

Beyond Getting Prices Right

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Economic Liberalisation in India: Analytics, Experience and Lessons by Deepak Nayyar (R C Dutt Lectures on Political Economy, 1993; Centre for Studies in Social Sciences, Calcutta, 1996); Orient Longman, pp 72, Rs 70.

SEEING the title of the book, one would be curious to know whether Deepak Nayyar is pro or anti liberalisation and what direction he would like the economy to take at this stage. Nayyar is not against liberalisation of the economy as such, but is critical of the manner in which economic reforms have been pursued in India since the early 1990s. To put it in his own words, he is averse to caricature perceptions: either state can do nothing wrong or state can do nothing right. Yet he is not as critical of the 'pre-reform' paradigm of development. In an otherwise forthright and non-dogmatic treatment of the subject, one would look for a frank appraisal of the earlier strategy, especially in view of the telling evidence accumulated on the breakdown of the centrally planned economies. This is perhaps explained by his uneasiness about the current cynicism that state can do nothing right. This prompts him to emphasise the positive aspects and the achievements of the earlier strategy of development, which provide a basis for a series of suggestions regarding the content, sequencing and speed of reforms with a view to effectively addressing the problems of poverty and development.

According to the author, the most important achievements under the earlier paradigm of development were the significant step-up in savings, investment and growth, development of a diversified industrial sector and ensuring food security. Among the important shortcomings of the earlier period are neglect of exports, human resources, agrarian reforms and slow reduction in poverty. The author asserts that the economic crisis that erupted at the beginning of 1990s is traceable not to the 'misplaced' strategy of development since the mid-1950s, as alleged by some, but to the soft options adopted by the government in the second half of the 1980s to sustain import liberalisation.

The author argues quite persuasively that the deflation associated with the orthodox stabilisation programme may lead to contraction of output, due to a squeeze in investment and working capital, rather than a reduction in demand and prices, the outcome being stagflation instead of stabilisation. Further, the orthodox approach is static rather than dynamic as it tends to ignore inter-temporal considerations and does not quite incorporate increasing returns, market structures or externalities inherent in any process of industrialisation. Thus success

at industrialisation, he says, is not only about resource allocation and resource utilisation at a micro level. It is as much about resource mobilisation and resource creation at a macro level.

The author cites the experience of Latin America and sub-Saharan Africa with the implementation of the standard package of economic reforms and shows how they resulted in stifling long-term growth by overestimating export prospects and the availability of external finance. Inflation redistributed incomes, even as there was a squeeze on public expenditures in the social sectors, so that the impact of these reforms on poverty was invariably adverse. Thus, according to him, 'adjustment with human face' is an illusion for the added reason that economies in crisis simply do not have enough resources for providing the so-called 'safety nets'.

In India, over the five years following economic reforms, inflation remained at 10 per cent, despite five good monsoons in a row and despite no significant exogenous shock. This could be considered a success, he says, only if Latin American economies are a reference point, but a failure if India's own past record is the norm.

The author points out that total external debt rose from less than one-fourth of GDP at the end of 1990-91 to one-third of GDP during the period of stabilisation, so that the proportion of export earnings pre-empted by debt servicing rose to 40 per cent. Insofar as a reduction in fiscal deficit does not always translate itself into a corresponding reduction in current account deficit on the balance of payments, a sustainable reduction in current account deficit, he argues, may be easier to attain through a reduction in the trade deficit rather than in the fiscal deficit. Macro-economic adjustment conducive to growth needs to raise the investment-GDP ratio by raising the saving rate and export-GDP ratio instead of allowing a compensatory increase in the import-GDP ratio supported by external borrowing.

The focus of adjustment being on fiscal deficit rather than on revenue deficit of the government, budgets relied on a surplus in the capital account to finance a deficit on revenue account. Such a process of fiscal adjustment meant a massive squeeze on public investment. The author shows that budget support for key infrastructure sectors, e.g. energy, transport and communications

registered a significant decline even in nominal terms leading to a decline in total investment, as public investment crowds-in rather than crowds-out private investment.

