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The inhumane face of India's reforms

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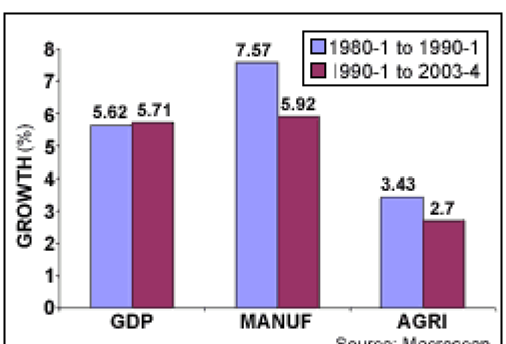
With the architect of India's economic reforms, Manmohan Singh, now at the helm of the brand new coalition government that has been in power for over 100 days now, it is perhaps time to take stock of what the much-vaunted reforms have delivered.

Overall, in terms of certain macro-economic parameters, the economy is surely on a much stronger base. Interest rates have been at an all-time low and inflation is under control (the recent spurt notwithstanding, as the point-to-point nature of calculation leaves the inflation numbers more prone to short-term shock). India's external sector has started showing an admirable degree of strength and resilience. Forex reserves have crossed the $100 billion mark, rising merchandise and service exports have led to a surplus in the current account balance after decades of deficit. Increased emphasis on non-debt-creating forex inflows have reduced the vulnerability of the economy to external shocks, with India's short-term external debt as a percentage of total external debt reduced to less than 5%. The issue, however, is while reformers of all hues have gone overboard talking about reforms with a human face, how humane has it turned out to be so far?

To put things in perspective, let's compare the GDP growth data during the 1980s and the post-reform period to date. During the 1980s (the period under consideration being 1980-81 to 1990-91), India's GDP grew at a CAGR (compounded annual growth rate)of 5.62%, while in the post-reform period, it was 5.71% - an increase of a mere nine basis points. Surprisingly, the impact of reforms on GDP growth has not been a few percentage points but a few basis points, and that, too, in single digit. Surely, after one-and-a-half decades of reforms, one would expect better numbers. In China, while the pre-reform (prior to 1978) economy had seen an annual growth of 6%, the post-reform average real GDP growth has been more than 9% annually.



Even more glaring has been the performance of the agricultural and the manufacturing sectors. There has been a marked deceleration in the growth rates of both during the post-reform period vis-a-vis the immediate pre-reform decade. While the average growth rate of the manufacturing sector during the 1980s was as high as 7.57%, it fell to 5.92% during the post-reform period. Similar has been the experience in the agricultural sector, where the growth rate fell from 3.43% to 2.7%.

Clearly, the booming service sector has made all the difference to India's economic growth in the post-reform period. The contribution of this sector to GDP rose by a whopping 10% in this period, thereby drastically reducing the contribution of the two other major sectors. A sectoral analysis reveals industrial revolution has bypassed India as it jumped from a predominantly agrarian economy to a service economy - a paradoxical situation of a developing economy showing signs of a developed economy.

Can a country, 70% of whose population depends on agriculture and 35% is illiterate (that, by the most conservative of estimates), afford to have a development skewed against employability of its millions? It's simply impossible to provide alternative employment to an unemployed farmer in the services sector.

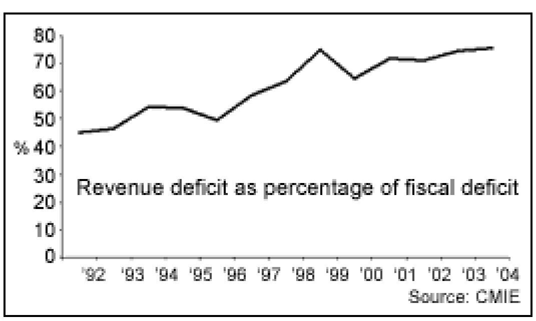
Clearly, the reforms process has failed to deliver. The aim of the reforms was to ensure sustainable growth in agriculture and manufacturing, the two major sectors on which most Indians depend for their livelihood. The impact of the services sector was more incidental than intended. Of course, had the services sector not grown the way it did in the 1990s, we would end up with the bizarre situation of reforms pulling down the growth rate.

