industrial production and about 4 per cent to the GDP. It provides employment to 35 million persons. Together with allied agriculture sector, it provides employment to over 82 million people. The contribution of this industry to India's gross export earnings is about 25 per cent. The Indian textile industry is predominantly cotton based, with about 55 per cent of raw material consumed being cotton. Naturally in those years when the production of raw cotton is small, the cotton textile industry faces a serious problem. The target for raw cotton was kept at 7 million bales in the Third Plan but the achievement was merely 4.9 million bales. There were extreme shortfalls in some other plans as well. Such shortfalls in the production of raw cotton as compared to the target affected the expansion programmes of the cotton textile industry adversely. However, things have now changed. From a period of low level of output and shortages, raw cotton has now reached an era of self-sufficiency. The cause for concern now is fluctuating and highly volatile prices of cotton month after month. Such large fluctuations adversely affect the decentralised sector and handloom weavers in particular. Therefore, the government should strive to ensure stability in cotton prices. Further, since 85 per cent of the textile exports are cotton based, the price policy for cotton must be such that Indian retains it comparative advantage. This is all the more necessary as now with the phasing out of the MFA (multi-fibre arrangement) the potential for increasing cotton textile exports from India can increase immensely provided, of course, the manufacturers are able to upgrade their technology and meet the quality standards of textile exporting countries like China, Taiwan, South Korea etc. at relatively lower prices.

Food Processing Industry

It is estimated that India is the third largest producer of raw food products in the world, after China and USA. However, the percentage of raw food processed into value-added products up the food chain is one of the lowest in the world. With the intention of giving a push-up to the food processing industry, the Government of India set up the Ministry of Food Processing Industries in July 1988. The Ministry acts as a catalyst for bringing in greater investment in this sector, encouraging exports and creating a conducive environment for healthy growth of the food-processing industry.

Foodgrain-milling industry. The number of modern/modernised rice mills has gone up from practically nil in 1970 to 35,088 as on January 1, 2002. As a result of improved availability of bran from these modernised mills, the processing of bran is now estimated to be around 34 lakh tonnes as against 32.70 lakh tonnes in 1996-97.

There being no controls on price and distribution of wheat products, no licence is required for manufacture of wheat products. As such, mills have been given a free hand to obtain their requirements of wheat from any source, thereby avoiding their dependence on the government. Nearly 12.5 million tonnes of wheat is converted into various products by about 820 roller flour mills in the country every year.

Consumer food industries. The consumer food industry mainly consists of ready-to-eat products or ready-to-cook products such as pasta products, cocoa-based products, bakery products, biscuits, soft drinks, beer and alcohol beverages (non-molasses), mineral and packaged water. The bread and biscuit segment constitutes the largest segment with a total output of about 3.70 million tonnes per annum. Of the total production of bread, about 40 per cent is produced in the organised sector. Another wheat-based product known by its generic name, i.e., pasta products comprising noodles, vermicelli, macaroni and spaghetti, is gaining popularity. There are 20 units engaged in the manufacture of cocoa products like chocolates, drinking chocolates, cocoa butter, cocoa butter substitutes, cocoa based malted milk foods with a production of approximately 34,000 tonnes.

Fruit and vegetable processing industries. India grows a wide variety of fruits and vegetables ranging from tropical to temperate. Technology has been developed in the country to process all types of fruits and vegetables. The prominent processed items are fruit pulps and juices, fruit based ready-to-serve beverages, canned fruits and vegetables, jams, squashes, ketchups, pickles, chutneys and dehydrated vegetables. More recently products like frozen pulps and vegetables, frozen dried fruits and vegetables, fruit juice concentrates and vegetable curries in retortable pouches, canned mushrooms and mushroom products have been taken up for manufacture by the fruits and vegetables processing industries. The estimated installed capacity of fruits and vegetable processing industries has risen from 9.8 lakh tonnes at the end of December 1991 to 21.18 lakh tonnes in January 2006. To ensure proper hygienic conditions in the manufacture of fruit products, the Ministry of Food Processing Industries administers the Fruits Products Order (FPO), 1955.

Sugar Industry

The production of sugar is directly linked to the production of sugarcane. Because of the extensive cultivation of sugarcane as a commercial crop in northern India, the sugar industry was localized for quite

sometime in UP and Bihar. For instance, 60 per cent of sugar production in 1960-61 came from these two States. However, in the last four decades, the industry has developed at a fast rate in other major sugarcane growing States of the country like Maharashtra, Andhra Pradesh, Karnataka and Tamil Nadu.

The pricing of sugarcane is the most important factor determining the growth of sugar industry. It is affected by a number of factors, the most important being the Statutory Minimum Price (SMP). SMP is the price for sugarcane fixed by the Central government on the basis of cost of production of sugarcane. SMP of sugarcane has been increasing over the years as the costs of production have been rising on the one hand, and on the other hand, the government feels that a remunerative price policy is a must for growers so that the incentive to grow more remains. Since cane prices account for as much as 60 per cent of the cost of producing sugar this, in turn, implies that the cost of producing sugar has been increasing year after year. However, since the prices of sugar have for long been controlled by the government at low levels, the realisations from the sale of sugar have not been rising adequately to meet the increasing cost resulting in heavy losses to sugar units. Since 1979, the government has been following a policy of dual prices through which a specified percentage of total production of each sugar factory is procured as levy sugar at notified prices for distribution through the PDS (Public Distribution System). The ratio of levy sugar and free sale sugar was 40 : 60 from 1992-93 to December 1999. This was reduced to 30:70 from January 2000 and further to 10 : 90 from March 1, 2002.

Production of sugarcane and sugar has increased considerably in India over the planning period. From 11.34 lakh tonnes in 1950-51, production of sugar shot up to 51.48 lakh tonnes in 1980-81 and further to the record level of 132.77 lakh tonnes in 1991-92. This enabled India to become the largest producer of sugarcane and sugar in the world leaving the other major producers—Brazil and Cuba—way behind. Sugar production in 2005-06 sugar season stood at 193 lakh tonnes and is expected to be around 245 lakh tonnes in 2006-07 (the official estimate for 2006-07 is placed at 227 lakh tonnes). ***The sugar industry was delicensed in September 1998.***

Vegetable Oil Industry

India is the third largest edible oils economy in the world after the USA and China. With a production of 25 million tonnes oilseeds in 1996-97, the country accounts for 10 per cent of the global oilseeds production (about 250 million tonnes), 8.7 per cent of world's production of major protein meals and 9.2 per cent of the global oil meal exports. The production of oilseeds in 2006-07 stood at 23.9 million tonnes. Not only in terms of area under oilseeds and production of oilseeds, India occupies a distinct position also in terms of diversity in cultivated oilseeds. It cultivates nine major oilseeds including seven edible oilseeds—groundnut, rapeseed-mustard, soyabean, sunflower, safflower, sesame and niger and two non-edible oilseeds, namely, castor and linseed apart from a wide range of other minor oilseeds and oil bearing tree species. India is the world's largest producer of sesame and castor and the second largest producer of groundnut and rapeseed-mustard, next only to China.

The demand for edible oils is income elastic and the increase in population coupled with rise in incomes has led to a demand growth at a little over 6 per cent per annum. As a result, the demand for oilseeds is also likely to surge further and touch 34 million tonnes by 2020 A.D. Hence increasing the production and productivity of oilseeds assumes paramount importance. This calls for "(1) improved productivity of farmers' fields through exploitation of the commercially untapped yield reservoir, (2) demand driven research agenda, (3) value addition to oilseeds and their products/by-products, and (4) favourable public policy."[5] It is also necessary to tap non-traditional sources of oil like rice bran, cotton seed, oil cakes and seeds of tree origin like sal, mango kernel, neem, karanja, mahua and rubberseed. Another promising area is oil palm.

The vegetable oil industry is administered through the following control/regulation orders: (*i*) Vegetable Oil Products (Regulation) Order, 1998; (*ii*) Edible Oils Packaging (Regulation) Order, 1998; (*iii*) Solvent Extracted Oils, De-Oiled Meals and Edible Flour Control Order, 1967; and (*iv*) Pulses, Edible Oilseeds and Edible Oils (Storage Control) Order, 1967. These orders are statutory in nature and derive their powers from the Essential Commodities Act. The market liberalisation and delicensing of the industry in 1990-91 has resulted in substantial increase in capacity. The details of the vegetable oil industry in India are as follows: (*i*) approximately 1,50,000 oilseed crushing units with an annual capacity of 425 lakh MT (in terms of seeds); (*ii*) 764 solvent extraction units with an annual capacity of 360 lakh MT (in terms of oil-bearing materials); (*iii*) approximately 400 refineries with an annual capacity of 60 lakh MT (in terms of oil); and (*iv*) 259 vanaspati units with an annual capacity of 50 lakh MT (in terms of vanaspati). The production of vanaspati/edible hydrogenated oil increased from 896 thousand tonnes in 1992-93 to 1,899 thousand tonnes in 2004-05, but fell to 1,349 thousand tonnes in 2005-06.

Tea and Coffee

The tea industry provides direct employment to more than one million workers. Tea is the major beverage consumed in the country—its share being around 47 per cent. According to the latest National Sample Survey, 65 per cent of rural households and 73 per cent of urban households drink tea. With rising population, urbanisation and increasing income levels, the consumption of tea is on the rise. Continued supply of tea at reasonable prices is not only necessary to meet the increasing domestic demand levels, it is also necessary to maintain (and possibly increase) India's share in total world tea exports. Total area under tea crop was 5.0 lakh hectare in 2003-04. Output of tea crop in 2003-04 was 857.1 million kgs. while production of tea in this year was 851 thousand tonnes. Production of tea rose to 893 thousand tonnes in 2005-06. Viewed from the long-term perspective, the industry has several constraints that affect production and productivity. These include old age of tea bushes (nearly 43 per cent of area is more than 50 years old), limited availability of land for extension in traditional areas, slower pace of replantation (present rate of replanting is less than 0.4 per cent as against the desired level of 2 per cent) and fluctuations in tea prices.

Total area under coffee in 2003-04 was 3.0 lakh hectares and output of coffee crop was 3 lakh tonnes. India consistently exports over 75 per cent of its coffee. It contributes around 3.5 per cent of the world production and with an all time high production of 2.23 lakh tonnes in 1995-96 was ranked sixth among the producing countries. The production of coffee increased further to 2.62 lakh tonnes in 2005-06. Indian coffee has created a niche for itself in the international market, particularly Robusta which is rated high for its blending quality. Indian Arabica is also well received in the international markets. While previously the entire produce was marketed by the Coffee Board, during the last few years with increasing economic liberalisation in the country, the process of privatisation in the field of coffee marketing has gained ground.

Rubber

Rubber plantations and rubber goods manufacturing industries have recorded a steady growth in India during the period of the last five decades. Today India is the fourth largest producer of natural rubber after Thailand, Indonesia and Malaysia. It ranks first among major producers in terms of productivity. Of the total consumption of rubber in the country the share of natural rubber is as high as 80 per cent while that of synthetic rubber is just 20 per cent. Although rubber cultivation in India is overwhelmingly small holder oriented with about 9.11 lakh small holdings having a total share of 86 per cent in area and production, the level of adoption of technology among them is quite appreciable. The average yield per hectare, which is higher than that of major producing countries, clearly underlies their better status in internalising frontier technologies.

The growth of rubber goods manufacturing industry in India has also been impressive. The major rubber goods produced by the industry are tyres and tubes of all kinds, surgical gloves, prophylactics, conveyor and V-belts, hose pipes, sports goods, etc. At present the industry has 43 tyre units, 300 medium scale units, over 5,500 small-scale units and an equal number of units in the tiny sector with an annual turnover of over Rs. 12,000 crore. It directly employs about 4.0 lakh people.

Paper and Newsprint Industry

The Indian paper industry is a century old industry. It has made steady progress with an installed capacity, at present, of nearly 6.2 million tonnes of paper and paper board and about 1.24 million tonnes of newsprint (the actual production of paper and paperboards in 2003-04 amounted to 5.6 million tonnes).

The industry in India is ranked among the top 15 global paper industries. The industry is fragmented with installed capacity ranging from 10 tonnes to 800 tonnes. Its turnover is about Rs. 16,000 crore, employing nearly 3 lakh people directly and 10 lakh people indirectly. The per capita consumption of paper in India is still at 5.5 kg. which is far below the global average of about 50 kg. The main constraints faced by the industry are inadequate availability of good quality cellulosic raw material and obsolete technology. High cost of basic inputs and environmental issues are the other two major issues required to be addressed by the paper industry to become globally competitive.[6]

DEPENDENCE OF NEW AGRICULTURAL STRATEGY ON BUSINESS

As stated earlier, the new agricultural strategy (or the HYVP) which ushered in the Green Revolution in the country is a package programme depending upon high yielding varieties of seeds, irrigation, fertilisers, pesticides and insecticides. The success of this strategy is, therefore, crucially dependent on the fertiliser and

pesticide industries. The spread of Green Revolution has also been aided considerably by the widespread adoption of agricultural machinery in progressive agricultural regions of the country.

