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4th G. RAMACHANDRAN MEMORIAL LECTURE
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India since Independence – Changing Contours of Economic Policies

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Mr. Ganapathi Ramachandran and other members of Ramachandran's family, and friends,

I am honoured by the invitation to deliver the 4th G. Ramachandran (GR) Memorial Lecture. I am thankful to the Southern India Chamber of Commerce and Industry and its Memorial Committee in particular, for giving me this opportunity. Any comments by me on GR's achievements or personality in this gathering are superfluous, if not impertinent, since most of you must have known him better than I did.

I will, therefore, move on to the subject of the speech just as GR would have done if he were in my place.

We are celebrating 70 years of Independence. We have also been celebrating completion of 25 years of India's economic transformation after the reform of 1991. My submission is that we should not forget that economic policies since 1991 were built on solid foundations laid brick by brick since 1947, by the generation to which GR belonged. It was that generation which made "India" between 1947 and 1972. Those foundations helped India to become an emerging economic power today. This theme will be the first part of my presentation.

Over the period of 70 years, changes in economic policies have been taking place and there have been some continuing elements also. There are several ways of analysing these changing contours. For example, Mr. Yashwant Sinha spoke about the liberalisation of the Insurance sector and more broadly about the financial sector in his first memorial lecture here. It was essentially a question of public ownership versus private ownership or more broadly the balance between State and Market. We have moved from social control over banks to nationalisation in 1969, competition between public and private sector since 1990, combination of public and private ownership in public sector banks, and now the issue of privatisation has been flagged. This is one example of changing contours of State and Market.

The second part of my presentation will relate to the broader aspects of changing balances between State and Market in India.

The third part of my presentation relates to the policy of engagement of national economy with the global economy. We started with pessimism regarding export led strategy and emphasised self reliance. We believed that global integration had more risks than rewards. But, over the years, we saw our working class benefitting from movement to Middle East; and our middle class through I.T. The consumers also benefitted with import liberalisation. Our Corporates are a force to reckon globally after liberalisation. It turned out that U.S. Corporates were hurting their middle class more than our people on account of globalisation. At the moment, U.S.A. is advocating "America First" policy and developing countries are in favour globalisation.

The fourth part of my presentation relates to India and globalisation.

The fifth and concluding part is a brief reference to recent developments in economic policies.

<u>Making India</u>

At the time of Independence, many had doubts whether India will remain united. Yet today there is far less threat to the unity of India, than perhaps Great Britain or Spain. India is now considered as an emerging power. The journey has been fascinating.

Baba Saheb Ambedkar introduced the draft Constitution in the Constituent Assembly on November 4, 1948, which proposed a Union of States amidst deep concerns about unity. I quote: *"The Draft Constitution* *has sought to forge means and methods whereby India will have Federation and at the same time will have uniformity in all basic matters which are essential to maintain the unity of the country. The means adopted by the Draft Constitution are three:*

(1) a single judiciary,

(2) uniformity in fundamental laws, civil and criminal, and

(3) a common All-India Civil Service to man important posts."

Baba Saheb adds, "The dual polity which is inherent in a federal system as I said is followed in all federations by a dual service. In all Federations there is a Federal Civil Service and a State Civil Service. The Indian Federation through a Dual Polity will have a Dual Service but with one exception. It is recognised that in every country there are certain posts in its administrative set up which might be called strategic from the point of view of maintaining the standard of administration. It may not be easy to spot such posts in a large and complicated machinery of administration. But there can be no doubt that the standard of administration depends upon the caliber of the Civil Servants who are appointed to these strategic posts."

He continues: *"The Constitution provides that without depriving the States of their right to form their own Civil Services there shall be an All India service recruited on an All-India basis with common qualifications, with* *uniform scale of pay and the members of which alone could be appointed to these strategic posts throughout the Union*."

It is no wonder that many Chief Ministers complain that IAS are gents of Union Government. But, often, when confronted with complex local controversies or agitations, they would assure the people that the Government is appointing a senior IAS Officer to enquire into the matter and give a report. While many people are unhappy with the IAS, for the common person in India, IAS still remains the least unacceptable bureaucracy. Political leadership is aware of this, and is also aware of their strengths and weaknesses.

GR belongs to the All-India Service, a service that is loyal to the State when in State; to the Union when in the Union, but above all, to the Constitution of India at all times. Often it is a difficult balancing act.

