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The gloss is wearing off India's economic reforms

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The Indian budget for the coming fiscal year (April 1, 1994-March 31, 1995), tabled before Parliament by Finance Minister Dr. Manmohan Singh on Feb. 28, is a pointer to the difficulties the reform plan has run into. Except for meeting the targeted level of export growth and a significant rise in foreign exchange reserves, all other major sectors in the economy have either done poorly or have contracted.

As can be seen from the major medium-term trends shown in **Table 1,** growth in most key sectors was higher in the mid-1980s, but since the advent of economic liberalization in 1991, has been stymied because of austerity. The pathetic showing of the industrial sector during the past year, in addition to the growing worries about stagnation of agricultural production and overuse of the country's dilapidated infrastructure, all signal that things are getting worse for the Indian people. It is also disturbing to note that the 1994-95 budget does not address those problems, but is boiled down to the usual monetary practice of expansion and contraction of the money supply "to generate growth and control inflation."

The 1992-93 budget of Dr. Singh a year before was hailed as a breakthrough; but its assumptions were false. Having promised that the fiscal deficit would be brought down to 4.7% of Gross Domestic Product (GDP), Dr. Singh kept developmental expenditure on a tight leash. At the same time, in hopes of enhancing industrial growth, he lowered tariffs, dropped bank lending rates by one percentage point, and tried to encourage buyers by lowering the excise duties on a number of durable goods.

The cut in capital outlay further adversely affected the improvement of physical infrastructure but was nonetheless effective in keeping inflation down to a single-digit figure. The lower import tariffs in certain sectors boosted exports, and certain liberalization measures in the financial sector led to a spate of foreign currency coming in. Both these factors helped boost India's foreign exchange reserves to $13 billion over the past year.

Revenues choked

However, early into the past fiscal year, it became clear that Dr. Singh's strategy would result in a major shortfall in revenue earnings. The lowering of import tariffs did not excite industrial investors to action, nor did the lowering of interest rates, which remained "too high" at 15%. Since industry continued to stagnate, the excise cuts were not passed on to buyers. As a result, industry did not grow at a desirable rate, nor did buyers come flocking to the marketplace. It became all too clear at that point, that the government had given something for nothing: Revenues were much too little, and the fiscal deficit would be massive. Faced with this inevitability, the government jacked up prices on almost all essential commodities in order to mop up some cash and keep the fiscal deficit under control.

Despite this drastic move, the net result at the end of the fiscal year is turning out to be most unpleasant. The fiscal deficit has soared to close to 340.58 billion rupees, or about 7.3% of GDP. This is almost twice that of the previous highest fiscal deficit ever, which was recorded in 1990-91 by the unstable V.P. Singh government and was cited often as the reason why India was forced to undertake economic reforms. And despite its repeated worries over inflation, the Rao government itself fueled inflation by hiking prices of all major commodities, including that of oil at a time when the crude price internationally was going down. As a result, inflation at the end of the last fiscal year was close to 9%.

On the positive side, a most remarkable turnaround has occurred in India's foreign exchange reserves. Buoyed by foreign investments in the industrial and consumer goods sectors, large foreign portfolio investments in the financial sector, and a sharp decline in the trade deficit (due to both a drop in imports and a rise in exports), India's foreign exchange reserves have gone up to $13 billion and are still growing. As a corollary, India's foreign debt during 1993-94 went up by only $0.4 billion, and India has called off further talks with the International Monetary Fund (IMF) over securing an extended fund facility loan.

