

A clear view from the bottom

FOR CONNOISSEURS of irony, here's a dish. Last Sunday, a pinko went overboard extolling the sagacity of Congress finance minister Manmohan Singh. Simultaneously, the Congress party was wryly absorbing its worst ever electoral trouncing. It went to polls crowing over liberalisation, but if votes mean anything, most people don't share the enthusiasm. According to Amit Bhaduri, one of India's foremost academic economists and Deepak Nayyar, an ex-chief economic advisor, liberalisation has failed to keep 'the proverbial common man or woman' happy. 'There is so much nervousness about the future course of liberalisation precisely because this has not happened.'

Messrs Rao and Singh were pushed into 'liberalising' by a Balance of Payments crisis, with roots in high deficits and debt. Economics says deficits can be financed through taxes or debt funded by lenders at home or abroad. Nobody lends if he expects his money to get swallowed up. So, once India went to the IMF and the World Bank for loans, it had to accept the conditionalities which came with the cash. These form the core of the 'reforms' in India. Have they been successful?

There are two views on that: the numbers view, is held by some economists, *industrywallahs*, journalists and mandarins at North Block. The other is the *aloo-gobi* view from the bottom, held by everyone else. The latter is not half as bothered about deficits or BoP, as about jobs and prices. Bhaduri and Nayyar show that reforms look passable from the former vantage, disastrous from the latter.

Tackling the BOP embarrassment is touted as the government's biggest achievement. Since 1991, the ratio of debt-creating flows to total forex inflow has fallen and reserves with the RBI have picked up. Yet, the situation remains tricky. Volatile portfolio funds, NRI inflows and various debt instruments make up the bulk of reserves. If there is a run on them, triggered by expectations of an imminent devaluation, dollars with the RBI would be wiped out.

It is untrue that India's capital controls rule out forex runs and do not bind FII or NRI money. NRI funds are especially vulnerable, as was seen during the Mexican peso crisis — locals with forex holdings ran first. A recent econometric estimate of 'effective capital mobility' by Atish Ghosh and Jonathan Ostry has classified India as a high to medium-capital mobility nation, using data through the 1980s. Since then, the mobility of funds has been eased further. The fear of a run is very real.

What about deficits, which led to the 1991 situation? The authors say that efforts to curb it have alternated between half-hearted and stupid. Instead of cuts on the revenue ac-

count, it has bit into the capital account. The government, instead of slashing spends on a lumbering bureaucracy, has cut into infrastructure investment. That has reduced overall productivity in agriculture or industry. Bhaduri and Nayyar contend that these mistakes stem from many factors: first comes IMF-Bank economic orthodoxy, which focusses on the fiscal deficit, rather than the revenue gap. Second, blinkered vision in the finance ministry, which refuses to see loopholes in the Washington scheme. Third, and this is never explicit in the book, is the resistance from the entrenched bureaucracy regarding spending cuts.

Structural reform is essentially contractionary policy, coupled with the removal of quantitative controls. Whenever governments run deficits, the Fund-Bank prescription is to slash spending. That is expected to lead to a fall in inflation, increase real wages, cut real demand and contract external deficits. All this is supposed to be driven through the price mechanism. But, Washington is silent about the assumptions on which the results hang: first, that proper markets exist for prices to play roles they are supposed to; second, that the effect of prices is not dominated by long-term effects on income and finally, that the economy is demand driven, which rules out supply bottlenecks. None of these assumptions hold true for India. Nor for Latin America or Sub Saharan Africa, where reforms have failed. For example, the lack of markets — in bonds, agricultural futures or hedging instruments — imply that interest rates and prices do not reflect relative supply-demand positions. Missing markets also imply that where future risk



The Intelligent Person's Guide to Liberalisation, Amit Bhaduri & Deepak Nayyar, Penguin Rs 150

is involved, economic activity will not be undertaken. That will reduce investment, incomes and growth. Inflation and unemployment follow from these apparently innocuous 'imperfections'. The contractionary effect tends to persist. The authors say that this might happen in India. Spending cuts should imply lower inflation. But the Washington model plus bumbling bureaucrats actually increase it. In the post-reform years, India has had the longest spell of double-digit inflation in history. That has happened because first, customs tariff cuts were made revenue neutral by hiking excise duties, which fuel inflation, rather than increase direct taxes, which don't. Second, because procurement prices were hiked when the government decided to cut farm subsidies, but later, had to hike issue prices when the cuts didn't come. And because the cuts actually affected productivity, and not prices. In theory, the contraction has to be offset by attracting foreign investment. Tariff walls are supposed to be lowered, leading to higher imports, facilitating technology

transfers to protected markets. The authors say that India's agreeing to uniform tariff cuts was stupid. Market access is a strategic tool, and India should have bargained for every item. But, given our high tariff levels and the doubtful attractions of the home market for exporters abroad, this argument does not hold. Japan can afford to quibble successfully with the US on market access, not India.

The authors have strong views on privatisation, and I agree that with the vaunted social safety net in tatters, there are big human costs involved in layoffs. But if resources are limited, the government will have to get off sectors where private participation can provide goods, and specialise where markets cannot deliver. These, obviously, will be sectors where private payoffs at least equal social gains, and will include public transport (which the authors believe should not be privatised), power, telecom, hotels, oil and gas exploration-pumping-distribution, among others. Privatisation will have to limit damage to employment and incomes. But the authors are wrong in ascribing the failure of PSU divestment to underpriced shares. PSU stock found few takers because the government fixed higher-than-market prices for them.

The book has a very well written chapter on the roles of the state and the market. The authors restate Karl Polanyi's thesis that the two are not substitutes, but play complementary roles. The state has to set up institutions to facilitate market functioning, regulate markets, check industry concentration and provide goods and services which markets will not.

Half of the chapter on the 'hidden script' of liberalisation is ironic and amusing. The authors lambast the IMF-World Bank, advisors, politicians and the strange tribe of 'technocrats', who manage the economy today. It is ironic, because Mr Nayyar was intimately involved with this technocratic process himself, not too long ago. It is amusing, because the description of the pettiness, greed and stupidity of most policymakers is accurate. This is the potboiler element in the book.

The book is appetising, but I have some bones to pick. It is patchy, seems hurriedly written and could have done with some structural adjustment and proof-reading. I spotted at least five infantile typos on a first reading (and, why is liberalisation spelt a la Washington?). The authors don't come clean on the theoretical framework on which their arguments hang, but not because they lack such artillery. It is no excuse to say that difficult economic ideas cannot be conveyed in readable English. So here's a tip for Messrs Bhaduri and Nayyar: before you embark on another volume (and I look forward to that), skim through *The Economist* for stylistic feel. Finally, a tip for the outgoing finance minister, who now has ample time to kill: Read this book.

■ Abheek Barman