financial intermediaries as well as the interest rate structure needs to be streamlined.

Contrary to a popular view, a more streamlined interest rate structure would also be more equitable in that it would allow for increased access to credit by small and marginal borrowers. It is well known that when interest rates are pegged below market-clearing levels, banks tend to deny credit to small borrowers first. The reason is that under interest rate restrictions, the share of overhead costs to total cost of lending tends to be higher for small borrowers than for large borrowers. Hence, the only option for banks to maintain profitability is to lend increasing amounts to large borrowers. There are empirical evidences to show that the priority sector lending by commercial banks at fairly low interest rate benefited more the relatively richer borrowers than the relatively poorer ones. Studies have shown that the category of borrowers who borrowed less than

Rs.10,000 accounted for only about 20 per cent of the priority sector lending by banks. Taking the priority sector lending to small scale industries separately, these studies have shown that borrowers who borrowed Rs. 1 lakh and less accounted for just about one-third of the amount of priority sector lending to small scale industry; the remaining two-thirds of the amount was lent to borrowers with loan sizes of above Rs.1 lakh. Lending relatively larger amounts to a few big borrowers rather than lending the same amount to a large number of relatively poorer, small borrowers helps banks not only to minimise their average cost of lending but also to achieve the "target amounts" for priority sector lending fixed by the government. It is more than likely that if interest rate restrictions are liberalised, small borrowers would have better access to credit though at somewhat higher interest rates.

Limiting public sector investment to mainly infrastructural sectors and streamlining the regulations on economic activity in the domestic markets would go part of the way in evolving a proper policy framework for operationalising the new growth strategy for the Eighth Plan. The other ingredient that is required for an effective operationalisation of the growth strategy is a set of policies aimed at a move towards an outward-oriented foreign trade regime. Admittendly, to minimise the transitional adjustment costs in terms of balance of payment imbalances, this movement has to be gradual. The first step

in this gradual process is a shift from import quotas and administered import allocations to tariffs. Though in the last few years the government has initiated such a move by transferring some import items from the restrictive list to the O.G.L., progress has been extremely slow in this direction. Efforts in this direction need to be stepped up in the next few years. While moving from quotas to tariffs, the most important question that needs to be addressed is the tariff structure across different commodities. The long run objective in formulating the tariff structure should be to go as close as possible to a fairly low and uniform tariff structure across commodities. In the transitional adjustment period, however, it would be almost unavoidable to follow a differential tariff structure.

Though the recent literature on trade reform clearly suggests that the aim of trde reform should be one of achieving a fairly low and uniform tariff structure, it has very little to offer on the commodity-wise pattern of tariff rates to be followed in the transitional period. It only provides the broad principle that in the interim the tariff structure should be worked out in such a way as to minimise the transitional adjustment costs, both in terms of unemployment of labour and under-utilisation of capital. As each country's initial conditions are distinctly different, the desirable transition path to follow would depend on the specific institutions and economic situation of the individual countries. Simpler schemes, however, seem to

work better than more complex ones in practice.

Keeping this in mind, a tentative tariff structure for the transitional period would be as follows. First, a basic import tax rate of say, about 20 per cent could be applied to all imports. Over and above this, an additional tariff rate at varying levels could be applied across three or four broad commodity groups formed on the basis of the existing (i.e. pre-reform) ratio of imports to domestic production. The higher the pre-reform imports to domestic production ratios, the lower should be the additional tariff rate. Some exceptions to this general rule may have to be allowed for, but as a matter of principle it would be better to have as fewer exceptions as possible. In general, this would ensure gradualism in opening up the domestic sectors to import competition. Domestic sectors which have been less accustomed to import cometition till now (the ones with lower import to domestic production ratios) would be opened up more slowly than sectors which have been more accustomed to import competition (the ones with higher import to domestic production ratios). It should also be pre-stated that over a specified number of years during the transition period, the additional tariff rates would be brought down to zero, so as to achieve the end result of a uniform tariff rate across imports.