The high foreign exchange level, which amounts to about six months of India's import requirements, is backed by a 20% growth in exports over the previous year's figure. In absolute dollar terms, the 1993-94 figures indicate that India exported over $1 billion more in 1993-94 than in 1990-91 and, as a result, India's trade imbalance for the year has come down to less than $1 billion. In addition, fears among some that the Indian rupee would collapse following establishment of virtually full convertibility of the rupee in the current account announced one year ago, have been proven to be

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TABLE 1
India's basic economic indicators

Indicator	Measure	1981-82	1985-86	1989-90	1990-91	1991-92	1992-93*	1993-94*
Industrial growth	% over previous year	9.3	8.7	8.6	8.3	0.0	1.8	1.6
Foodgrain production	million tons†	133.3	150.7	171.0	176.4	168.4	180.0	179.1
Electricity generation	billion kwh	–	170.3	245.4	264.6	287.0	301.4	237.8‡
Coal production	million tons	–	154.2	200.89	211.7	229.3	238.3	165.6‡
Crude oil production	million tons	–	30.2	34.1	33.0	30.4	27.0	20.0‡
Crude oil consumption	million tons	–	40.9	54.1	55.0	57.0	59.2	39.2‡
Railway	million net ton-kilometers	–	196.6	229.6	235.8	250.2	251.5	183.89‡

* Provisional.
† All tons are metric (2,205 lb.).
‡ Figures for 9 months (April-December).

misplaced. In fact, the rupee was remakably stable, and would surely have gained over the U.S. dollar if Delhi had not intervened periodically in the market to protect India's exporters.

For the Finance Ministry, these developments mean that the country will no longer be at the mercy of the IMF or any single outside agency during 1994-95. You may recall how in 1990-91, the withdrawal of some $2 billion by non-resident Indians from Indian banks had brought foreign exchange reserves down to $1.5 billion, obliging India to face the immediate possibility of becoming a debt-defaulting nation. It is that foreign exchange crisis which brought the IMF onto the scene in the first place, with its loans tied to macroeconomic conditionalities. The Indian government has already paid off $1.4 billion to the IMF in advance against interest and some principal, and it is expected that India's credit rating among the foreign commercial banks will rise if things continue to move in the same direction. India will not have to push the begging bowl before the Aid India Consortium in Paris, and will not have to subject India's economic policies to the approval of the donor countries.

In the 1994-95 budget, India's revenue expenditures—mostly domestic interest payments, defense outlays, and various subsidies—will not be cut further. This suits the political situation, because the Rao government will be facing state assembly elections in four states during this fiscal year. Dr. Singh's lowering of direct and indirect taxes, which may generate some revenue, is also popularly accepted. But India will be incurring a very large fiscal deficit unless measures are taken to accelerate the industrial and agricultural sectors.

Misplaced optimism?

The 1994-95 budget lowers import tariffs in order to give import-based exports a push, but it remains to be seen if the tariff cuts do not pose problems to domestic industries.

Under the prevailing conditions created by Dr. Singh and the Finance Ministry in their zeal to globalize the Indian economy, it also remains to be seen whether Indian industrialists will feel confident to invest their money in new facilities with upgraded technologies. Some note that interest rates have been kept too high at 14%, which cannot be offset by the cut in corporate taxes and lowering of import tariffs on raw materials and intermediate goods. In this view, investors will continue to shy away from making domestic investments, and will opt for the lower-priced import products. As of now, finished industrial goods abroad are selling at a low price because of a worldwide recession, under-utilization of existing capacities, and the low international price of crude oil.

If and when global prices begin to move up, Indian industry may face a major crisis. Lacking adequate manufacturing facilities to meet the demand, India will have to depend more on increasingly costly imports. The process itself will hike the prices of domestic products, leading to erosion of the foreign exchange reserves, and setting up conditions for another currency devaluation, in turn making the cost of imports dearer still. Such catastrophes have occurred in many Ibero-American countries in the past, and such possibilities cannot be overlooked.

Meanwhile, in the areas of fertilizers (**Figure 1**), electricity production, and transport and engineering goods (**Table 2**), much too little has been achieved during the past 4-5 years, and because of a lack of attention to infrastructure, foreign investors will tend to shy away from making large investments in essential areas.