Fertilizer Industry

The production of fertilizers has increased by leaps and bounds in the post-Independence period. Adding the production and import figures for nitrogenous, phosphatic and potassic fertilisers, we find that the availability of fertilizers in the economy rose from a mere 155 thousand tonnes in 1955-56 to 1,688 thousand tonnes in 1970-71 and further to 19,321 thousand tonnes in 2005-06. As far as the consumption of fertilizers is concerned, it was a meagre 66,000 tonnes in 1952-53. The advent of the HYVP in 1966 completely changed the picture and consumption of fertilizers shot up substantially. For instance, in 1970-71 it rose to 21.8 lakh tonnes and in 2005-06 stood at 203.40 lakh tonnes. However, there are wide inter-State differences in per hectare fertilizer consumption with only five States of Punjab, Haryana, Uttar Pradesh, Andhra Pradesh and Tamil Nadu together accounting for more than half of the total fertilizer consumption in the country. Moreover, rainfed areas which constitute more than 60 per cent of the cultivated area account for only about 20 per cent of the total fertilizer consumption. The government has tried to push up the use of fertilizers among small and marginal farmers of the country by making them available fertilizers at highly subsidised prices. As a result, the burden of fertilizer subsidy on the government has increased considerably from Rs. 505 crore in 1980-81 to Rs. 11,504 crore in 2005-06. Despite this, it has been estimated that the use of fertilizers in India is very low as compared with other countries. For instance, amount of fertilizers used per hectare was merely 104.4 kgs in India as against 257.8 kg in China, 173.8 kgs in Bangladesh and 447.8 kgs in Egypt in 2000-02. It has been estimated that an increase in fertilizer consumption of 40 to 60 kgs per hectare in India can push up the production of foodgrains by around 30 to 45 million tonnes.

Pesticides

India is one of the most dynamic generic pesticide manufacturer in the world with more than 60 technical grade pesticides being manufactured indigenously by 125 producers consisting of large and medium scale enterprises and more than 500 pesticide formulators spread over the country. Indian exports of agrochemicals have shown an impressive increase over the last five years. The key export destination markets are USA, U.K., France, Netherlands, Belgium, Spain, South Africa, Bangladesh, Malaysia and Singapore.

Keeping in view the ill-effects of chemical pesticides such as the development of pest resistance, pest resurgence, outbreak of secondary pests, pesticide residues in food, fodder, soil, air and water resulting in human health hazards and ecological imbalances, the Government of India has not encouraged the indiscriminate use of pesticides. Instead, the focus has been on Integrated Pest Management (IPM) as a cardinal principle and main plank of plant protection strategy in the country. IPM is an eco-friendly approach aimed at minimum use of chemical pesticides by employing available alternative methods for pest control like cultural, mechanical and biological use of bio-pesticides. With the adoption of IPM approach, consumption of pesticides has come down over the years and there is consistent increase in the use of bio-pesticides which are environmentally safe.

Agricultural Machinery

Spread of the new agricultural strategy over the last four decades has been accompanied by increased use of farm machinery like tractors, power tillers, combine harvesters, irrigation pumpsets and other power-operated machines. As a result, power availability for carrying out various agricultural operations has been increasing to reach a level of 1.4 kw/ha in 2003-04 from only 0.3 kw/ha in 1971-72. Moreover, the share of mechanical power has increased from 40 per cent in 1971-72 to 84 per cent in 2003-04. The average annual sale of tractors during the five year period ending 2003-04 in India as a whole was 2,23,333 of which Uttar Pradesh accounted for the highest number (58,102). Production of tractors rose to 2,53,800 in 2005-06. The average annual sale of power tillers during the five year period ending 2003-04 in India as a whole was 13,606 of which West Bengal accounted for the highest number (5,107).

Agricultural machinery in India are manufactured by village artisans, tiny units, small scale industries, and organised industries.

Village craftsmen. Village artisans are the main source of supply, repair and maintenance of farm equipment. More than 80 per cent of hand tools and traditional implements are made by village artisans. These include ploughs, bakhar, yoke, khurpi, spade, sickle, oil ghani, kolhu, grinding mill, hand mill, hand operated milk churning tool, winnowing devices, sieves, bullock carts, manual water lighting devices etc.

Tiny and small scale industries. Agricultural machinery are reserved for manufacture by small scale

units. There are more than 18,000 such units scattered all over the country but are concentrated in select regions. Farm machinery made by small scale units includes soil working tools (ploughs, disc ploughs and harrows), seeding and planting (dibbler, broad casters, seed drills, planters etc.), land handle hoes, khurpi spades, rakes, sprayers and dusters, sickles, reapers, threshers, combine harvesters, maize shellers, decorticators, oil expellers, diesel engines, irrigation pumps, dairy machinery etc.

Organised industries. Agricultural machinery manufactured by organised sector includes diesel engines, electric motors, irrigation pumps, sprayers and dusters, land development machinery, tractors, spare parts, power tillers, post harvest and processing machinery, dairy equipment etc.

Use of farm machinery in India is constrained by the poverty of small and marginal farmers, low (and uneconomic) size of holdings, easy and cheap availability of agricultural labour to undertake farm work, limitation of technical manpower and inadequacy of resources with the small scale units to invest in R & D, inadequate fuel and electricity in rural areas, and absence of a well thought out farm mechanisation policy.

INDIAN AGRICULTURAL POLICY: AN OVERVIEW

The First and Second Plans placed great emphasis on expanding irrigation facilities by developing major and medium irrigation projects. Programmes for reorganisation of agrarian relations and rural development like land reforms programme and community development programme were also taken up on a nation-wide basis. Community Development Programme was a comprehensive programme of rural development touching all aspects of rural life. Agricultural growth was just a part of this programme : other aspects included rural literacy, health and sanitation, improvement in communications, rural housing, rural industry, animal husbandry etc. Stress was also laid on co-operative farming. This emphasis on major and medium irrigation projects, Community Development and co-operation continued almost till the end of the Third Plan. In 1965-66 and 1966-67 the country faced serious drought conditions and some 19 million tonnes of foodgrains had to be imported to avert starvation. This called for a re-examination of the agricultural strategy pursued so far and initiation of steps to increase agricultural production and productivity. Thus ***from institutional reforms, the focus of agricultural policy shifted to technology.*** The New Agricultural Strategy (NAS) was introduced in selected (better endowed and high-productivity) regions of the country in a bid to push up agricultural production. The focus now shifted to minor irrigation from major and medium irrigation; provision of credit and other agricultural inputs to farmers at subsidized rates to encourage their widespread usage; guarantee of remunerative prices to farmers to ensure that the incentive to produce more remains; better agricultural marketing facilities etc. The entire emphasis was now on increasing the 'marketed surplus' of foodgrains. Side by side, a massive food security system was built up in the form of public distribution system to ensure availability of foodgrains to the consumers at reasonable prices. Rural employment programmes were also introduced for poverty alleviation. In conjunction with the public distribution system, these rural employment programmes were expected to provide a ***'safety net'*** to the rural poor.

Important policy measures introduced in the agricultural sector in India during the period of planning are as follows:

1. Technological measures. Initiation of measures to increase agricultural production substantially to meet the growing needs of the population and also to provide a base for industrial development included steps to increase both extensive cultivation and intensive cultivation. For the former, irrigation facilities were provided to a large area on an increasing basis and area hitherto unfit for cultivation was made fit for cultivation. For the latter, new agricultural strategy was introduced in the form of a package programme in selected regions of the country in 1966. To sustain and extend this programme to larger and larger areas of the country, steps were initiated to increase the production of high-yielding varieties of seeds, fertilizers and pesticides within the economy and supplement domestic production by imports whenever necessary. As a result of these measures, agricultural production and productivity increased substantially. Foodgrains production which was merely 50.8 million tonnes in 1950-51 rose to 216.1 million tonnes in 2006-07. Largest contribution came from wheat. Its production rose from 6.4 million tonnes in 1950-51 to 74.9 million tonnes in 2006-07.

2. Land reforms. Land reform measures to abolish intermediary interests in land (*viz.* zamindars, jagirdars, etc.) and transfer of land to actual tiller of the soil were expected to be taken up on a priority basis. Measures taken under this head included: (*i*) Abolition of intermediaries; (*ii*) Tenancy reforms to (*a*) regulate rents paid by tenants to landlords, (*b*) provide security of tenure to tenants, and (*c*) confer ownership rights on tenants; and (*iii*) Imposition of ceilings on holdings in a bid to procure land for distribution among landless labourers and marginal farmers. These land reform measures were designed to eliminate the parasitic

class of zamindars and absentee landlords and abolish all types of exploitation of the tenants at the hands of these people. Thus the attempt was aimed at changing the entire agrarian structure of the rural areas.

3. Cooperation and consolidation of holdings. In a bid to reorganise agriculture and prevent subdivision and fragmentation of holdings, the Indian agricultural policy introduced the programmes of cooperation and consolidation of holdings. The latter programme aimed at consolidating all plots of land owned by a particular farmer in different places of the village by sanctioning him land at one place equal in area (or value) to his plots of land. Consolidation avoids wastage of time, land and energy employed in cultivation and also enables farmers to practise scientific techniques of production. Cooperation aims at bringing small and marginal farmers together to reap the benefits of large-scale farming. Under cooperative farming small and marginal farmers pool their land and resources (or only resources) and practise joint cultivation.

4. Institutions involving people's participation in planning. Bringing small and marginal farmers together to cultivate jointly is only half of the story. No planning in any country can be successful unless the masses are encouraged to join hands with the planning authorities in a bid to carry out the plans and programmes framed for their uplift and betterment. It was precisely with this end in view that the programme of ***Community Development*** was initiated in 1952 in this country. It was aimed to be a project of the people, by the people and for the people, wherein the role of the government and administrative authorities was defined as 'to help the people to help themselves'. The experience of the Community Development programme reads a sad story. It could never become the people's programme and remained tied to the umbilical cord of government assistance. Another programme designed to encourage the participation of masses in the planning process (and political decision-making) was the programme of democratic decentralization, often known as ***Panchayati Raj.*** Its experience was no different from Community Development. In fact, it proved to be worse. It conferred powers (howsoever limited) on local dadas and influential political elements to exploit masses to their advantage and indulge in all sorts of political bickerings and corrupt practices.

5. Institutional credit. Another important measure initiated was the expansion of institutional credit to farmers, especially through cooperatives and commercial banks. After nationalisation in 1969, nationalised banks have paid increasing attention to the needs of agriculture. Regional Rural Banks were also set up to deal specially with the needs of agricultural credit. A National Bank for Agriculture and Rural Development (NABARD) was also set up. As a result of the expansion of institutional credit facilities to farmers, the importance of moneylenders has declined steeply and so has the exploitation of farmers at the hands of moneylenders.

6. Procurement and support prices. Another policy measure of significant importance is the announcement of procurement and support prices to ensure fair returns to the farmers so that even in years of surplus the prices do not tumble down and farmers do not suffer losses. This is necessary to ensure that farmers are not 'penalized' for producing more. In fact, the policy of the Commission for Agricultural Costs and Prices in recent years has been to announce fairly high prices in a bid to provide incentive to the farmers to expand production.

7. Input subsidies to agriculture. The government has provided massive subsides to farmers on agricultural inputs like irrigation, fertilizers, electricity and credit. The objective of input subsidisation is to increase agricultural production and productivity by encouraging the use of modern inputs in agriculture. Under the government policy, various inputs to the farmers are supplied at prices which are below the level that would have prevailed in the open market. The prices of these inputs, therefore, do not reflect their true value, i.e., the real cost of supplying these inputs. However, over a period of time, strong farmer lobbies and vested interests build up which makes the withdrawal of some of these subsidies impossible even after their economic rationale ceases to exist. In fact, the subsidies show a tendency to increase continuously. The level of input subsidies in Indian agriculture has risen to astronomical heights cutting into the resources available for public investment in agriculture. Many economists have argued that agricultural subsidies in India have reached 'fiscally unsustainable' levels.

8. Food security system. In a bid to provide foodgrains and other essential goods to consumers at cheap and subsidised rates, the Government of India has built up an elaborate food security system in the form of Public Distribution System (PDS) during the planning period. PDS not only ensures availability of foodgrains at cheap prices to the consumers but also operates as a 'safety net' by maintaining large stocks of foodgrains in order to combat any shortages and shortfalls that might occur in some years and/or in certain areas of the country.

9. Rural employment programmes. PDS alone cannot serve as an effective safety net. This is due to the reason that unless the poor have adequate purchasing power they cannot buy their requirements from the PDS. Therefore, large-scale poverty alleviation programmes in the form of rural employment programmes are

required to provide purchasing power to the poor. On account of this reason, the government introduced various poverty alleviation programmes particularly from Fourth Plan onwards like Small Farmers Development Agency (SFDA), Marginal Farmers and Agricultural Labour Development Agency (MFAL), National Rural Employment Programme (NREP), Rural Landless Employment Guarantee Programme (RLEGP), Jawahar Rojgar Yojana (JRY), Jawahar Gram Samridhi Yojana (JGSY), Sampoorna Grameen Rozgar Yojana (SGRY), National Food for Work Programme (NFFWP), National Rural Employment Guarantee Scheme (NREGS) etc. Taken together and implemented efficiently, PDS and rural employment programmes can work as effective safety net for the poor.