According to the author, the contraction in public expenditure had an adverse effect on rural non-agricultural employment and urban informal sector employment. In an effort to contain subsidies, the issue prices of foodgrains were raised steeply which led to a significant decline in their off-take. Inflation was thus concentrated in the prices of wage goods which redistributed income away from the poor. As a result, the incidence of poverty rose, rural poverty rising steeper, representing a reversal of previous trends.

The author favours the dismantling of the complex regime of controls. Such a step, according to him, was both necessary and desirable. However, the author's assertion that there is no concrete evidence so far to validate or refute the hypothesis that structural reform would impart efficiency and dynamism to the process of economic growth may be a bit premature. Also, the author's fears that a rapid liberalisation of the import regime may force a de-industrialisation, especially in the capital goods sector, may be exaggerated in the light of the more recent evidence in regard to the growth of this sector. He also strikes a pessimistic note when he says that direct foreign investment is likely to be modest even as he is right in saying that it cannot be an important source for financing current account deficit or investment in the economy. Further, he underestimates the impact of reforms launched so far on the fortunes of agriculture: "the reforms proceeded as if agricultural sector does not exist or, if it exists, it does not matter". It is true that reforms directly affecting agriculture have not been conspicuous, but the experience elsewhere shows that the impact of economywide reforms on agriculture has been far more powerful than of those directly affecting agriculture.

The author echoes the widely shared feeling that it would be desirable to use capital receipts from disinvestment to retire public debt or to mop up excess liquidity, and use it for restructuring public enterprises, and fears that the sale of government assets and privatisation "may instead of resolving the real problems of efficiency can end up socialising costs and privatising benefits!" The financial system remains under-governed because the institutional and legal frameworks that would govern the markets have not yet been put in place. He is also not happy with freeing interest rates as it would no longer be possible to use them as a strategic tool for guiding the allocation of scarce investible resources in a market economy. Further, a significant rise in interest rates on government securities would increase the burden of public debt.

One could not agree more when the author says that "industrialisation is not only about getting prices right; it is also about getting state intervention right". As he puts it, in a world of uneven development, rapid technical progress, ever-changing comparative advantage and imperfect market structures, the role of government in industrialisation remains vital. Human resource development, acquisition of technological and managerial capabilities and the creation of institutions

that would regulate, streamline and facilitate the functioning of markets are some such areas. The reform process neglects the possibilities of building on past strength in this regard.

This monograph reveals the author at his best as a teacher: informative, analytical and, not the least, eloquent. Balanced as his presentation is, one wishes he was a little more forthcoming on the failures of centralised bureaucratic planning.

Understanding the 'Informal Sector'

Arup Mitra

Informal Sector in India edited by P M Mathew; Khama Publishers, New Delhi, 1995; pp 400, Rs 580.

'INFORMAL SECTOR' is a term in the development economics literature which has been used extensively by scholars despite severe criticisms. The volume under review is a fruitful attempt in such usage. I call it 'fruitful' because while the term is used without bothering too much about a clear understanding of its characteristics, the book succeeds in integrating various issues and in interpreting the term in an operationally meaningful way.

Following an introduction by the editor, 15 articles have been presented in six sections, namely, (a) the urban informal sector, (b) urban poor and political economy of urban development, (c) the labour market, (d) the ensemble: theory and policy, (e) informalism, (f) gender and informalism.

Some of the major concerns of the paper by Mehta in the first section are the characteristics of the informal sector and the differentiations within the informal sector itself. Ramana and Krishna point out that the dichotomy of the labour market is a myth, though the concept of the informal sector has served a useful purpose in throwing light on issues such as distribution of wages and incomes.