In the fiscal year ending March 31, industry has grown by a meager 1.6%, a far cry from the projected 5%, and about one-fifth the rate of growth achieved during the mid-1980s. Individual performance of selected industries such as steel, cement, fertilizers, machine tools, and power transformers shows stagnation. Man-made and blended textiles

FIGURE 1
Production, imports, and consumption of fertilizers
(thousands of tons)

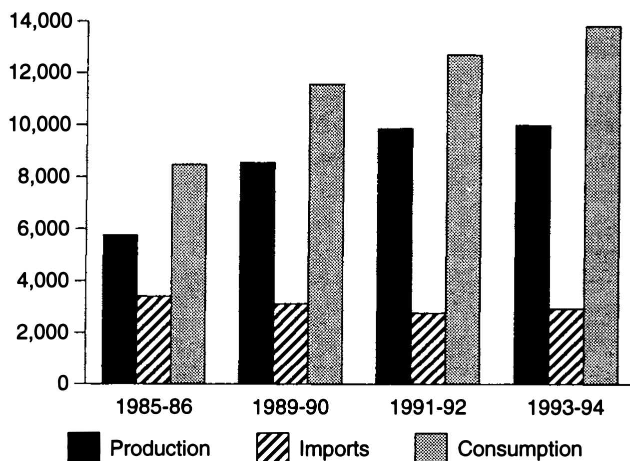

TABLE 2
Production in selected industries
(number of units, unless otherwise noted)

	1985-86	1987-88	1989-90	1991-92	1992-93*
Commercial vehicles	103,000	119,900	125,500	149,800	132,600
Railway cars	13,100	13,400	29,000	25,200	25,000
Power driver pumps	512,000	516,000	464,000	531,000	525,000
Earthmoving equipment	1,800	2,000	2,400	2,900	2,100
Agricultural tractors	76,300	82,900	125,100	166,300	146,900
Power transformers (million kva)	27.25	24.73	36.55	34.28	34.1
Electric motors (million hp)	5.25	4.26	5.23	6.07	5.4

* Provisional.

TABLE 3
Irrigated area under cultivation
(million hectares)

	1985-86	1988-89	1990-91
Rice	17.7	18.7	19.2
Wheat	17.5	18.6	19.3
Total food grains	40.6	42.9	44.3
Oilseeds	3.4	4.4	5.2
Cotton	2.2	2.3	2.6

show little growth, while passenger car production, cotton textiles, and sugar actually show contraction. Such stagnation of production has not pushed prices up significantly, because the population's buying power has also eroded over the three years of planned recession.

The growing dangers

These unhappy developments have not gone completely unnoticed. "Indian industry simply cannot afford another poor year," N. Vaghul, chairman of the Industrial Credit and Investment Corp. of India (ICICI), told the *Economic Times*. Acknowledging that "a price is to be paid for reforming a system," Vaghul pointed out that the finance minister is banking on three factors: restructuring of indirect taxes, reduction in direct taxes, and a cut in interest rates. Although the first two are in the right direction, Vaghul believes, the third may not have much effect. If imports take off, the demand for money will rise fast, and Vaghul doubts that the Finance Ministry, with one eye on inflation, will be willing to lower lending rates any further, as some industrialists demand.

Similar apprehensions were expressed by the manufacturers of capital goods. The capital goods sector went into a tailspin last year, registering an 8.8% *contraction* over the previous year. The industry has already complained that despite a lowering of import tariffs on raw materials, in many cases the import duty on raw materials is still higher than or equal to the duty on finished products. The capital goods industry has demanded that a difference between the two should be maintained in such a manner that finished products attract higher duty, and raw materials and components, lower duty.

Nor have the economic reforms done much for the agricultural sector, where more than 60% of India's work force is employed. As indicated in **Tables 3** and **4**, agriculture has been stagnating badly for the past 6-7 years. Neither the area under irrigation, nor the productivity of major crops, shows any significant improvement. There has been no attempt to shift the emphasis from large input subsidies to creation and maintenance of public infrastructure. As the *Economic Review*, a government publication which comes out annually a few days before the annual budget presentation, has rightly pointed out, public investment in irrigation, rural communications, schemes for control of land and water degradation, and other agriculture-related infrastructure must be increased. Why doesn't the government do what it itself prescribes?