10. Other Measures. In addition to the measures mentioned above, the Indian agricultural policy contained a number of other elements, some of which are outlined below:

(*i*) Provision and extension of irrigation facilities through major and medium irrigation projects and of power for minor irrigation through the programme of rural electrification.

(*ii*) Improving the system of agricultural marketing through the establishment of regulated markets and introducing a variety of measures like standardization of weights and measures, grading and standardization of farm output, providing information regarding market prices to farmers, etc. Efforts have also been made to strengthen the cooperative marketing structure.

(*iii*) Provision and expansion of storage and warehousing facilities to enable the government to build up adequate buffer stocks to cope with the food problem in years of shortage of foodgrains, and save the farmers from indulging in 'distress' sales during surplus years.

(*iv*) Initiation of steps to improve the economic condition of agricultural workers. In this category come measures to enforce minimum wages, abolition of bonded labour, grant of agricultural land to landless labourers, schemes for expanding rural employment, etc.

(*v*) Promotion of agricultural research and training to discover new high-yielding varieties of seeds, avoid wastage of grains in storage, successfully counter the attacks of pests, insects and rodents, develop techniques for increasing productivity of soil, and ensure optimum utilisation of soil, water and sunlight resources. The triple function of agricultural research, education and extension is being implemented through the various research institutes, agricultural universities, project directorates, etc. At the apex stands the Indian Council of Agricultural Research (ICAR).

(*vi*) In an effort to extend green revolution to the Eastern Region of the country and develop dryland areas, the Seventh Five Year Plan introduced two specific programmes: (*a*) Special Rice Production Programme, and (*b*) National Watershed Development Programme for Rainfed Agriculture. The former was initiated by the government in the Eastern Region (comprising of Assam, Bihar, Orissa and West Bengal, eastern Uttar Pradesh and eastern Madhya Pradesh). The latter, introduced in 1986-87, lays emphasis on land and water management through introduction of optimal cropping system, dryland horticulture, farm forestry, fodder production, etc. Since Green Revolution which was confined to irrigated areas is showing signs of fatigue, the focus is now increasingly shifting to rainfed areas. The *Tenth Five Year Plan (2002-07)* had a target of treating 15 million hectares of rainfed land under the various Watershed Development Programmes.

(*vii*) In order to increase the production of pulses, a centrally sponsored National Pulses Development Programme was launched in 1986-87. The basic objective of the programme was to increase the production of pulses by adopting location specific technology. A centrally sponsored programme was also launched in 1984-85 to increase the production of oilseeds. Known as National Oilseeds Development Project, this programme aimed at providing to the farmers various services such as inputs, extension, credit etc. so as to assist them in increasing production of oilseeds. In addition to the above, an Oilseeds Production Thrust Project (OPTP) was launched in 1987. During 1990-91, the above two projects was merged under one programme i.e. Oilseeds Production Programme (OPP). Since April 1, 2004, an Integrated Scheme of Oilseeds, Pulses, Oil Palm and Maize (ISOPOM) is in operation. It is being implemented by 14 States for oilseeds and pulses, 15 States for maize and 10 States for oil palm.

(*viii*) In recent years a number of policy changes have been introduced to make agricultural exports more viable. Most of the restrictions on agricultural exports have been removed, Export Oriented Units in the floriculture sector are being set up and import of capital goods, plant and machinery for establishing food processing units has been made more liberal.

(*ix*) The Small Farmers' Agri-Business Consortium (SFAC) was set up in January 1994 to generate agri-business activities with the theme objective of securing expanding employment opportunities and raising income levels in the rural areas through effective support to various types of agri-business.

(*x*) A large number of irrigation projects have been launched since the beginning of the era of planning in India. However, many projects remained incomplete owing to financial constraints of the States. An Accelerated Irrigation Benefit Programme (AIBP) was launched during 1996-97 to give loan assistance to the States to help them complete some of the incomplete projects. Rs. 19,438 crore had been released under AIBP as Central Loan Assistance during 1996-97 upto March 2006.

(*xi*) A National Rainfed Area Authority was created in November 2006 to support upgradation and management of dryland and rainfed agriculture. The Authority would cordinate all schemes relating to watershed development and other aspects of land use.

(*xii*) To meet the demand for bringing in more crops into the purview of crop insurance, extending its scope to cover all farmers (both loanee and non-loanee) and lowering the unit area of insurance, the government introduced a new scheme titled 'National Agriculture Insurance Scheme' or 'Rashtriya Krishi Bima Yojana' in the country from Rabi 1999-2000. The scheme envisages coverage of all the food crops (cereals and pulses), oilseeds and annual horticultural/commercial crops, in respect of which yield data are available for adequate number of years. The scheme replaced the earlier Comprehensive Crop Insurance Scheme which had been in vogue since the 1985 Kharif season.

(*xiii*) In view of the critical importance of rural infrastructure and the lacklustre growth in agricultural investment in the past, concerns were raised about the country's ability to increase production. Consequently, an initiative for setting up of independent fund called the Rural Infrastructure Development Fund (RIDF) within National Bank for Agriculture and Rural Development (NABARD) was taken in the Union Budget of 1995-96. The corpus of RIDF-I was kept at Rs. 2,000 crore. The successive Budgets continued with RIDF scheme. RIDF-XIII covers the year 2007-08. Loans under RIDF are given for various rural infrastructure projects like irrigation, rural roads, rural bridges, watershed development, etc. Cumulative sanctions and disbursements under various tranches of RIDF stood at Rs. 51,283 crore and Rs. 31,337 crore respectively as on March 31, 2006.

LINKING AGRICULTURE WITH BUSINESS: CORPORATE INDIA'S INITIATIVES[7]

The last few years have seen a tremendous growth in the demand for industrial goods in rural areas due to increased income of the rural rich during the period of 1990s. In many years of this period, monsoon has been normal. In a country where 60 per cent of the farming is rain-fed, this means a lot for farmers' prosperity. Moreover, the price paid by the government to buy foodgrains from the farmers rose by more than 100 per cent in the 1990s – the highest in all decades. By tripling its spending on rural development between the Eighth and the Tenth Plans – from around Rs. 30,000 crore to Rs. 90,000 crore – the government opened up the floodgates to rural India. Although it is common knowledge that only a fraction of public money reaches the beneficiary yet, as long as we can assume that fraction to be constant, we can say that the absolute flow of funds to rural areas has tripled during the 1990s. There has been massive expansion in agricultural credit also during the last few years (agricultural credit by institutional agencies increased from Rs. 86,981 crore in 2003-04 to as high as Rs. 1,90,000 crore in 2006-07). As a result, the flow of funds to the rural areas had increased in a significant way.

Increased prosperity of the rural rich is showing up in income and consumption. FICCI estimates show that rural India's share in total consumption of FMCG (for example, toothpaste, cream, food products) and consumer durables has exceeded urban India's share. All this indicates the increasing nexus between rural growth and business. The pull for agri-business is coming from outside the farm sector as well. The food habits of Indians, especially urban Indians, are changing fast and a greater corporate participation in agriculture will ensure a better alignment of farming patterns with food consumption pattern. For instance, the French fries sold by McDonald's in India are imported because the kind of potato used in fries in not grown in India. Same is the case for most packaged fruit juices which are all imported from abroad. These are small indications of the huge opportunities companies see in the food business. According to Saran, "Less than 1 per cent of the farm produce is processed (it is about 50 per cent in the US) while 25 per cent of fruits and vegetables grown in India (worth Rs. 2,500 crore) rot in farms."[8] This shows that the scope for agri-business — from cultivation to processing to retail — is immense.

Corporate India is waking up to this huge business opportunity and has begun experimenting with ways to tap the large opportunity across the agri-value chain. Of course, the rural market is not a new terrain for these corporations. ITC has been in the trading of commodities like tobacco leaves and soya for a number of years. Mahindra & Mahindra's tractors and jeeps have a dominant share of the market. Rallis had an agro-chemicals

and pesticides business for the last five decades. Nagarjun and Tata Chemicals have been dominant players in the fertiliser business while EID Parry is into the procurement of sugarcane for its mainline sugar business. Godrej, Bharti, Pepsi, Shriram and Reliance have all entered agri-business in recent years in a big way. Below we discuss the innovative business models being employed by some of the corporate biggies in their rural thrust initiatives:

ITC: The E-Choupal Initiative

The biggest and the most ambitious initiative undertaken by any corporate enterprise in rural areas in recent times has been the ***e-choupal*** initiative of ITC.

What in E-Choupal and How Does it Benefit Farmers ? The e-choupal redefines *choupal,* the Hindi word for village square where elders meet to discuss matters of importance. The all-important letter in the word is 'e'. It stands for a computer with an Internet connection for farmers to gather around and interact not just among themselves but with people anywhere in the country and even beyond. A local farmer called *sanchalak* (conductor) operates the computer on behalf of ITC, but exclusively for farmers. The e-choupal offers the farmers and the village community five distinct services:

1. **Information:** Daily weather forecast, prices of various crops, e-mails to farmers and ITC officials, news–all this in local language and free of cost.

2. **Knowledge:** Farming methods specific to each crop and region, soil testing, expert advice mostly sourced from agriculture universities — all for free.

3. **Purchase:** Farmers can buy seeds, fertilisers, pesticides and a host of other products and services ranging from cycles and tractors to insurance policies. Over 35 companies have become partners in the e-choupal to sell their products through the network.

4. **Sales:** Farmers can sell their crops to the ITC centres or the local market, after checking the prices on the Net.

5. **Development work:** NGOs working for cattle breed improvement and water harvesting, and women self help groups are also reaching villages through e-choupal.

Agriculture universities and government agencies like the Meteorological Department provide ITC with the latest information.

Each e-choupal covers between five to six villages. The most critical link in the e-choupal network is the *sanchalak* (called *pratinidhi* in some States). In just 2-3 years, *sanchalaks* have become the agents of change. For the work done by them, they are paid commission. To manage the hub of 50-odd e-choupals, ITC appoints a *sanyojak* (coordinator) who is either a former mandi trader or a local dealer of ITC products. He is the link between ITC and the *sanchalaks* and also earns a commission on e-choupal deals. ITC is setting up six e-choupals a day at the cost of about Rs. 3 lakh per installation. Since each e-choupal covers between five and six villages, the company is entering 30-36 new villages every day. About Rs. 125 crore has so far been invested in e-choupals and the company is committed to spending Rs. 1,000 crore on the initiative.

In the words of Rohit Saran, "By building this unique human organisation in which farmers, traders, companies, government agencies and NGOs compete and collaborate with each other, the ITC is — by design or by default—creating a new institution that is not a company, not a cooperative venture, not a government department but has some merits of all. It is this institutional innovation that puts ITC ahead of other companies entering rural India."[9]

Tata: Tata Kisan Sansar

Tata's journey to rural India has evolved over several years. Till sometime ago, the group's two companies, Tata Chemicals and Rallis India ran separate rural initiatives. Tata Chemicals owned a chain called Tata Kisan Kendras in Uttar Pradesh, Punjab and Haryana. The centres offered farmers a host of products and services ranging from agri-inputs (*e.g.*, seeds, fertilisers) to financing to advisory services. Rallis, among other things, was involved in a unique programme with select farmers in Madhya Pradesh. Farmers were first provided with seeds, pesticides and other inputs, mostly funded through loans from ICICI Bank. Once the crop was ready, it was bought by HLL and ICICI Bank loans repaid through income from sale. But the experiment did not sustain for long.

In April 2003, Rallis' operations were merged with Tata Chemicals. On October 26, 2004 the company relaunched its Kisan Kendras as Tata Kisan Sansar (TKS) which will evolve as a network of one-stop shops for farmers providing everything from inputs to loans to know-how. Important features of TKS are as follows:

BOX 23.1. ITC's Bold Rural Bet: The E-Choupal Initiative

Features	*Achievements and Ambitions*
• Solar-powered computer with VSAT for Internet. Crop-specific websites available in local languages. • Each e-choupal is set up by ITC at a cost of Rs. 3 lakh each. It purchases foodgrains, pulses and oilseeds, some of which are used in ITC's brand of food products. The e-choupals currently cover UP, MP, Rajasthan, Maharashtra, Karnataka and Andhra Pradesh. • A village farmer known as *sanchalak* operates the computer and earns commission on every sale and purchase through e-choupal. • Indian farmers typically buy at retail prices and sell their produce at wholesale prices, losing out on both ends of the deal. By virtually aggregating them, ***e-choupal brings the power of scale to the smallest of farmers.*** Bargain and choice—two key virtues of competition—are delivered to the farmers right at their doorstep. • The work of co-ordination of a hub of e-choupals in done by *sanyojak.* Sanyojak earns commission on transactions and monitors quality and payments.	**Achievement** • 6,400 choupals, 38,000 villages in 9 States, 4 million farmers (2000 to 2007). • Using e-choupal to source a range of farm produce (foodgrains, oilseeds, coffee, shrimps). • Marketing a variety of goods and services through e-choupal (agri-inputs, consumer goods, insurance, market research). • e-choupal serves as a purchase centre for ITC for 13 agricultural commodities. In 2006-07, ITC purchased about 2 million tonnes of wheat, soybeans, coffee, shrimp and pulses valued at $ 400 million. **Ambition** • To reach 1,00,000 villages, 10 million farmers by 2010. • Source large range of farm produce (spices, vegetables, cotton). • Market a wider variety of goods and services (education, health, entertainment, e-governance). • Transactions: $ 2.5 billion (2010).