Problems and issues related to the growth of the urban economy are quite complex in nature as various forces emerging from immigration, urbanisation and industrialisation interact with one another simultaneously. To get a better picture of the informal sector it needs to be studied, as Ramana and Krishna point out, from at least two major angles, that is, enterprises and labour. The study by Kashyap and Tiwari on the diamond shaping industry in Surat is stimulating. The fact that the diamond processing industry is organised on the basis of firms and commission agents rather than firms and suppliers results in the weak bargaining power of the small firms particularly. As the authors' findings suggest, the earnings of the commission agents are almost two-thirds of the incomes of the entire workforce and four times those of the entrepreneurs. The study by Deshi and Wadhwa

citing evidence from Punjab confirms that informal sector enterprises are mostly labour intensive and fixed assets do not have any influence on earnings, labour productivity and employment. However, the econometric model tried in this study needs to be improved considerably. The second equation, that is, the earnings function of the entrepreneur, involves too many explanatory variables.

In part two, both the papers (one by Chakravarty and the other by Das) deal with the concept and growth of the informal sector in the context of the political economy of urban development. In part three, drawing upon his field visit in south Gujarat (Valasad district) Breman focuses on labour relations in the formal and informal sectors. He deals in detail with the social composition and size of the informal sector and then goes over to describe the recruitment process and job accessibility in the informal sector: "The very short-term and precarious way in which unskilled workers are incorporated into the labour system compels them to maintain a wide network of contacts." Casual employment in the face of an abundant supply of labour weakens the workers' position in this sector. The comparison of the informal sector with the formal sector carried out in this paper is interesting and useful. The paper by Harriss based on survey results from Coimbatore examines the extent of overlap and the degree of mobility between the sectors. Of the five groups of workers in Coimbatore, disguised wage workers and dependent workers/dependent producers and traders, and self-employed workers/independent producers and traders are taken to constitute the category of petty producers and traders. Harriss's findings suggest that the labour market is highly segmented and factors like caste and kinship bonds are some of the strong determinants of job accessibility. On the whole, industrialisation in Coimbatore has not really contributed to the break down of social divisions and ideologies although one would expect so.

Ray's paper in part four of the volume holds the view that the path of development

India has been following has led to rural underdevelopment. "It fails, by and large, to set in motion the forces of production by circumventing circular and cumulative causation of a low level trap." Although it is true, as Mathew points out, that the policies advocated by the ILO mostly talk about the development of the urban informal sector and not the rural sector, the position taken by Ray seems to be one-sided. Various studies have suggested that urban informal sector workers and/or the urban poor are not necessarily the rural outmigrants. In fact, many of them have been residing in cities for several decades. And this is one of the reasons why policies related to informal sector workers and urban poverty need to be implemented separately from those for the rural poor.

The papers by Mathew and Kabra are analytically rich and highly informative. Kabra, while arguing that the economy of independent India inherited a vast and varied informal sector, deals with the concept of the illegal economy comprising illegal activities originating in different forms of production. He points out three distinctly recognisable elements: "(1) aspects of the organised sector belonging to higher forms of production which emerge in the process of violation of various economic laws, giving rise to the lumpen bourgeoisie, (2) the declassed, semi-declassed and lumpen elements among the paupers and unemployed who are engaged in or are associated with various lower forms of production, and (3) the elements in state bureaucracy, political sphere and in the ideological apparatus of the civil society which not only permit but actively continue with and encourage the first two sets of activities, i.e., lumpen bureaucracy, politicians and intellectuals."

In section five Usha's paper focuses on labour utilisation in the tanning industry. After the introduction of an Export Trade Control Order in August 1973 with the purpose of encouraging the export of high-value added finished leather and leather products, capital intensification in the tanning industry has increased considerably. This seems to have challenged the basic proposition that the informal sector can generate employment on a large scale and hence rendered its relevance in a labour surplus economy like India unquestionable.

Finally, in section six the paper by Banerjee argues that given the basic imbalance between economic investment and the size of the labour force, privileges accrue differently to different groups, and one such group which has never benefited from this is the category of urban women workers. This discrimination cannot, however, be explained either in terms of demand differentials or women's lack of specific skills. Standing and Bandyopadhyaya argue that the main reason of women being in the lowest paid jobs and the secondary labour market is that they do not enter the labour market on the same terms as men.