With some lag, the rationalisation of the imports through a properly framed tariff structure should help to reduce costs domestically. This should give a natural boost to manufactured exports, as it happened following even the

limited import liberalisation of the recent years. In the last year or so, manufactured exports, such as, cotton fabrics, leather and leather products, chemicals and allied products, iron and steel, and a whole host of engineering goods covering machinery and transport equipment and non-ferrous metal manufactures have recorded exceptionally high growth rates. However, to minimise the initial strains on current account deficit, some special consideration may have to be given to exports during the transitional period. For example, it may be desirable to provide exemption from imports duties (either from both the basic and additional duties or only from additional duty) for imported inputs used exclusively in the production for exports.

The success of the rationalisation of the tariff structure and the movement towards an outward-oriented foreign trade policy would depend to a large extent on the exchange rate policy as well as on the domestic fiscal and monetary policies. The real exchange rate should not be continuously kept overvalued. The best way to do this is to follow a domestic fiscal-monetary policy which is not only stable over time but also is not excessively inflationary. To a large extent, the government can then avoid frequent and large adjustments in nominal exchange rate. However, despite this if the real exchange rate continues to be overvalued, the government should not be excessively averse to adjusting the nominal exchange rate to balance the current account deficit.

5. **Direct Anti-Poverty Programmes :**

Re-orientation of the growth strategy and the attendant policy framework would be a major step forward in making the planning process more effective in the all eviation of poverty and raising the living standards. Admittedly, it would take some time for the benefitial effects of faster growth to reach the poorest of the poor, say, the bottom half of the currently estimated 222 million poor in rural India and about 51 million in the urban areas. It is keeping this in mind that the recent Plans have emphasised the importance of the direct anti-poverty programmes. This is a highly laudable approach and the Eighth Plan should give due priority for this. The specific nature of the anti-poverty programmes, however, needs certain modifications for a more effective direct attack on poverty.

As is well known, the direct anti-poverty programmes persued by the Plans fall into two broad categories : (i) programmes such as IRDP which aim at providing "self-employment" to the poor by giving the benefitiary a certain amount of money, partly in the form of cash subsidy and partly in the form of a bank loan at low interest rates and (ii) programmes such as NREP and RLEGP, which aim at providing gainful wage-employment to the poor through public works schemes such as construction of roads, schools, drinking water wells, minor irrigation, village tanks, etc.

It is by now widely agreed that the IRDP type programmes aimed at providing self-employment are largely

ineffective for reaching the poorest of the poor. A cash subsidy or a bank loan can at best help the benefitiary to acquire a physical asset (largely cattle!). But without proper rural infrastructural facilities such as rural roads, transport facilities and even markets for selling the products from the physical asset, the scheme is bound to be ineffective. Alternatively, the wage-employment programmes like NREP and RLEGP have the twin advantages of not only providing employment and incomes to the poor but also of building a wide variety of rural infrastructure in the process. Not that there are no loopholes and misuses involved in this type of programmes. But certainly, compared to the self-employment programme, these are far better in directly attacking poverty in rural areas.

The Eighth Plan should, therefore, primarily concentrate on the wage employment type programmes for implementing the direct anti-poverty strategy. A much better integration of these wage-employment programmes with the various schemes and targets of the Minimum Needs Programme is also called for getting the maximum benefit out of these programmes. A strong case, therefore, exists for scrapping IRDP altogether and provide the rsources under it to the wage-employment programme. In this context, one cannot help quoting from the Planning Commission's Document on the Mid-term Appraisal of the Seventh Plan : "It is somewhat unrealistic to expect alleviation of poverty solely on the basis of a self-employment programme like IRDP. It

is, therefore, essential that in the development strategy in the remaining years of the Seventh Plan and, particularly in the Eighth Plan, special emphasis be given to the creation of regular wage employment opportunities".