***Source*: Rohit Saran , "Call of the Countryside: To Boldly Go Where..." *India Today*, December 13, 2004, pp. 46-54 and World Bank, *World Development Report* 2008 (Washington, 2007), Box 5.2, p. 121.**

- TKS presently comprises 421 centres spread over 14,000 villages in 3 States.
- The centres are linked to 20 hubs owned by Tata Chemicals.
- TKS has three broad sources of income: sale of inputs, advisory services and fee charged on the sale of partners' goods.
- TKS presently has 15 partners, including ICICI Bank, ING, SBI and agri-input companies.
- The company also undertakes contract farming in 15,000 acres of land. It grows paddy and vegetable seeds in Uttar Pradesh and Punjab and fruits in Maharashtra and Karnataka. The produce is sold to retail chains or exporters.

CFCL: Uttam Bandhan

In 2000, the K.K. Birla group's flagship company Chambal Fertilisers and Chemicals (CFCL) launched a community welfare initiative called Uttam Bandhan in Rajasthan. Under the programme, the company trains unemployed local youth as extension workers, known as Uttam Krishi Sewaks, who interact with farmers and advise them. Uttam Bandhan also manages an Internet website which provides information on weather, cropping techniques and markets.

In 2002, the company entered the food processing business by taking over a unit in Haryana. The unit processes and freezes fresh vegetables and markets them under the 'Ever Fresh' brand.

Mahindra and Mahindra: Shubh Labh

With 36 outlets, M & M's Shubh Labh network is spread over eight States. The company sells farm inputs and equipment through 'Shubh Labh'. It also undertakes contract farming in over a lakh acres. It also offers borrowing support to farmers through the Mahindra Krishi Vihar, a platform for banks to provide loans to farmers with minimum documentation, quick sanctions, and attractive interest rates. For banks it is a good way to make their rural lending safer without too much overheads.

Godrej: Adhar & Manthan

What started out as a small animal feeds sub-division of the soap division three decades ago has today become a Rs. 1,000 crore agri-business for the Godrej group, under its two companies Agrovet and Goldmohur Foods. The companies' products include natural pesticides, animal feed, oil palm plantlets and other farming inputs. More products are in the pipeline. The group is testing two new concepts, 'Adhar' and 'Manthan'. Adhar is a retail project — the company has opened stores in Andhra Pradesh and Maharashtra to sell it own as well as other brands. Services like soil analysis and veterinary care are also offered to farmers. Manthan focuses on

supplying quality animal feed so that animal produce — dairy and poultry which are integral to farmers' income — gets a boost.

Pepsi: Pepsi Foods

As a part of its food processing foray, Pepsi imported a state-of-the-art tomato processing plant from Italy to Punjab in 1989. The plant's processing capacity was 35,000 tonnes while Punjab's total tomato crop was 28,000 tonnes a year. In the next four years the company worked extensively with farmers and experts to develop a new breed of tomato and implement new ways of field preparation, crop monitoring, processing etc. By 1994 the production of tomato in Punjab had shot up to 1,30,000 tonnes while productivity increased by more than three times in a matter of just five years.

The company sold the tomato processing plant to HLL in 1995 and moved to other crops. It is heralding citrus plantation in the country. By end-2005 over one lakh citrus saplings were planted in Punjab and the number of trees is estimated to go up to 2 lakh by 2007. This will feed Pepsi's Tropicana juices, the raw material for which is currently imported.

EID Parry: Indiagriline

EID Parry's experiment with technology in rural Tamil Nadu focuses on 271 villages around its Nellikuppam sugar factory near Cuddalore. Parry has tried to build a community of "Parry farmers" through an IT initiative called 'Indiagriline'. It provides advisory services, finance facilities and other occupational information through village information kiosks called Parry Corners.

Reliance: Relicare

India's largest private sector company Reliance set up Reliance Life Sciences in January 2001 as a biotech venture with a $ 5 million investment. The company has developed a 200-acre herbal garden in Navsari, Gujarat, where it grows medicinal and herbal plants (MAP) such as ashvagandha, aloe vera, patchoulli, geranium and lemon grass. It plans to invest Rs. 1,000 crore and already has many MAP brands in the market under the brand name 'Relicare'.

Bharti: Field Fresh Foods

In September 2004, Bharti (the telecom company) entered into a 50 : 50 joint venture with the Rothschilds of Europe to set up a $ 50 million (Rs. 225 crore) 'Field Fresh Foods'. The company will take the contract farming route and provide the best of farming practices and technologies to farmers. It will export fresh fruits and vegetables to Europe, south-East Asia, Middle East and CIS (Commonwealth of Independent States) countries.

DSCL: Hariyali Kisan Bazar

DCM Shriram Consolidated used its experience in the sugar and seed business to set up 11 'Haryali Kisan Bazars' or rural malls in four States, with the first one in western Uttar Pradesh. The malls — six acres large — cater to farmers' needs by storing some 400 categories of products like stock feeds, seeds, fertilisers, veterinary medicines and farm implements. They are managed by agronomists who assist the farmers with technical know-how for free. The idea is to build a relationship with farmers and enhance their productivity.

NOTES

1. Defined to include 'agriculture, forestry and fishing, mining and quarrying'.
2. "Agriculture's Contribution to Development—Note" in Gerald M. Meier (ed.), *Leading Issues in Economic Development* (Delhi: Oxford University Press, 1995), p. 398.
3. Ragnar Nurkse, *Pattern of Trade and Development* (Stockholm, 1959), pp. 41-2.
4. Subrata Ghatak and Ken Ingersent, *Agriculture and Economic Development* (New Delhi: Selectbook Service Syndicate, 1984), p. 69.
5. K. Virupakshappa and V. Kiresur, "Oilseeds: Policy Options for Plenty", *The Hindu: Survey of Indian Agriculture,* 1997, p. 65.
6. Government of India, *India—A Reference Annual 2007* (New Delhi 2007), pp. 537-8.
7. Discussion in this section is based on Rohit Saran, "Call of the Countryside", and other related stories published in *India Today*, December 13, 2004, pp. 46-59.
8. *Ibid.*, p. 47.

UNIT 5

Business and Government — Indian Perspective

24. Economic Roles of the State and Government
25. Economic Planning in India
26. India's Fiscal and Monetary Policies
27. Industrial Policy
28. Export Import Policy and Trade Liberalisation
29. FERA and FEMA
30. Consumer Protection

The consequences of an overzealous rejection of government has shifted attention from the sterile debate of State versus market to a more fundamental crisis in State effectiveness. In some countries the crisis has led to outright collapse of the State. In others the erosion of the State's capability has led non-government and people's organisations — civil society more broadly — to try to take its place. In their embrace of markets and rejection of State activism, many have wondered whether the market and civil society could ultimately supplant the State. But the lesson of a half century's thinking and rethinking of the State's role in development is more nuanced. State-dominated development has failed, but so will Stateless development. Development without an effective State is impossible.

— World Development Report, 1997

CHAPTER

24 ECONOMIC ROLES OF THE STATE AND GOVERNMENT

The Evolving Role of the State
Economic Roles of the State/Government
• The State as Regulator • The State as Promoter • The State as Planner • The State as Producer • Consensus on Functions of the State
Economic Roles of the Government in India
• Role of the Government as Regulator • Role of the Government as Promoter • Role of the Government as Planner • Role of the Government as Producer • Role of the Public Sector

State is generally defined ***"as a set of institutions that possess the means of legitimate coercion, exercised over a defined territory and its population referred to as society. The State monopolizes rule making within its territory through the medium of an organized government."***[1] Government often refers to the system of governing in the society. Thus it means the structure and arrangement of offices and also the people who hold the positions of authority in a State. However, in discussion and writing, the terms State and government are often used interchangeably and we may also follow this common practice.

THE EVOLVING ROLE OF THE STATE

Under the influence of great classical economist Adam Smith who wrote *An Enquiry into the Nature and Causes of Wealth of Nations* in the late eighteenth century it was generally agreed that the ***market was the most appropriate instrument for realising economic growth and improving human welfare.*** The State's role was thus to be restricted to certain core functions—***providing public goods such as defence and highways, maintaining law and order to ensure security of persons and property, enforcing contracts and providing primary education to the people. However, in certain cases, State intervention was effectively used in Germany, Japan and even in the USA to support market guided development.*** In fact, there was no prejudice against State intervention and often business firms welcomed it because it served their interests. In the nineteenth century the State's role in redistributing income was limited and tax systems were used entirely for revenue raising. States thus remained small by modern standards until World War I.

Between the two world wars certain dramatic events led to significant expansion of the State. The first was the Bolshevik Revolution of 1917 in Russia which introduced central planning replacing the market. In the socialist system that was adopted in the Soviet Union the government became the planner and promoter of business development. ***Replacing private enterprise by the public enterprise the government also assumed the role of the producer. The second event was the Great Depression of the 1930s which caused unprecedented economic turmoil in industrially developed capitalist countries.*** The widespread economic devastation and rampant unemployment completely shattered the faith in the market system and people saw hope only in the government's counter cyclical policies to revive economic activity. ***The third event was undisputed endorsement of the welfare State in the industrialised countries in the aftermath of World War I.*** The second and third events expanded the role of the government in the developed countries.

In the developed economies of the West, after the Keynesian revolution, the policy makers by and large agreed on three principles. ***First,*** there was agreement on the limitations of the private enterprise and thus a mixed public-private economy was regarded as desirable. This implied nationalising a wide range of strategic industries. ***Secondly,*** need for a coordinated macroeconomic policy was recognised because market alone failed to ensure macroeconomic stability that is needed for sustained growth of business. ***Finally,*** reliance entirely on market for the welfare of the people was a questionable proposition. Hence, it was generally agreed that the State should provide social security and welfare benefits to those who suffer from transitory loss of income or other deprivation.

In the three and a half decades between 1960 and 1995, governments in developed western economies assumed new roles and expanded existing ones. By the mid-1990s the range of tasks performed by the government and its agencies included not only maintenance and development of infrastructure and utilities but also much more support for education, health care and social security. As a result, in the 35 year period from 1960 onwards the Central government expenditure rose from less than 20 per cent of GDP to over 35 per cent. In this period transfers and subsidies led to a dramatic increase in government expenditure. However, the increase in government expenditure was not at the same rate in the various industrial countries. From "a point of rough equivalence in 1960, the Swedish State grew to nearly twice the size of that in the United States by 1995, in terms of both spending as a share of income and public employment as a share of population."[2]

Governments in developing countries also expanded their existing activities and reached new areas in the 1960s and 1970s. After the collapse of colonialism most developing countries in Asia, Africa and the Middle East attempted to initiate growth process. These countries had a strong belief in State-dominated economic development. Since private enterprise was lacking in these countries, ***government assumed the role of the programmer, promoter and energiser of development.*** In some of the countries, the public sector was seen as an engine of growth. State control of the economy was central to this strategy. How India followed this strategy is described in Box 1.3 of *World Development Report 1997.* The Report points out that in the Nehru era, a powerful State with a planned economy was regarded essential for transforming India's agrarian economy into an industrialised economy. The strategy of growth did not assign an important role to foreign trade. Under Indira Gandhi as the Prime Minister, there were two major shifts in the role of the State. First, the State became active in the agricultural sector, as it subsidised fertilisers and new seeds, expanded institutional credit and provided electricity for farm operations. This strategy led to green revolution. The second shift was tightening of State control over industrial finance, foreign investment, trade and industry.