GR belongs to that group of IAS Officers who could command the trust and confidence of both the Chief Ministers of Tamil Nadu and the Prime Ministers of India.

The senior bureaucracy in India has to face challenges more complicated than those in U.S.A. or U.K. In U.S.A., the Constitution imposes constraints over rapid change by political leadership, but political leadership has the liberty to appoint loyal people to the senior positions to drive the forces of change. In U.K., there is no restraint on political leadership through the mechanism of a written Constitution, but the permanent civil service compensates for it by being a stabilising influence. In India, the political leadership is often frustrated with the double constraints, namely, a written Constitution and the permanent bureaucracy at senior level. Therefore, senior bureaucracy in IAS has to combine elements of dynamism and stability as appropriate to the circumstance. It is not that all civil servants are able to achieve this balance. GR was among those who performed well on this account also.

How does this narrative fit with the economic transformation that took place in 1991 and not before that? My submission is that India was ready for transformation in 1991 because of the foundations laid well before that. In fact, India was made between 1947 and 1972. A working Constitution and a stable federation was built which ensured political system stability even in the face of uncertainties. The language issue was settled. Four wars were fought, and after some managing and mismanaging between 1972 to 1990 we obtained the peace dividend from 1991. In any case, the acceleration in growth after 1991 is not sudden.

Our economic performance had been in a self-accelerating mode since Independence. For five decades in the first half of 20th century, the decadal annual growth rate of GDP was 1.0 per cent, but in the 50s it was 3.5 per cent, in the 60s it was 4.0 per cent, in the 70s it fell to 3.0 per cent, but picked up in 1980s to reach the decent growth rate of 5.6 per cent. The next decade saw an improvement to 5.8 per cent, and the first decade of 20th century showed a performance of 7.3 per cent. From 2010, there have been some controversies about the rate of growth itself, but by all accounts it has been one of the fastest growing major economies of the world. There are a few developing countries that have done far better, but our performance is something with which we can be satisfied, if not proud. But there are many areas of serious concern.

Where have we failed? It is in terms of social indicators and poverty reduction. Our life expectancy in 1960 was 43 and in 2010 it was 65, while in China it rose from 41 to 73. In regard to the infant mortality (for 1,000 births) in the corresponding period; it fell from 165 to 48 in India whereas in China it feels from 165 to 16. On poverty, in 2011-12, we have more poor people than the rest of the world -269 million as per Suresh Tendulkar definition and 363 million as per C. Rangarajan.

There is another area in which we seem to have failed, namely, the investments in public goods such as Parks or streets. Public policy had been focusing on provision of private goods to the people or sections of the people. In the classical debate on the relative roles of State and Market, the capitalist system expects provision of public goods to be the primary responsibility of the State. Our public policies still seem to be short in recognising the importance of public goods whether it was under socialism of Pandit Nehru or in the market oriented reforms after 1991 – a period which has witnessed all the conceivable configurations of political parties in the government.

State and Market

When we got our Independence, we decided on mixed economy model of managing economy and its first phase lasted till 1969. During this period, there were pro-State policies without being anti-Market. Government set up Steel Plants, but without nationalising the existing ones. That was a glorious period for India's openness to ideas. We had distinguished economists and statisticians visiting India, and discussing with policy makers, political leadrs and academia from U.S.A., Europe, and U.K. For example, Michael Kalecki, Jan Tinbergen, J.K. Galbraith, W.W. Rostow, Charles Bettleheim, IMD Little, Nicholas Kaldor, Gunnar Myrdal, Milton Freidman, Rosenstin Rodan. We had several volunteers, young U.S. citizens, spread all over India, participating in development work in villages. We benefitted from private sector, such as Ford Foundation, Rockfeller Foundation and Fullbright Scholarships. We were confidently welcoming ideas and support from diverse countries, scholars and private sector foundations.

The second phase started in 1969 and lasted till 1980. This was characterised by anti-market sentiment. Nationalisation of banks, Insurance

Companies, the draconian foreign exchange regulations are reflective of the anti-Market approach. Planning by definition is rationalistic approach and planning in a mixed economy enables changing mix of State and Market depending on the evolving circumstances. Instead, during this period, there was expansion of State in a uni-directional manner. We became inward looking in our policies relating to external sector.

The third phase was from 1980-1991, when we had recognised the pitfall of the anti-Market approach, and cost of inward looking policies but did not do much about it. Our policies did not reflect the fundamental changes in the optimal balance between State and Market due to many reasons, in particular, developments in technology.