Circular arguments

The answers to this question are circular. The Finance Ministry's pet answer is that given the high fiscal deficits India has registered over the years, the only way fresh resources can be mobilized and invested is through drastic reduction of

TABLE 4
Yield of India's major crops
(kilograms per hectare)

	1985-86	1988-89	1990-91	1991-92	1992-93
Rice	1,552	1,689	1,740	1,751	1,744
Wheat	2,046	2,244	2,281	2,394	2,323
Total foodgrains	1,175	1,331	1,380	1,382	1,445
Oilseeds	570	824	771	719	793
Cotton	197	202	225	216	261
Potatoes†	12	16	16	16	15

* Provisional.
† Tons per hectare.

TABLE 5
Budgetary expenditures on research and development
(billions of rupees)

Sector	1993-94	1994-95*
Defense	9.84	10.56
Atomic energy	9.32	9.58
Space	7.28	7.54
Agriculture	4.60	4.77
Electronics	1.78	1.54
Biotechnology	0.88	0.90

* Estimated.

subsidies for water, electricity, and fertilizers and through foreign and domestic private investment. In addition, the bureaucrats point out, revenue expenditure must be curtailed. But given the requirements, these cuts have to be so deep that no democratically elected government can administer them. Moreover, such measures will lead to a high level of unemployment among people who have little cushion.

The other side of the argument, presented by the free trade-promoting, anti-public sector proponents, is that the fiscal deficit must be brought down so that interest payments—which now take away 53% of the revenue expenditure and have grown to almost the entire amount that the government needs to borrow from the Reserve Bank of India in the coming year—are reduced to make way for productive investments. To reduce this deficit, these proponents say, sell off the public sector enterprises to the highest bidder—if possible, in the Euromarket, where they are expected to bring higher prices—and pay back the debt. They also suggest that government expenditure be pruned severely. They argue that large-scale infrastructure developments cannot be undertaken by the government alone, and it should not even be tried. The private sector has to be offered adequate sops to lure them into investing in these areas, they insist.

It is not clear how the private sector, which is not even investing in medium-size ventures, can be persuaded to put large sums of expensive money into long-term projects. What does not figure in these arguments, is the issue of directing cheap credit to selected economic activities, such as infrastructure development. Infrastructure projects do not fetch large profits and have long gestation periods. Only through directed cheap credit can such projects be built. Moreover, that is the only meaningful "lure" the government can offer to private entrepreneurs.

But this line of approach is never heard, perhaps because the concept of money has become synonymous with economy. According to reform "wisdom," cheap credit fuels the "mother of all economic evils"—inflation. While free market proponents attack the concept of cheap credit to selected economic activities as the creeping shadow of a socialist pattern of economy, the monetarists and money managers are too attached to money to give it away at a low price to anyone.

Also ignored is the role of science and technology in upgrading labor productivity. The relatively inadequate allocations in science and technology (**Table 5**) and industrialists' practical abhorrence to invest in research activities define reality. While India wants to globalize its economy, the effort to bridge the technology gap seems minimal. Now that the budgetary deficit has gone up, and the government has come under attack for fueling inflation, it is likely that in the future India will have to depend increasingly on borrowed technologies.

In India, as of now, the definition of a healthy economy is one in which competition is free. Ostensibly frustrated with having failed to move industry forward with his economic policies, Dr. Singh said recently that he will lift all tariffs from imported goods if industrialists do not pass the duty cuts on to buyers—a threat only, no doubt; but one may ask who—the country or the industrialists—would suffer most if the tariffs are completely removed?

India's actual economic development cannot be achieved unless the government succeeds in fostering technological superiority in the industrial and agricultural sectors. Fair competition among inefficient manufacturing facilities will only result in the big and inefficient fish eating up the small and inefficient fish. The process will create unemployment and contraction in overall production of goods. The result will be new unemployment and price rises.

Three years of economic reforms and the 1994-95 budget fail to address these problems, as the government falls behind further in its commitment to make Indian industry and agriculture technologically stronger. What we have seen so far is some successful and some not-so-successful money tinkering and a lot of borrowed optimism. This packaging, glossy as it was, is now losing its shine.