Between 1977 and 1991 the process of relaxing controls started. However, both open and hidden subsidies went on increasing. In this period fiscal deficit became unsustainable and the country was in deep economic crisis in 1990-91. In response to this crisis the reform process began in this country. Most of the controls were dismantled and the State's role changed from that of principal investor to that of facilitator of entrepreneurship.[3]

State activism was extremely popular throughout the world during the 1960s and 1970s. The Great Depression of the 1930s had discredited market based capitalism. In contrast, the Keynesian demand management with an effective State intervention seemed to be quite successful. In developing countries also market failures were emphasised and the State was assigned central role to correct them. Following the Soviet Union many Latin American, African and Middle Eastern countries adopted a State dominated, ***import-substituting strategy for industrialisation.*** Comprehensive centralised planning, regulated resource allocation and a public sector led industrial development constituted the core of this strategy. By the 1960s in many developing countries the State had become involved in important aspects of the economy as a regulator, promoter, planner and producer. The confidence in this strategy was shaken in the 1970s and the collapse of the Soviet Union exposed the limitations of the government dominated economies. There was a radical shift in the perspective. ***Market friendly strategies became popular in the 1980s and everywhere in the developing world State's role was drastically curtailed.*** This caused fiasco in a number of countries because in an attempt to correct fiscal imbalances important infrastructural development programmes were abandoned and expenditures on health and education programmes were reduced. This naturally eroded foundations of market oriented development and threatened social welfare. ***The overzealous rejection of government proved to be disastrous in several countries. It was not appreciated that State-dominated development had failed, but so will Stateless development. "Development without effective State is impossible."***[4]

ECONOMIC ROLES OF THE STATE/GOVERNMENT

Economic roles of the State/Government are broadly classified under the following heads:

1. Regulation
2. Promotion
3. Planning
4. Production

Governments in different countries have played the first two roles in various degrees at different points of time. Even in countries where regulatory structure has been liberalised in recent years, certain controls have been retained in the larger social interest. Promotion of business by the State is normally accepted by the private sector. As a matter of fact, corporates often expect the State to mobilise resources for them, carry out R & D activity at public cost, develop infrastructure and subsidise exports. The third role of the government listed above does not have universal acceptability and thus only in some countries over certain periods planning has been followed. Government's role as a producer is often influenced by its ideology. In some cases, however, government sets up enterprises in the public sector not because of any ideological conviction but on account of the vacuum in the industrial sector that is created by the limitations of the private sector.

The State as Regulator

More than two hundred years ago, Adam Smith stated in his classic work, *The Wealth of Nations* that competition in business is not a "natural" practice. Given the opportunity, business executives would prefer to seek ways of avoiding competition if they could strengthen their market positions by doing so. The history of business suggests that this is indeed the case. As a result, governments world over made a body of laws and policies to assure that competition is at least maintained if not enhanced. The antitrust laws passed in different countries commit the government to preventing monopoly and maintaining competition.

In developed countries, now-a-days industrial activity is not regulated. Corporate enterprises are thus free to carry out whatever industrial activity fits in their goal. There are no restrictions on industrial location. However, industrial units operate under environmental and safety regulations. In contrast, some of the developing countries are still persisting with industrial licensing. There are also restrictions on industrial location. Production of certain goods is reserved for small scale units. However, in recent years even developing countries have withdrawn many stringent regulations. Import controls, foreign exchange regulations, and price controls are now rare. The governments today prefer to rely more on fiscal and monetary measures to regulate business activity. Modern business is aware that the regulatory structure will never be dismantled completely. If the system suffers from certain limitations, it may be reformed or liberalised.

The State as Promoter

Promotional role of the government in a capitalist economy is determined by the limitations of the business. Since business firms are profit maximisers, they have virtually no interest in making investments in sectors where return is either small or, because of long gestation periods of projects, quite uncertain. Infrastructure, especially road development, rarely attracts private investment. At the same time, adequate development of highways and other modes of transport is a prerequisite for business growth. The governments have thus accepted the responsibility of infrastructure development. It has been observed that not only in developing countries but also in some of the leading developed countries, business suffers from a failure to use the most advanced management techniques, to cope with the scarcity of scientists and engineers, to introduce promptly advanced technical processes and to spend enough on research and development. The governments in both developed and developing countries thus recognise the need of business education and education for engineers. The efforts in the field of research and development improve labour efficiency and industrial productivity. ***Had industry and business been resourceful to conduct research and development the government's promotional role would have been rather limited.***

The government's promotional role is most pronounced in the field of finance. In developing countries, new issues by corporate enterprises are generally unsuccessful due to inadequate development of capital markets. Under the circumstances, resource mobilisation by the government owned financial institutions assumes great importance. Development banks are special industrial financing institutions. They have been set up during the post-World War II period in both developed and developing countries, but their role is more prominent in developing countries where the governments have taken upon themselves the responsibility of mobilising resources for much desired industrialisation. In developing countries, the governments felt the need for setting up special industrial financing institutions due to inadequate development of capital markets.

For a sustained economic growth business firms must make large investments in plant and equipment on a regular basis. However, businessmen will be unwilling to make heavy investments if they anticipate recessionary conditions due to lack of effective demand. In a capitalist economic system, recession inevitably follows boom because in the prosperity phase economic forces which tend to lower the marginal efficiency of capital begin to assert themselves. Costs of production rise and the output from competing investments flowing into the market does not always find buyers. In this situation, business firms have a tendency to reduce investments which further curtails effective demand. The situation can, however, be saved with the intervention of the government. ***Under the influence of the Keynesian economics, governments often undertake the task of demand management. By undertaking certain projects they increase their expenditures, which compensate for the loss of effective demand on account of reduced consumption and private investment.*** In this case, fiscal measures adopted by the governments promote business activity and thus should not be construed as regulatory.

Finally, it must be stressed that to a great extent business growth depends on the size of market. Modern corporates in the present day globalised world thus operate in both domestic and foreign markets. The giant transnationals of developed countries with international competitiveness and tremendous resources at their command rarely face any problem in selling their products in foreign markets. In contrast, producers in developing countries often lack international competitiveness due to cost disadvantages. Use of sophisticated technology sometimes affects the quality of the product. Hence, business firms in developing countries face difficulties in augmenting their exports. The governments in these countries are aware of the limitations of their business enterprises and thus they pursue various export promotion measures.

The State as Planner

The government sometimes plays an important role as a planner, especially in developing countries. During the post World War II period, many developing countries adopted economic planning for achieving higher growth rate and better standard of living. The common arguments advanced in favour of economic planning are as follows:

First, market forces fail to attain efficient allocation of resources in most developing countries due to imperfections in the product and factor markets. Hence, governments adopt economic planning for obtaining efficient allocation of resources. In these cases, market prices provide wrong signals to the decision makers.

Second, private investors usually ignore the dynamic externalities which account for the differences between social benefit and private benefit. Governments in developing countries follow planning for removing the differences between social benefit and private benefit that is considered to be necessary to obtain optimal allocation of resources.

Third, private investors usually attempt to maximise short term profits rather than long term profits. This naturally leads to a resource allocation which is socially sub-optimal in the long run.

Fourth, the path to economic progress via total reliance upon market forces has been considered very long. It is believed that economic planning if properly executed would accelerate growth process in developing countries. At present gap between rich and poor nations is quite large and economic planning with organised efforts can narrow it down.

Fifth, institutional reforms are sometimes necessary for realising rapid economic growth. A market economy usually does little to carry out institutional reforms. In contrast, economic planning permits the government to introduce necessary institutional reforms which in turn create conditions for more rapid growth.

Finally, developing countries lacking productive resources such as capital, skilled manpower, and foreign exchange want to use them in the most productive way and this can only be achieved if the whole economy is covered under an overall planning mechanism.

Many neo-liberal policy makers reject most of these arguments in favour of planning. In their opinion, the role of the government as a planner is based on false assumptions.

The State as Producer

In most capitalistic countries, the bulk of production is done in the private sector. Small scale manufacturing, commerce and agriculture are mostly in private hands, while large scale manufacturing, mining and finance are under the control of transnationals, domestically owned corporates and public sector enterprises. ***In developing countries State-owned utilities provide electricity, gas and water. Public enterprises also play a significant***

role in transport and communications. In contrast, pattern of ownership differs substantially in different countries in mining and manufacturing. During the 1970s and 1980s State owned enterprises in a number of countries, notably Egypt, Syria, Tunisia, Ethiopia and Burma accounted for around 60 per cent of value added in manufacturing. As against this, share of public enterprises in the value added in manufacturing was below 20 per cent in India, South Korea, Sierra Leone and Pakistan. ***Public enterprises also contribute substantially to investment in a large number of developing countries.***

Theoretically there is no reason why public enterprises should not operate at the highest possible efficiency level. But, according to World Bank, in practice there has been a great difference between what is theoretically feasible and what actually happened. Explaining the reasons why efficiency levels are low in the State owned enterprises (SOEs) the *World Development Report* 1983 stated, ***"As a commercial entity, an SOE must sell in the market place. As a public organisation, it is given other objectives and is exposed to pressure from politically powerful sectional interests.*** SOEs are often operated as public bureaucracies, with more attention to procedures than to results; and ready access to subsidies can erode the incentive for managers to minimise costs."[5]

Consensus on Functions of the State

Lately there seems to be a consensus on the functions of the State. Box 24.1 classifies the functions of government along a *continuum.* First, there are activities that will not be undertaken at all without State intervention. At the other extreme one finds activities in which the State plays an activist role in coordinating markets or redistributing assets. In between these minimal and activist functions are intermediate functions, such as regulation of monopolies and addressing externalities.

BOX 24.1. Functions of the State

	Addressing Market Failure			Improving Equity
Minimal Functions	*Providing pure public goods* Defence Law and order Public health Macroeconomic management			*Protecting the poor:* Antipovery programmes Disaster relief
Intermediate Functions	*Addressing externalities* : Basic education Environmental protection	*Regulating monopoly*: Antitrust policy Utility regulation	*Overcoming imperfect information*: Insurance Financial regulation Consumer protection	*Providing social insurance:* Redistributive pensions Family allowances Unemployment insurance
Activist Functions	*Coordinating private activity*: Fostering markets Cluster initiatives			*Redistribution*: Asset redistribution

Source : **The World Bank, *World Development Report 1997* (New York: Oxford University Press 1997), Table 1.1 p. 27.**

World Development Report 1997 has stated that the role of the State should match its capability for improving the effectiveness and efficiency of public resource use. Countries with low State capability should ordinarily confine their activities to basic functions: the provision of pure public goods, such as defence, law and order, control of infectious diseases, safe drinking water, roads, macroeconomic stability and protection of poor. In many less developed countries, the State has failed to provide even these services. Beyond these basic functions are the intermediate functions, such as control of monopolies, management of externalities, especially primary education and environmental protection, and the provision of social insurance. Regarding intermediate functions the government has no choice but to perform them. It can only decide as to how best to intervene. The government has the option of working in partnership with the private sector. But it must ensure that these public goods are provided. States with strong capability can perform more activist functions, dealing with the problem of non-existence of markets. In East Asian countries the State has played an important role in promoting markets through active economic policies.

ECONOMIC ROLES OF THE GOVERNMENT IN INDIA

As explained in Chapter 17, Indian economy is a mixed economy characterised by coexistence of private and public sector. In such an economy, ***the government is both regulator and promoter of private enterprise. The existence of public sector determines the role of the government as producer. Moreover, since market was partially replaced by economic planning, the role of the government as planner assumed great importance.*** In this section we propose to analyse these roles of the government in India.

Role of the Government as Regulator

Overtime, India had created a plethora of economic legislations for regulating various aspects of economic behaviour. The objectives of most of the legislations were commendable as they tried to fulfil a perceived economic or social need. Some of the main instruments of economic legislations—Industries (Development and Regulation) Act, the Monopolies and Restrictive Trade Practices (MRTP) Act, the Foreign Exchange Regulation Act (FERA) and the Imports and Exports (Controls) Act—fitted well with the economic planning introduced in India after Independence. However, as the reports of Monopolies Enquiry Commission (1966), the Industrial Licensing Policy Enquiry Committee (1969) and the Committee on Controls and Subsidies (1979) show, government regulation failed in achieving the desired objectives.

The report of the Industrial Policy Enquiry Committee is quite exhaustive. It has noted that the licensing system and other industrial controls did not succeed in developing industries according to Plan priorities. ***Licensing rarely prevented growth of non-essential industries and also failed in ensuring the development of the more essential ones.*** The Industrial Licensing Policy Enquiry Committee Report identified 45 companies producing far in excess of the licensed capacities. In many cases the excess capacities created by the erring companies were later approved by the government. Influential industrialists often obtained licenses to pre-empt entry of competitors. These licenses in many cases were not implemented. Applications of less influential industrialists were often rejected on the pretext that there was no scope for additional capacity.

During the 1970s the government enlarged regulatory framework as it legislated the Monopolies and Restrictive Trade Practices (MRTP) Act in 1970 to control large corporates and the Foreign Exchange Regulation Act (FERA) in 1974 to control foreign firms. The objectives of these regulatory legislations were laudable as they attempted to cover important social and economic needs. However, their enforcement was found to be difficult. Bimal Jalan opines, "The complex web of laws and regulations are not enforced in practice; what is worse, they cannot be enforced even under the best of circumstances".[6]

J.N. Bhagwati, Padma Desai, T.N. Srinivasan and Isher Judge Ahluwalia among others have been highly critical of the regulatory regime which this country had for more than four decades since Independence. In their opinion, controls and regulations were a fundamental constraint on industrial growth. They also contended that ***disappointing industrial performance reflected simply poor productivity performance. And the low industrial productivity was the result of extensive bureaucratic controls over production, investment and trade.***[7]

Role of the Government as Promoter

The government has played a vital promotional role in the Indian economy. Like other governments in both developed and underdeveloped countries, the government in this country has actively developed infrastructure, especially means of transport, communication system and sources of energy. The government's direct involvement in agricultural development has enabled farmers to raise their production and thereby incomes. This has created extensive market in the rural areas for manufactured goods. Reservation of certain products for the small scale industries has promoted their development. The government's role as mobiliser of financial resources for the private sector by setting up development banks and other investment institutions has been particularly important in the absence of a developed capital market. Policy of protection to domestic industries until recently promoted industrial development. Lately since the government has adopted the strategy of export led growth, it has introduced various export promotion measures.