What is it that we missed?

Firstly, the idea that the State or the Government can make up for all the failures of the market is not entirely correct. The State also has a tendency to fail in some respects. Therefore, it was necessary to weigh weakness of the State and the market in a given context. Secondly, the State failures happened because the Governments may be serving the interest of the group that is in power or bureaucracy in power, and not necessarily in public sector. Bureaucracy often operates to maximise the budget of individual departments and pursue their career prospects. Thirdly, regulation may be serving the interests of the regulated partly because they have to depend on the regulated for information. Finally, in the public system there is no incentive for promoting the efficiency.

The process of rebalancing which was recognised by mid 1980s at a professional level in India was not translated into actions. The delay in recognition of State failures vis-a-vis Market failures was the main reason for our lagging being the rest of the world and becoming vulnerable.

The collapse of USSR and the Gulf Oil prices triggered the balance of payments crisis in 1991.

The reform period commencing from 1991-2008 was dominated by pragmatism. However, it was pragmatism incrementally but not fundamentally. The entry of private sector was permitted or competition enhanced, but the base of large presence of State continued. However, this basically meant that deregulation resulted in private sector being liberated from choking regulation. It did not necessarily mean improvement in the functioning of the public sector. The private sector quickly adapted to the new environment and developed global ambitions. It explored the synergies available in an expanding global economy. However, the policies of the State were business friendly rather than market friendly. The gap between private sector capabilities and public sector capabilities widened. State institutions became relatively weaker.

The economic policy debates in the run up to elections in 2014 were Bihar Model or Tamil Nadu Model, but not State vs. Market. Implicitly, however, there was a popular endorsement in favour of outcomes rather than presumption in favour of market or State. Pragmatism and incrementalism were not questioned.

<u>Globalisation</u>

During the first three decades of planned development (1950-80), successive plans emphasized the need for minimising dependence on the rest of the World both for trade and finance. First, Indian planners shared the export pessimism than pervading the developing world. Secondly, the existence of a large domestic market provided scope for internalising forward and backward linkages. Thirdly, development strategy hinged upon a programme of industrialization to break through the vicious circle of backwardness. Fourthly, the availability of foreign exchange was a major constraint, especially after the running down of the Sterling balances during the 1950s. Export pessimism dominated the policy stance throughout the early decades of our planning. Accordingly, exports were regarded as a residual, a vent-for-surplus on those occasions when such surpluses were available. Import substitution was the principal instrument of trade policy and was regarded in the early years as not only the correct strategy but also inevitable in a continental economy like India.

The objective of self-reliance did not find an explicit commitment in the second and third five-year plans (1956 to 1966) which were mainly concerned with generating the foreign exchange resources required for the plans. The third plan reflected the first signs of rethinking in the policy strategy by dedicating itself to 'self-sustaining growth' which required 'domestic savings to progressively meet the demand of investment and for the balance of payments gap to be bridged over'.

Droughts and two wars in 60s landed us with a need to import Wheat from USA ("ship to mouth existence") and seek support of IMF and World Bank. We had to devalue our currency. But we opted for inward looking approach rather than outward looking approach; we believed that there was a 'foreign hand' in our difficulties. The fourth plan (1969-74) contained an articulated approach to achieving self-reliance. It was in the fifth plan (1974-78) that self-reliance was stated as an explicit objective. After a brief period of Rolling Plan (1978-80), the sixth plan (1980-85) emphasized the strengthening of the impulses of modernization for the achievement of both economic and technological self-reliance.

We sought IMF support in 1981 for structural transformation, and got Extended Fund Facility. We had the disbursement front loaded and conditionalities back loaded. We surrendered the third installment.

Rajiv Gandhi initiated in 1984 a process of modernisation in general and liberalisation of imports, autonomy for public enterprises and fiscal stimulus in particular. The process was a technocratic response and in trying to make the new economic policy painless, it made the economy vulnerable. Global events triggered a crisis on balance of payments.

There are several lessons that can be drawn from the experience of stress in 1990 and crisis in 1991.

Firstly, being a closed economy did not guarantee that we would not be affected by external sector problems. In fact, we were a closed economy but we have been continuously facing shortage of foreign exchange for decades, and in this case, a crisis.

Secondly, the crisis was triggered by war in Iraq and jump in global oil prices on top of disruption of trade with Russia. However, it was the domestic vulnerabilities that got us into serious problems. We had been living in 1980s on borrowed time and borrowed money. We liberalised imports and entry conditions for industry, but did not make corresponding adjustments in other aspects, namely, exports and exit from sick units.