As things stand, reforms in India have failed to ensure a more equitable economic development. Can a country with such vast unutilized resources afford to have growth with rising inequity as the agricultural and the manufacturing sectors continue to languish? The answer is an unqualified no.

When a controlled economy is liberalized, the government should play the role of the facilitator. An important reason why the reforms failed to deliver has been the government's failure to do so. For a capital-scarce country like India, the government should have ensured more development expenditure, either through its own or by encouraging private participation. But in reality, Gross Fixed Capital Formation (GFCF) in the economy grew at a CAGR of 6.92% between 1980-81 and 1990-91, while the same during 1990-91 until 2001-02 dipped to 5.33%.

The basic difference between achievements of the reforms in China and India has been the unbelievable pace of growth in China's infrastructure. In India, though everybody realizes just how inadequate the physical infrastructure is, there has been more rhetoric than real action on the ground. The government has not only failed to galvanize the private sector into infrastructure development but has also failed to do so itself. On top of it, rather than aiming to reform itself by reducing wasteful expenses, the government has gone the profligate way in all the wrong places.

With the expenses of the government rising faster than its income, the revenue deficit rose at a CAGR of a whopping 16.31% between 1991-92 and 2003-04. Clearly this is eating up the resources that the government can utilize to create assets. So much so, that the revenue deficit as a percentage of fiscal deficit in India rose from 44.90% in 1991-92 to as much as 75.62% in 2003-04, meaning that more than three-fourths of government borrowings are used to finance current expenditure and the remaining one-fourth is used to create assets to service the total debt.



This is obviously eating up the resources that the government could have otherwise used to create assets. And even when the government undertakes infrastructure projects, the end result leaves much to be desired. The number of unfinished projects, such as in irrigation, road works, railways and power, is mind-boggling. According to some estimates, as much as Rs1,000 billion (about US$21 billion) may be stuck in unfinished projects. A substantial part of this investment will be lost forever and the remaining will see time and cost overruns rendering the projects unviable. An example of a state government project would be a case in point.

In the 1970s, the government of Madhya Pradesh, a central Indian state, began to harness Narmada river. It built a dam near Jabalpur at Bargi, submerged 162 villages, displaced thousands of people, but forgot to build the canals. So far, it has spent Rs28 billion on this project but realized only 14% of its irrigation potential - just 56,000 hectares have received water instead of the promised 400,000. Hundreds of thousands of people in the districts of Jabalpur, Katni, Narsinghpur and Satna are still waiting for water that is so near and yet so far. Had another 25% of the outlay been spent, this vast area would be bursting with prosperity and become the granary of central India. Instead, it remains arid and poor.

What went wrong is that succeeding chief ministers diverted Bargi's funds for projects in their own constituencies. The first one started a dam at Bansagar in northeast Madhya Pradesh. Before he could finish it, the second deflected Bargi's and Bansagar's funds to his constituency in Chhattisgarh, a state recently curved out of Madhya Pradesh. A third came along and rerouted the funds to his Khandwa district. Had they built canals simultaneously in Bargi, Bansagar and Khandwa, they could have completely transformed Madhya Pradesh. Droughts would have been averted and peoples' incomes doubled to the levels of Punjab. They spent 75% of the funds on each project, still the farmers got nothing out of it.

Any process of sustained economic reform and investment requires a framework of long-term policy to which the government can credibly commit itself. But the political process in India seems to be moving in the opposite direction. While becoming more democratic and inclusive in terms of incorporating newer and hitherto subordinate groups, it is frittering away most of the structures of economic management because of the wheeling-dealing of day-to-day politics. There are very few assurances that commitments made by a government will be kept by successive ones, or even by itself if under pressure. A political party that introduces some reforms is quick to oppose them when it is no longer in power. What has been described above is a microcosm of a much bigger picture.

More than five decades after India's independence and one-and-a-half decades after reforms, the Indian economy has such inadequate infrastructure that the monsoon-dependence of the agricultural sector has almost remained the same. As of now, Rs500 billion worth of agricultural produce in India is wasted due to inadequate infrastructure. A criminal wastage in a country where around 30% of the population lives in poverty. Every monsoon failure leads to a spate of suicides by Indian farmers, unable to withstand the worsening debt burden.

Robust forex figures are of little use for hungry farmers. Reforms anyone?

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