Agriculture at the time of Independence was extremely underdeveloped. Techniques of production in agriculture were outmoded and the productivity was low. Hence, market for industrial products in the countryside was almost non-existent. The government thus introduced new technology, especially in the wheat belt during the 1960s. This strategy did miracle in Punjab, Haryana and Western Uttar Pradesh. There was a spectacular rise in agricultural productivity and in big farmers' income.

The government's role in promoting industrial activity in the private sector has been both direct and indirect. Indirectly it facilitated industrial development by developing infrastructure and agriculture. Directly

it promoted industrialisation by participating in the risk capital of certain private sector enterprises, by setting up institutions to train technical and managerial cadres and by providing incentives for export production. The government's role as a mobiliser of financial resources for the private sector is, however, most commendable. For a few decades since Independence capital market was highly undeveloped. As such, corporate enterprises could not raise the necessary resources in the new issues market. In India, the household sector accounts for more than two-thirds of gross domestic savings. Most people who do savings in this sector are risk averters and are usually reluctant to invest their savings in corporate enterprises. Under the circumstances, government's role as resource mobiliser for the private sector assumed great importance. During the post Independence period, thanks to the initiative taken by the government, a number of financial institutions were set up with the purpose of providing finance to private enterprises.

Role of the Government as Planner

Economic planning was adopted by the government in India for transforming its underdeveloped agrarian economy into a modern industrialised economy. The government thus as a planner set up basic and capital goods industries, developed infrastructure, carried out agrarian reforms and created conditions for the growth of private business. It also promised social justice to the disadvantaged sections of the society.

Over the past five and a half decades ten five year plans have been completed and currently the Eleventh Five Year Plan is being implemented. During these years not only the national income has increased, but considerable development has also taken place in the various sectors. Nonetheless, it remains true that the trend rate of growth has been quite modest, for long periods the modern industrial sector reflected all the symptoms of stagnation and retrogression, employment situation has not improved, income inequalities have not decreased and fiscal mess has created inflationary pressures. The crux of the matter is that there is currently a deep rooted economic crisis in the country. It is often contended that this situation has developed on account of a defective planning perspective, wrong strategies and the government's indifferent attitude towards the realisation of the plan objectives. This scathing attack on the basic planning framework and planning practice may not be correct but there is no doubt that the Indian plans have often failed to realise their proclaimed objectives.

Economic planning was adopted in India because it could compensate for 'market failure'. But the first four decades of development planning have shown that there can be 'government failure' as well. In this country, the regulatory system caused economic losses due to misallocation of resources resulting from wrong investment decisions and diversion of resources to what economists call 'rent seeking'. C. Rangarajan thus argues that ***there can be both government failure and market failure, and that "critical issue is not so much the presence and absence of State intervention but the extent and quality of intervention."***[8] However, the issue could not be posed in this manner in the fifties or even sixties. In that period, India's primarily agrarian economy could not be exposed completely to the imperialistic designs of the western developed countries. Hence, economic planning had to orient itself towards self-reliance. This naturally forced India to follow the strategy of import substitution based growth even if it meant slow growth. The stress on heavy industry development first was thus not wrong as perceived by some economists. This development policy nonetheless resulted in the growth of high cost industry which was not internationally competitive. ***Unfortunately plethora of controls and bureaucratic restrictions created a mess in the economy and provided scope for rent seeking activities.***

Now former World Bank economists popularly known as liberalisers have come to occupy the centre stage in the country's government set up. Their entire concern is economic growth. Who benefits from this growth is of little interest to them. With this frame of mind they are arduously trying to bury economic planning beyond retrieval. For these economists market is the panacea of all the ills. Keynes is no longer relevant for them. They are confident that the wasteful, energy intensive and environmentally destructive life-style of the elites will create sufficient effective demand to sustain growth. The problem of poverty can be taken care of merely by denying the very existence of it.

Most people in the country, however, do not subscribe to the viewpoint of liberalisers. In their opinion, ***the broad objectives of planning are still valid and in India's liberalised economy, with some changes in instrumentalities to achieve these goals, economic planning should play an important role.*** However, given the policies of the Indian government economic planning is likely to be sabotaged both at the programming and implementational level. There is now incontrovertible evidence of the government's casualness towards

planning. The Ninth Five Year Plan had officially commenced on April 1, 1997 but the Plan document was released by the Planning Commission only in March 1999, i.e. almost two years after the commencement of the Plan. With this kind of lack of commitment for economic planning there are real risks in assigning even a limited role to planning in the liberalised economy of the country. But there is no choice in this regard because market failure is a reality and public goods in any case have to be supplied by the government. In addition to these reasons, planning may be required for tackling problems arising from the irrationalities of the capitalistic economic growth.

The basic justification for planning is clearly stated in Narasimha Rao's foreword to the Eighth Five Year Plan : ***"The market can be expected to bring about an 'equilibrium' between 'demand'—backed by purchasing power—and 'supply', but it will not be able to ensure a balance between 'need' and 'supply'."***[9]

Role of the Public Sector

In India, the government's involvement in industrialisation began in the mid-1950s when it set up large-scale units in the public sector. Its action since then in this direction had nothing to do with socialist ideology. In fact, growth of public enterprises is to be viewed as a gap-filling exercise or as an antidote to investment failure in the private sector. The private sector had neither the resources nor incentive to develop capital-dominated industries. The public sector over the past four decades accounted for a much larger fraction of gross investment than of gross or net domestic saving. This implied that the public sector failed to generate enough internal resources for financing its own investment. This situation arose on account of deliberate under-pricing of public goods and services, alongwith open and concealed subsidies provided by the public enterprises to private users of their products in addition to inefficiency and underutilisation of capacity in these enterprises.

The government should now withdraw from direct production of goods and services except in the areas of basic and social infrastructure because the experience of public sector in India has confirmed Lange's worst apprehensions about the success of attempts to control and plan production and investment without removing private enterprise and private ownership of means of production. Lange stated even before the experiments in economic planning in the mixed economy framework had started, ***"the great economic power of corporations and banks being what it is, it would be they who would control the public planning authorities, rather than the reverse. The result would be planning for monopoly and restrictions, the reverse of what was aimed at...."***[10].

NOTES

1. The World Bank, *World Development Report 1997* (New York : Oxford University Press, Inc. 1997), Box 1.1 p. 20.
2. *Ibid.,* p. 22.
3. *Ibid.,* p. 24.
4. *Ibid.,* p. 25.
5. The World Bank, *World Develoment Report 1983* (New York: Oxford University Press, 1983), p. 50.
6. Bimal Jalan, *India's Economic Policy* (New Delhi: Viking, 1996), p. 1.
7. Jagdish N. Bhagwati and Padma Desai, *India: Planning for Industrialisation* (London: Oxford University Press, 1970); Jagdish N. Bhagwati and T.N. Srinivasan, *Foreign Trade Regimes and Economic Development: India* (New York: National Bureau of Economic Reserch, 1975); and Isher Judge Ahluwalia, *Industrial Growth in India : Stagnation since the Mid-Sixties* (Delhi : Oxford University Press, 1985).
8. C. Rangarajan, "Indian Planning : Objectives, Strategy and Instrumentality", in Manbendu Chattopadhyay, Pradip Maiti and Mihir Rakshit (eds.), *op. cit.,* p. 36.
9. Government of India, Planning Commission, *Eighth Five Year Plan 1992-97,* Volume I, (Delhi, 1992), Foreward.
10. O. Lange, *On the Economic Theory of Socialism* (University of Minnesota Press, 1939), p. 119.

CHAPTER

25

ECONOMIC PLANNING IN INDIA

The Rationale For Planning
The Planning Process
Important Features of Indian Plans
Objectives of Economic Planning
India's Five Year Plans : Basic Approach
• The Earlier Period: 1951 to 1969 • The Seventies: The Fourth and Fifth Plans • The Sixth Five Year Plan • The Seventh Five Year Plan • The Eighth Five Year Plan • The Ninth Five Year Plan • The Tenth and Eleventh Five Year Plans

Economic planning as an instrument of development was adopted in India in 1951. Over the past fifty seven years the country has completed ten five year plans. Currently the Eleventh Five Year Plan is in progress. Economic planning in India laid down the parameters of private business in this country. Hence, careful analysis of Indian plans has always been necessary for the business enterprises to be successful. Precisely for this reason we also propose to analyse basics of economic planning in India.

In India, development plans were formulated and carried out within the framework of the mixed economy. The public sector in India's mixed economy generally remained confined to infrastructure and basic and heavy industries while all other productive activities were performed in the private sector.

In such an institutional setting of the Indian economy, one can identify two principal components of economic planning:

1. The ***government mobilises domestic resources and also raises foreign finance to carry out such projects which are expected to induce productive activities in the private sector.*** From this point of view development of infrastructure, particularly railways, hydro-electric projects and irrigation system, receives overriding priority. The other activity that invited government's direct involvement in the past was setting up of heavy industries involving large finance and long gestation period. However, with the adoption of liberalisation policy in the early 1990s, the government has been withdrawing from the industrial sector.

2. ***The government also adopted on the one hand certain economic policies (e.g., taxation, industrial licensing, tariffs, wages, prices and interest rates) which stimulated private economic activity, and on the other introduced restrictive physical controls in order to ensure a harmony between the social objectives of the government and the behaviour of the private producers and businessmen.***

From the above characterisation of planning in India, it is clear that ***economic planning in this country did not replace the market. In fact, the market and economic planning have been complementary to one another.***

THE RATIONALE FOR PLANNING

Economic planning was accepted in India as a development tool on account of various reasons. Of these, the following are the most important:

1. Limitations of the market mechanism. The need for economic planning has often been felt on account of the limitations of the market mechanism in respect of both efficiency and equity. In market economies—both developed and underdeveloped—planning has been adopted for overcoming these limitations of the market mechanism. In the socialist path of development alone there was a ray of hope. The country, therefore, wanted to benefit from the Soviet Union's experience in economic planning. ***Rhetoric notwithstanding, India never aspired to build socialism. The agenda was always capitalism.***

2. The need for social justice. The experience of the past five and a half decades in this country clearly suggests that in a free enterprise economy gains of economic growth do not necessarily trickle down. In fact, market forces operate in such a manner that further concentration of economic power takes place and the growth bypasses those very people who deserve to be helped most. It is this reason why in this country need for undertaking poverty alleviation programmes in the overall framework of development planning is felt. Moreover, India will find it increasingly difficult to tackle the unemployment problem if it relies entirely on market forces.

3. Resource mobilisation and allocation in the context of overall development programme. India suffers from resource constraints and, therefore, it has to use the resources judiciously. Investment projects in this country should not be chosen entirely on the basis of privately profitability. In developing countries like India, the choice of development projects should rest on social benefits rather than private profitability. Hence the State's intervention in the economy with a view to optimise social gain from the utilisation of scarce resources becomes necessary.

THE PLANNING PROCESS

Since economic planning in India has been considered a far more efficient system of managing the affairs of the economy than relying exclusively on the market mechanism, it is necessary for us to follow the planning practice in this country. We thus propose to explain practical aspects of planning considered to be important by the economists.

1. Planning body. ***The first condition for economic planning is the constitution of a planning body by the government. In India, this planning body is known as the Planning Commission.*** The main functions of this body are to survey the resources, spell out the broad objectives, lay down the priorities, formulate the strategy for realising the objectives, determine macro-economic goals, finalise targets for different sectors and/or units, and plan resource mobilisation for the implementation of various programmes.

2. Survey of resources and collection of necessary data. ***Survey of resources and availability of necessary data are two important requisites of economic planning.*** The size of the Plan is often limited by the availability of the resources. Therefore, the planning body must know the volume of material, human and capital resources at its disposal while formulating a plan.

3. Planning objectives. Economic planning implies certain goals. These goals are often clearly defined and the efforts are directed under the plan to realise them. If the plan is not consistent with the national goals, it is a useless exercise or even a deceit.

4. Priorities. ***Economic planning requires that priorities are spelt out for the public investment programme.*** No country can ever meet all the investment requirements of its various sectors. Therefore, India always had well defined priorities under its plans. If that had not been done, then the meagre resources would have been so much diffused that their possible impact on the overall growth activity would have been lost.

5. Development strategy. ***Economic planning implies a strategy for the realisation of the broader goals. In the absence of proper strategy the planning might lack direction and the realisation of the potential may always be in doubt.*** Therefore, India which aspired to attain a higher level of development over the years had to decide whether it could sustain its long-term development merely by giving a big push to the development of capital goods industries or there had to be a consistency between the development of both consumer and producer goods industries. Further, it had to settle whether it preferred growth via export promotion or import substitution.