Thirdly, the endorsement of International Monetary Fund was critical to our managing the crisis, even after using our gold for discharging payment obligations.

Fourthly, a number of studies conducted by IMF and World Bank on Indian economy, in a way, helped us prepare our own version of managing the crisis and managing the reform. In particular, we had differences with IMF on raising NRI deposits to meet the crisis and on capital account management. Yet, it did not hurt our relationship.

Finally, from the reform point of view, we believed in relatively open trade regime, in gradual development of foreign exchange markets and carefully calibrated capital account liberalisation. The foreign exchange budget was dispensed with.

Our view of self reliance changed dramatically since 1991 and a redefinition of self reliance since then could be as follows:

First, the reality of global trends in trade in goods and services warrants international competitiveness as a key to a sustainable trade regime. In other words, a differential approach to export sector and import of goods or services is becoming increasingly difficult to operationalise. Consequently, barriers to efficiency, especially physical and institutional infrastructure would operate against economic strength and thus against self reliance.

Second, an appropriate exchange rate policy, coupled with price stability as a component of macroeconomic policies is critical to maintain competitiveness of economy both to facilitate exports and fine-tune imports. Subsidies and incentives are at best temporary measures in extra-ordinary circumstances.

Third, vulnerability on trade account is mainly on import front and it relates to food (for which there is a more than adequate buffer stock); fuel (POL on which imports are still large); and fertilisers (which are essential). Policy initiatives to manage such potential shocks would be of value.

Fourth, on capital account, there are several developments in regard to international trade in goods and services, international business, technology, cross border flows of capital, etc. that would necessitate an active management of capital account, with a view to continuously assessing the costs and benefits of liberalisation vis-à-vis control or regulation.

Management of the capital account involves control, regulation and liberalisation. Gradualism in liberalisation implies that the mix between controlled, regulated and liberalised capital transactions keeps changing gradually. The option of re-imposing controls to meet an emergency should be kept to meet unforeseen circumstances.

Fifth, as an economy becomes more sophisticated, we need to recognise that as other countries find it profitable to invest in India, and we too can benefit from investments abroad. It is erroneous to equate all capital outflows with capital flight.

Sixth, there is a need to recognise the resource and other limitations on multilateral and other official bodies to extend adequate support if a large economy like India were to face a crisis. India has to take extra precautions to minimise vulnerability and continue to be risk averse in this area.

Finally, it is clear that while several initiatives are proposed at the global level, the task of preventing a crisis is essentially a national responsibility though an enabling international environment is sought to be put in place to facilitate action by individual countries. No doubt, in today's globalised world, prevention of crises as well as mitigating the effects require multilateral efforts, but the social consequences of such crisis are to be met by the national governments concerned. In this sense, the ultimate responsibility in regard to crisis prevention and management of external sector rests primarily on the policy makers of the countries concerned."

This approach to management of external sector has served us well. The global financial crisis required extra-ordinary measures, but the basic framework continues to determine the management of external sector.

Recent Developments

The substantive elements of economic policies remain the same since 1991 despite several changes in the political leadership. I believe that the latest change in political leadership in 2014 is not making significant difference to the continuing pragmatic approach.

The balance between the State and the Market continues to be governed by pragmatic considerations. The private sector is encouraged incrementally, but public sector does not retreat. In regard to the interface between State and Market, there is intensification of efforts to reduce collusion between the two and improve cooperation.

Capital account continues to be managed. Liberalisation of foreign investment in financial sector remains pragmatic.

The strategy of integrating with global economy continues to be the same as before, but with a tilt against round tripping.

The rhetoric of economic policies has changed and the presentation has changed; the style has changed, but the substance remains the same. The reform which was consensus based in the past is now agenda based. There is greater emphasis on implementation, a determined effort to bring about fundamental changes which were already envisaged.

However, the task ahead is complicated by the fact that building institutional framework for a modern middle income country, replacing contact based system with contract based system, is time consuming and complex.

At the global level, the trend towards globalisation has been stalled at a time when India wants to take advantage of globalisation. There are more uncertainties in regard to global economic order than ever before. Yet, India has a better standing in the global investment community than before, with prospects better than most of the developing World. The sense of optimism about the future is more in India than most other countries.

This has been facilitated by many generations, and not the current one only.

Thank you.