
The Hindu Business Line : The unfinished agenda

SIGNIFICANT reduction of fiscal deficit is the first order of business. Unless substantial fiscal consolidation is achieved, in our view, continued fiscal deficits pose India's greatest risk to future destabilisation. Despite several years of fiscal consolidation effort, large and persistent fiscal deficits remain.

India's overall government spending, currently around 33 per cent of GDP (Centre and States together), will need to be brought down substantially as a proportion of national product to achieve its reform goals of macroeconomic stability and long-term rapid growth.

Government dis-savings at the federal and State levels need to be reduced through cuts in, and re-focusing of, explicit and implicit subsidies, stricter control of non-developmental expenditure, improvement in the tax ratio through deepening reform of the indirect tax regime and stronger tax enforcement.

Lower fiscal deficits will help move towards a regime of low interest rates, which, with efficient financial intermediation, can give a boost to private sector investment.

Privatisation of India's state-owned enterprises (SOEs) is critical. Many of the SOEs are inefficient and loss-making firms. These firms tend to be protected by grants of state monopoly, especially in areas of finance, such as commercial banking and insurance, and infrastructure, in areas such as telecommunications, port facilities, and road building.

An end to the state monopolisation of these sectors is crucial to permit new, privately owned firms to

introduce competition and higher productivity into these sectors.

Privatisation of these enterprises is also desirable in most cases, since the government has no particular comparative advantages in running these enterprises, and may have severe disadvantages, especially the politicisation of key investment and employment decisions of the enterprises.

Reforms to further opening up of the economy to trade and FDI are crucial if India is to sustain high rates of economic growth. India's average tariff rate of 27 per cent vastly exceeds the average tariff rates of the other economies.

India also displays continuing high barriers to foreign direct investment in contrast to most of the fast-growing Asian economies.

While it is true that not all of East Asia relied heavily on FDI to achieve rapid growth (Japan and Korea are the two main exceptions), most of the region, especially South-East Asia, has relied heavily on FDI, and the East Asian countries tend to have much simpler rules for FDI approvals than are now in place in India.

If India has to become an attractive destination for FDI and a major platform for labour-intensive manufacturing exports, reforms in India's labour laws and exit policies are very essential. China's experience suggests that while workers in the Chinese state sector are accorded generous job guarantees, workers in the non-state sector do not receive guaranteed employment.

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By contrast, in India, workers in both the public and the private sectors, once employed, cannot be laid off without governmental permission.

As a result of liberal hiring and firing policies in China, there has been rapid growth of employment, since firms can hire workers without fear of being stuck with unwanted labour in the future due to restrictions on dismissals. Formal sector employment in China has increased dramatically, from 95 million in 1978 to 158.5 million in 2000.

India, by contrast, has experienced a meagre increase from 22.9 million in 1978 to 28.1 million in 2000, of which 19.3 million are employed in the public sector.

Similarly, reform to put in place an exit policy for firms is significant in the Indian context. An exit policy needs to be formulated such that firms can enter and exit freely from the market.

While the policy should recognise the need for, and potential merit of, certain safeguards, if wrongly designed and/or poorly enforced it would turn into a barrier that may adversely affect health of the firms.

India has so far made little progress in commercialising the key infrastructural sectors. In power, for example, most electricity continues to be a public-sector monopoly, run by State electricity boards (SEBs).

The SEBs are responsible for generating and distributing power, setting tariffs, and collecting revenues.

Almost all of the SEBs make losses and some are even unable to pay for coal or the power they purchase. This is due to the fact that SEBs implement social subsidy policies of State governments leading to inefficient patterns of energy consumption, and even to non-recovery of their own costs.

Also, there is considerable theft of power from the distribution networks. SEBs had accumulated dues of Rs 41,400 crore, with interest amounting to Rs 15,700, as of February 2001. Tariff reform, that is, higher prices actually collected on electricity use, is the first order of business.

Privatisation of power generation and the conversion of SEBs from electricity providers to market regulators should come next. Power capacity will not be expanded until the SEBs are fundamentally overhauled or eliminated.

Even private power projects currently are expected to sell their electricity to the SEBs as their only power purchaser, so that the bankability of private sector power projects depends fundamentally on the financial health of the SEBs.

There is no doubt that geography heavily influences economic performance. Both in China and to a lesser extent in India, the real economic success has come in the coastal provinces/states, which can take advantage of export-led growth.

The interior has done much less well. GDP growth in the hinterland has lagged behind the coastal states by several percentage points per year.