6. Balancing in the plan. Indian Plans have always been consistent in the sense that proper balances were maintained between saving and investment, demand for goods and their supply, availability of human resources and manpower requirements, imports and the availability of foreign exchange. Planners' inability to ensure these balances can result in either shortages or excess supply of productive resources.

In India, planners attempt to ensure two types of balances in a plan. The first is the ***monetary or financial***

balance which implies that planned spending at the macro level has to be equal to the disposable income. In recent years inability on the part of the planners to ensure this balance has resulted in inflation and balance of payments problem. The second is the ***physical balance which implies inter-sectoral consistency between the demand and supply.*** In order to ensure physical balance planners often rely on the input-output technique associated with the name of W. Leontief.

7. Resource mobilisation. ***Indian plans lay down investment targets for both public and private sectors.*** As far as the private sector is concerned the major responsibility for resource mobilisation lies with the private business units. These units raise either equity capital or obtain loans from banks and other financial institutions. The role of the State in this case is subsidiary, as it merely facilitates mobilisation of savings for investment in the private sector. For public sector outlay, funds are obtained from both domestic and external sources. Taxation, market borrowings and surpluses from public enterprises are the major sources of finance from domestic sources. In India, among other sources one can mention small savings, and State provident funds. The resources from these sources generally fall short of the investment requirement in the public sector. Therefore, India has been seeking external assistance for its development plans.

8. Administrative efficiency. Since a plan has to be implemented by the State machinery, its success greatly depends on the quality of administration which a country has. In India, the administration is both inefficient and corrupt and this invariably provides ample scope for scuttling the plan at the various levels. For the success of a plan a necessary condition is that the administrative staff prepares good feasibility reports of the proposed projects.

IMPORTANT FEATURES OF INDIAN PLANS

Economic planning in India has been resorted to with the object of translating development premises into practice. Let us spell out the main features of planning as practiced in India.

1. Indicative economic planning. Indian plans do not carry an element of compulsion or inevitability as found in the planning of socialist countries. The Indian plans generally lay down targets even for those sectors of the economy over which the government has no control. Since the management of the activities in these sectors rests in private hands, the government can never be too sure of achieving the targets laid down in the plans.

The main reason for this state of affairs is the presence of the mixed economy. Such a system gives ample incentives to the private capital and uses few controls. ***There is no compulsion or inevitability in any work though there might be some regulation and regimentation of economic activities.*** As against the private sector, it is indeed more essential to accomplish the targets laid down for the public sector. However, even here there is no complusion as such. This shows that Indian planning is indicative economic planning or planning by inducement only.

2. Indian plans are comprehensive. The Indian plans are comprehensive and encompass all fields of economic activity. Viewed in this way, they are different from economic planning in West European countries where it is partial (touching a few sectors). The attempt in those countries is mostly directed towards maintaining a high level of employment through fiscal measures. When conditions of scarcity or shortages of certain commodities emerge plans are drawn for their judicious distribution through rationing and price control. As against this type of partial planning, ***Indian planning is comprehensive. In Indian plans, targets are laid down separately for all the sectors of the economy like the agricultural sector, manufacturing industries, electricity generation, transport, communications, etc.***

3. Physical planning. ***Economic planning can be of two types—(i) physical planning, and (ii) financial planning.*** The former implies allocation of resources in terms of men, material and power to accomplish the targets laid down in the plan documents. The latter implies the provision of financial resources to make this possible. ***Both are complementary and proceed side by side in rational planning strategy.*** However, both P.C. Mahalanobis and Pitamber Pant who influenced the framing of the Second Plan most were physical planners. They believed that "provided the investments were technically feasible, saving ought to be forthcoming somehow."[1] ***The obviously wrong assumption that "What is physically possible is financially possible too"[2] led to complacency on the financial front and the neglect of financial planning led to large-scale deficit financing giving rise to inflationary conditions.***

4. Unreliable data. In India, the quality of data is extremaly poor. It is hardly reliable. Any planning, if it has to be purposeful, should be based on authentic data. Without reliable data, projections would be a mere guesswork and the analysis would lack the rigour of sound economic reasoning.

OBJECTIVES OF ECONOMIC PLANNING

The long-term objectives of economic planning in this country have been spelt out in various Plan documents. Broadly the main objectives have been: (1) economic growth (approximately 6 per cent per annum increase in the net national product or gross domestic product), (2) self-reliance, (3) removal of unemployment, (4) reduction of income inequalities, (5) elimination of poverty and (6) modernisation. Some of these objectives have been elaborately discussed in the Second and Third Five Year Plans. In the subsequent plans they have been simply reiterated. Various plans, however, did not place equal emphasis on these objectives. Whereas earlier plans laid stress on rapid economic growth more than any other objective, the later plans attached great importance to self-reliance, generation of employment and removal of poverty. In the Seventh Plan modernisation was stressed. The P.V. Narsimha Rao government which assumed office in June 1991 virtually abandoned these long term objectives of economic planning. Its entire concern was to implement a programme of macro-economic stabilisation through fiscal correction. Moreover, the trade, industrial and public sector policies aimed at undermining the very system of economic planning. The government's lack of commitment towards economic planning can be appreciated from the remarks of the Deputy Chairman of the Planning Commission in the preface to the Eighth Plan document that ***the Eighth Plan is a Plan "for managing the transition from centrally planned economy to market led economy".***

The objectives of economic planning as they have been spelt out in various plans cannot be realised simultaneously. Often ignoring the incompatibility between various objectives it is expected that the success will be achieved in all the directions. The experience in the past, however, has belied these expectations.

In India's mixed economy, the objectives of rapid economic growth and reduction in income inequalities seem to be in conflict. India's underdeveloped economy is basically different from the Keynesian world. In the developed West, recourse to various redistributive measures will raise the marginal propensity to consume, which in turn will induce investment. Obviously with an increase in investment not only employment level will rise, but overall development will also take place. However, this policy will not work in India with the same effectiveness. Shortage of capital is the major obstacle to development in this country. Most of the unemployment in this country is structural in character and differs from unemployment of the Keynesian world. The saving rate is not high enough to match the investment rate required for providing employment to everyone. The techniques which can generate adequate surplus for rapid economic growth are such that they will hamper creation of new jobs and will thereby accentuate inequalities in income and wealth. If, on the contrary, labour-intensive techniques are adopted so as to create employment opportunities on an extensive scale, adequate surplus required for realising warranted rate of growth may not be generated. This, as a matter of fact, is a major problem to which in the past Indian plans have not paid sufficient attention.

Ignoring the incompatibility between growth and other objectives, Indian plans have accorded the highest priority to growth and, in practice, whenever other objectives have come in conflict with the objective of growth, they have been given up in favour of the latter. There is ample evidence in support of this contention.

While spelling out the objectives of the Fourth Plan, reference in most unequivocal terms was made to reduction of inequalities in income and wealth. However, the indifference of the Planning Commission towards this objective was unconcealed. One can easily judge this from its broad approach defined in the Fourth Plan document itself which states, "To some extent income disparities can be reduced through fiscal measures aiming at reduction of income at the top levels; but for us it is important to lay far greater stress on positive steps for ameliorating the conditions of poorer people through planned economic development. In a rich country greater equality could be achieved in part by transfer of income through fiscal, pricing and other policies. No significant results can be achieved through such measures in a poor country, where whatever surpluses can be mobilised from the higher incomes of richer classes are needed for investment in the economy to lay the basis for larger consumption in the future."[3]

The approach of the Fourth Plan was criticised by Dandekar and Rath who wrote: ***"But a plan of development, which accepts a national minimum and aims at assuring the same to all within the shortest possible time, cannot depend entirely on a high rate of economic growth. Without a deliberate policy to ensure an equitable distribution of the gains of development, the processes of development benefit the upper middle and richer sections of the population much more than they do the lower middle and the poorer sections. As a result even a high rate of growth, probably beyond the range of feasibility, cannot lift the bottom of the society to the desirable minimum within the foreseeable future. This is not a plea for a lower rate of growth but a warning that a high rate of growth is not a substitute for deliberate policies to ensure***

equitable distribution of the gains of development.[4] Mahbub-ul-Haq seems to speak on behalf of a great number of economists when he succinctly remarks that ***"we were taught to take care of our GNP as this will take care of poverty. Let us reverse this and take care of poverty as this will take care of the GNP."***[5]

INDIA'S FIVE YEAR PLANS: BASIC APPROACH

Since we have discussed the Eleventh Five Year Plan separately this next chapter, we have restricted the discussion in this section to first ten plans. Under these plans theoretical basis of India's planning process has undergone considerable discussion and refinement. However, the actual planning process does not seem to have been influenced much by this theoretical reasoning.

The Earlier Period: 1951 to 1969 — First Three Five Year Plans

The First Five Year Plan nowhere specified on what model it was based. However, when we examine the estimates of savings, investment, capital-output ratio, and the long-term objectives alongwith short-term national income projections, it becomes clear that the underlining model was the Harrod-Domar model though some modification in it was effected. The Domar equation is represented as

$$\Delta I \frac{1}{\alpha} = I\sigma$$

where I is the rate of investment in a given period, α the marginal propensity to save, and σ the potential average productivity of investment. In the model, I_0 (i.e. investment in the initial period), is taken as given and values to σ and α are assigned according to what seems feasible. In the First Plan I_0 (the rate of investment in 1950-51) was taken as 5 per cent of the national income; σ was taken as 0.33 and it was assumed that the value of α could not be raised above 0.20 in the plan period. On the basis of these assumptions the likely rates of investment in subsequent years (and their impact on incomes) were worked out. ***The modification made in the Harrod-Domar model in the First Plan was that whereas the original model assumed that the average and marginal rate of saving were equal, the First Plan model assumed that the marginal rate of saving was greater than the average rate of saving. The implication of this modification was that with the rise in national income, saving rate would increase. Thus with the progress of each plan, the rate of growth would also increase. The main drawback of this model was that it did not pay proper attention to the structural problems of the economy and considered the development process to be a result of the rate of capital formation.*** Accordingly, it did not take into account the real problems that the economy had to face in the development process.[6]

The initial attempt of P.C. Mahalanobis (whose models formed the basis of the Second and Third Plans), was based on the Harrod-Domar formulation. In the course of a lecture delivered in 1952, he used the following mathematical model:

$$Y_t = Y_0 (1 + \alpha\beta - \rho)^t$$

where Y_t is per capita net national income in year t, α is the rate of net investment, β is the addition to national product which is generated by a unit of net investment and ρ is the rate of increase of population. On the basis of this model, ***Mahalanobis concluded that for achieving a reasonably high rate of growth it would be sufficient if α (i.e., the rate of net investment) was stepped up to 10-11 per cent of the national income.***

The really important model that formed the basis of the planning strategy in the Second Plan was presented by Mahalanois in 1953. This model describes the growth path of the national economy in terms of the following curve:

$$Y_t = Y_0\left[1+\alpha_0 \frac{\lambda_i\beta_i + \lambda_c\beta_c}{\lambda_i\beta_i}\left\{(1+\lambda_i\beta_i)^t - 1\right\}\right]$$

where Y_t is the gross domestic product in year t, α_0 is the rate of investment in the base year 0, λ_c is the share of investment going to investment goods industries and λ_c is the share of investment going to consumer goods industries, β_i is the incremental output-capital ratio in investment goods industries and β_c is the incremental output-capital ratio in consumer goods industries. Now if α_0 and β_i are constant and $\beta_c > \beta_i$ and $Y(\lambda_i')$ and $Y(\lambda_i'')$ are curves corresponding to $\lambda_i = \lambda_i'$ and $\lambda_i = \lambda_i''$ and if $\lambda_i' > \lambda_i''$ then the curve $Y(\lambda_i')$ will intersect the curve $Y(\lambda_i'')$ from below.[7] This has the following important significance for planning—***higher the allocation of investment to the investment goods industries, lower will be the rate of growth of income in the short run, but higher will it be in the long run.*** Similar results hold for the curves representing growth of consumption

and this implies that ***if one wants a high rate of growth of consumption in the long run, then the best policy is to give priority to the development of investment goods industries over consumer goods industries.***[8] This meant that the investment goods sector should get precedence over the consumer goods sector and the higher the proportion of investment goods output that is reserved for the investment goods industries, the sooner would the desired rate of investment be reached. And since the rate of investment was regarded as the kingpin of national development and growth, it was found desirable to accept the strategy advocating more investment in investment goods sector (or the heavy and capital goods sector). On account of various considerations, it was also deemed necessary to continuously increase the role of public sector in the national economy. Thus ***the strategy of industrialistion as it finally emerged in the Second Plan had the following three basic elements:***

(*i*) ***stepping up the rate of investment since rate of development depends upon the rate of investment;***
(*ii*) ***rapid expansion of the productive power of the economy by increasing appreciably the proportion of investment in heavy and capital goods sector; and***
(*iii*) ***increasing the scope and importance of the public sector so that this sector comes to control 'the commanding heights' of Indian economy.***[9]

These elements of the industrial strategy can be taken to be the basic elements of Indian planning strategy as it evolved in the Second Five Year Plan. The subsequent plans also continued to accept these elements as basic though the Third and Fourth Plans did talk of giving more importance (as compared to the Second Five Year Plan) to agriculture and allied activities.

