Growth needs steps beyond reforms

While the reform agenda must continue, social cohesion and equity considerations must be guaranteed

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The Indian economy has travelled through an eventful period through the last three decades. In the post-independence economic history of our country, 1991 stands out as a watershed year. This was the year in which the economy was faced with a severe balance of payments crisis. In response, we launched a wide-ranging economic programme, not just to restore the balance of payments but to reform, restructure and modernise the economy.

Thus, the crisis was converted into an opportunity to bring about fundamental changes in the approach and conduct of economic policy. A near tragedy was averted and a new path was laid out before the country. The words of Charles Dickens in somewhat reverse order seem appropriate: "It was the worst of times, It was the best of times,... it was the winter of despair, it was the spring of hope."

The shift, key players

It is important to recognise in what way the new regime was different from the earlier one. The break with the past came in three important ways: in dismantling the vast network of licences, controls and permits that dominated the economic system; in redesigning the role of the state and allowing the private sector a larger space to operate within, and in abandoning the inward looking foreign trade policy and getting integrated with the world economy and trade. The last was particularly important because it was the opposite of what we normally did when faced with a balance of payments crisis.

Dr. Manmohan Singh as Finance Minister spearheaded the new policy. He articulated the need for change and provided not only the broad framework but also the details of the reforms. P.V. Narasimha Rao as Prime Minister gave the valuable political support and shield which were very much needed. It must be noted that as Prime Minister, P.V. Narasimha Rao also held the portfolio of Industry which was directly responsible for initiating the changes that led to the dismantling of various types of controls and licences related to the industrial sector. This was indeed a key element of the reform programme. At the ministerial level, strong support came from P. Chidambaram as Commerce Minister who oversaw the transformation of the external sector.

The metrics

There is a common thread running through the various measures introduced since 1991. The objective has been to improve the productivity and efficiency of the system by creating a more competitive environment. Thus, barriers to entry and growth were removed. As the saying goes, the proof of the pudding is in the eating. It is therefore appropriate to look at three broad parameters to judge the performance of the economy after liberalisation – growth rate, current account deficit and poverty reduction.

Between 1992-93 and 2000-01, GDP at factor cost grew annually by 6.20%. Between 2001-02 and 2010-11, it grew by 7.69% and the growth rate between 2011-12 and 2019-20, was 6.51%. The best performance was between 2005-06 and 2010-11 when the GDP grew by 8.7% showing clearly what the potential growth rate of India was. This is the highest growth experienced by India over a sustained period of five to six years. This is despite the fact that this period included the global crisis year of 2008-09. The recent decline in growth rate which started even before the advent of COVID-19 should make policymakers reflect and introspect.

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Foreign reserves

The balance of payments situation had remained comfortable. There were three years in which the current account showed a small surplus. Most of the years showed a small deficit. The exceptions were 2011-12 and 2012-13 when the current account deficit exceeded 4%. This was taken care of quickly. Foreign exchange reserves showed a substantial increase and touched $621 billion as of last week. The opening up of the external sector, which included liberal trade policy, market determined exchange rate and a liberal flow of external resources, has greatly strengthened the external sector. Of course, we still run a high merchandise trade deficit which is offset to a large extent by the surplus in services.

Poverty ratio

Besides growth, the other major objective of economic policy is to reduce the number of people living below the poverty line. There are many problems associated with the definition of poverty and the kind of data required to measure it. Going by the procedure adopted by the erstwhile Planning Commission using the Tendulkar expert group methodology, the overall poverty ratio came down from 45.3% in 1993-94 to 37.2% in 2004-05 and further down to 21.9% in 2011-12. The per year reduction in percentage points in poverty ratio between 2004-05 and 2011-12 was 2.18. The post-reform period up to 2011-12 did see a significant reduction in poverty ratio because of faster growth supplemented by appropriate poverty reduction programmes such as the Rural Employment Guarantee Scheme and the Extended Food Security Scheme. With the decline in growth rate since then and with a negative growth in 2020-21, this trend must have reversed, i.e. the poverty rate may have increased.

Had the growth trend seen up to 2011-12 continued, we would have an unqualified answer to the impact of reforms on growth. Growth requires more than reforms. Reforms are, in the words of economists, only a necessary condition. It is not sufficient. In a developing economy, in the final analysis, growth is driven by investment. It is the decline in investment rate of nearly five percentage points since 2010-11 that has led to the progressive decline of the growth rate. Reforms normally create a natural climate for investment. But 'animal spirits' are also influenced by non-economic factors such as social cohesion. Reforms supplemented by a careful nurturing of the investment climate are needed to spur growth again. This should become the sole concern of policy makers.

Need for continuity

The reform agenda must continue. It will be incremental in character. It has to be. Policymakers should be clear about the directions in which they should move. First of all, there is a need to move in the same direction in which we have been moving in the past three decades. Policymakers should identify the sectors which need reforms in terms of creating a competitive environment and improving the performance efficiency. From this angle, we need to take a relook at the financial system, power sector and governance. Centre and States must be joint partners in this effort. Second, in terms of government performance, there should be increased focus on social sectors such as health and education. In terms of the provision of services, the emphasis must be not just on quantitative expansion but also quality. To achieve the latter is even more difficult. The advent of COVID-19 has clearly shown our inadequate health facilities and preparedness.

Reforms are necessary to improve the productivity of the economy and achieve higher growth. But the story does not end there. We cannot ignore equity considerations. Growth and equity must go together. They must not be posed as opposing considerations. They are truly interdependent. It is only in an environment of high growth, equity can be pushed aggressively.

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