The Seventies: The Fourth and Fifth Plans

By 1970 a distinct change in the thinking of planners was clearly discernible. As a result of the pioneering study of V.M. Dandekar and N. Rath *Poverty in India* in 1971 and the follow-up discussion in which a number of economists participated, the conviction grew strong that poverty and misery were widespread in India and there was an urgent need to take account of this problem in plan exercises. The revelation made by the study that more than 40 per cent of the population was unable to achieve even the minimum necessary level of subsistence called for a drastic revision of plan priorities and programmes. ***Accordingly, for the first time in Indian Planning history, the Approach Paper of the Fifth Five Year Plan talked of a redistributive scheme aiming at bringing down the per capita consumption level of the richest 30 per cent of the population so that the lowest 30 per cent of the population could be guaranteed a minimum level of subsistence.*** The following objectives were laid down to achieve this purpose: (*i*) the most important ultimate objective of planning was that by the final year of the Fifth Plan, poverty should be removed in the sense that practically nobody should have a consumption level below a certain minimum; (*ii*) the second important objective was that inequality of distribution of consumption should be reduced by a certain stipulated degree (expressed in terms of change in the Lorenz ratio); (*iii*) target for aggregative consumption should be set for the final year of the plan in such a way as to be compatible with the above two objectives; (*iv*) other macro-economic targets for the final year of the plan (e.g., terminal year capital formation, exports, imports, etc.) should be set as to be in agreement with the target for aggregate consumption; and (*v*) a production structure at the disaggregated level should be worked out as to permit the realization of the macroeconomic objectives as (*i*) and (*ii*) above.[10]

Severe doubts were expressed about the proposed plan of redistribution in favour of the poor people and the scheme invited a scathing criticism from various quarters. Though the production process, with some changes, could be diverted to produce mass consumption goods, no definite strategy was enunciated to carry out the actual process of transfer of income to the poor. It was also not specified how the incidence of the cut proposed on 30 per cent upper strata of society was to be distributed among them. A considerable proportion of these people belonged to the lower strata of the middle class or even lower class and a cut in their income would spell misery to them. Because of the difficulties involved in tackling these problems satisfactorily, and on account of the lack of political will and courage to actually carry out the scheme, the Draft Fifth Plan abandoned the exercise. ***Though the importance of redistribution was stressed, the policy measures did not envisage any radical or bold redistributive scheme.***

The Sixth Five Year Plan

The Sixth Plan's development perspective visualised accelerated progress towards the removal of poverty, generation of gainful employment and technological and economic self-reliance. The plan had argued that a substantial acceleration in the overall rate of growth was an essential condition for the realisation of these objectives. However, it admitted that benefits of such achievements do not percolate downwards to the masses of people who remain poor and starved of necessities of life. On account of this reason the development

strategy incorporated some specific action programmes like the National Rural Employment Programme and some other anti-poverty measures.

As far as the selection of the growth path was concerned, the Sixth Plan document considered the question of choice between two alternatives—more growth now and less growth later, and less growth now and more growth later. Keeping the constraint of domestic and foreign exchange resources and the range of possible technological choices in view, the Planning Commission considered the following alternatives: (*a*) the alternative of a growth rate of 6 per cent in the post Sixth Plan period which could be achieved provided the Sixth Plan growth rate was kept down to 5 per cent per annum or even less and (*b*) somewhat higher growth rate in the Sixth Plan and a slightly lower growth rate in the period beyond. Given the initial capacity constraints, the Plan assumed that it would not be possible to achieve a higher growth rate than 5.2 per cent per annum in the Sixth Plan. Accordingly, the choice of growth rate in this Plan was kept at 5.2 per cent per annum.

The Seventh Five Year Plan

The basic task of economic planning in India has been to bring about a structural transformation of the economy so as to achieve a high and sustained rate of growth, a progressive improvement in the standard of living of the masses leading to eradication of the problems of poverty and unemployment and the building up of a self-reliant egalitarian society.

The strategy to attain these goals was evolved after careful consideration of the attendant costs and benefits. A major shift in the perspective was ***acceleration in the pace of industrialisation.*** It was expected that as a result of the pursuance of the new development strategy the share of manufacturing would increase to 20 per cent of the total GDP from below 15 per cent on the eve of the Seventh Plan. The shares of infrastructure and service sectors were also expected to increase, while the share of agriculture was expected to decline from around 37 per cent to 25.5 per cent.

The long-term development strategy under the Seventh Plan accorded the highest priority to creation of opportunities for productive employment for a continuously growing labour force. Alongside, effective measures were to be adopted to lower down the rate of population growth. In planning for food self-sufficiency nutritional requirements were to be adequately taken care of. Energy planning was an important constituent of long-term strategy. It was felt that in this sector particular efforts would be required to restrain the rate of growth of demand for petroleum based energy.

The main objectives of the Seventh Plan were the same as stated in the earlier plans. Hence under this plan the stress was on growth, modernisation, self-reliance, employment and social justice. The planners thus once again ignored the possible conflict that could develop between these objectives. They perhaps believed that it was possible to strive for the realisation of all these objectives in perfect harmony even in a class society like ours. However, they appeared to be conscious of the fact that in the past progress towards social justice has not been very encouraging. It was probably this reason why they asserted that "the movement towards social justice has to be faster and there must be a sharper focus on employment and poverty alleviation."[11] It was recognised that productive employment develops self-confidence in people and, in turn, ensures their participation in developmental tasks. Keeping in view this importance of employment the planners did not wish to rely on general economic growth for raising employment opportunities. ***In the Seventh Plan employment was treated as a direct focal point of policy.*** They, however, asserted that ***"employment can be sustained only if it is productive and adds to output and incomes on a continuing basis."***[12]

The Seventh Plan aimed at non-inflationary growth in employment. In order to realise this objective agricultural production, particularly food production, had to be augmented significantly. In the recent years, agriculture has done well, but the wide gap between the potential and actual achievement persists. The planners had pinned their hopes under the Seventh Plan on the prospects of agricultural growth for employment generation both in the countryside and urban areas. They had argued that in the past employment potential of the industrial sector had not been properly recognised. The fact, however, is that growth and employment potential of the industrial sector largely depends on the rate of agricultural growth. The Seventh Plan thus aimed at loosening the agricultural constraint on industrial development.

On the eve of the Sixth Plan infrastructural bottleneck was particularly serious and on account of it for some time the whole development exercise looked in doldrums. This situation had developed in spite of huge investments made in this sector. ***The Seventh Plan aimed at ensuring desired results from investments in the infrastructural development. This was expected to remove an important constraint on growth in the primary and secondary sectors.***

The Eighth Five Year Plan

The Seventh Plan completed its term on March 31, 1990. Hence the Eighth Plan should have logically commenced from April 1, 1990. However, due to political uncertainties at the Centre and severe economic crisis in the country needing immediate attention, this schedule could not be kept and the Eighth Plan was delayed by two years. Thus it could commence only on April 1, 1992.

On April 1, 1992 when the Eighth Plan commenced 41 years of economic planning were over and in this period seven Five Year Plans were completed. Over these four decades of economic planning a largely agrarian economy was transformed into one based on a developed and diversified infrastructure with considerable potential for industrialisation. India now has a resilient agricultural economy with almost self sufficiency in food production. The industrial base of the economy is both strong and diversified. Unlike many other underdeveloped countries, India has skilled manpower and entrepreneurial capabilities in abundance. Although the existing rate of saving may not be very high, yet it is sufficient for modest economic growth. Hence the country can take advantage of these positive factors for further growth, provided the government does not create a fiscal mess by pursuing wrong policies. During the 1980s the growth performance of the economy was quite impressive. At the same time in this period wrong policies of the government led the economy to the brink of disaster. ***The government had to be very careful about the critical imbalances which emerged sharply during the earlier decade. These imbalances were : "(a) increasing fiscal and budgetary deficits, mounting pubic debt and severe constraints on the resources of the Government and the public sector to undertake the essential developmental activities, (b) a critical situation in the balance of payments, and (c) a high rate of inflation."***[13]

Apart from the problems arising from the critical imbalances referred to above at the threshold of the Eighth Plan, there was a high backlog in the provision of social consumption needs of the people, particularly the underprivileged and the poor. There was also unacceptably high level of poverty and hunger in the country with high concentration in some regions. Illiteracy, particularly among the rural poor and women, high incidence of infant mortality and the widening gap between growth of labour force and growth of employment due to decreasing employment elasticities in almost all sectors were some major challenges before the Eighth Plan. The imperatives of growth in the face of these challenges required an innovative approach to economic development.

The main concern of the Eighth Plan was with human development. The objectives listed to achieve this goal were employment generation, population control, literacy and education, provision of health facilities and drinking water, and provision of adequate food and basic infrastructure.[14] It is surprising to note that 'economic growth' did not appear at all in the list of objectives stated in the Eighth Plan document. However, the targeted rate of growth in the Eighth Plan was kept at 5.6 per cent per annum which was only slightly less than the 6 per cent per annum growth rate achieved in the Seventh Plan. The actual performance of the Eighth Plan was still better as the rate of growth registered in this Plan stood at 6.8 per cent per annum.

The Eighth Plan provided for a total outlay of Rs. 7,98,000 crore. The pubic sector was expected to be 45.2 per cent of the total domestic investment. ***The actual share of public investment in total investment, however, was only 34.3 per cent. This shows that the private sector was accorded a far more important role in the Eighth Plan as compared to the earlier plans.***

Given the overall growth target of 5.6 per cent per annum increase in GDP during the Eighth Plan, the Planning Commission had worked out the sectoral pattern of output and related growth rates through the consistency model. The model started with the final demand and took into account the inter-sectoral linkages via inputs and outputs. The main components of the final demand were private final consumption, capital formation, exports and imports.

While capital formation and imports were endogenous to the model, final consumption, both private and government, and exports were exogeneously determined. Each one of these components of the final demand were worked out through a sub-model which had taken into account the dominant parameters obtained from the analysis of data pertaining to the previous plan periods. The pattern of growth both in terms of gross value added and in terms of value of gross output that emerged from the exercise is provided in Table 25.1.

TABLE 25.1. Sectoral Growth Rates of Gross Value Added (GVA) at Factor Cost and Value of Gross Output

	Sector	*Trend of Growth Rate 1981-82 to 1990-91 (10 years) % per annum*	*Projected Growth Rate 1992-93 to 1996-97 % per annum*	
		GVA	*GVA*	*Value of Gross output*
1.	Agriculture	3.8	3.1	4.1
2.	Mining and Quarrying	6.3	8.0	8.9
3.	Manufacturing	7.2	7.3	8.2
4.	Electricity, gas and water supply	9.0	7.8	7.6
5.	Construction	3.6	4.7	5.3
6	Transport	7.3	6.7	7.7
7.	Communications	6.2	6.1	6.9
8.	Other Services	6.5	6.0	6.6
	Total	5.6	5.6	6.7

Source : Government of India, Planning Commission, *Eighth Five Year Plan 1992-97,* Volume I (Delhi, 1992), Table 3.14, p. 54.

The Planning Commission had worked out sectoral distribution of investment in the Eighth Plan on the basis of the pattern of sectoral output. Since investments invariably contribute to output with a lag, the investment-output relationships take into account this fact. The estimates of average lags between investment and output were obtained through the analysis of past trends in investment-output relationships. However for working out sectoral distribution of investment in the Eighth Plan certain modifications were made in them, keeping in view the expected changes in technology and efficiency in the use of energy and other inputs.

Agriculture, irrigation and allied sectors received 19.5 per cent of total investment under the Eighth Plan as against 11.2 per cent under the Seventh Plan. This was a significant shift in investment pattern, as investments in agriculture and irrigation had been declining over the years. The agricultural sector received greater attention under the Eighth Plan because of its importance from the point of view of maintaining food security and employment generation.

Because of its importance for industrial and economic development of the country, the sector of energy has all along received substantial resources. It received 26.6 per cent of total resources under the Eighth Plan. The transport and communications sector is crucial for the development of infrastructural facilities and was, therefore, provided 18.7 per cent of total resources under the Eighth Plan. The industry and minerals sector, in contrast, received only 10.8 per cent resources.[15] This was in line with the thinking in the government circles that the State should reduce its participation in this sector and allow more space to the private sector. The role of the State in the new scheme of things is expected to be 'facilitatory' providing better infrastructural facilities to the private sector.

The Ninth Five Year Plan

The Ninth Five Year Plan commenced on April 1, 1997. However, the Ninth Five Year Plan document was released by the Planning Commission only in March 1999, i.e. almost two years after the commencement of the Plan. The delay can be explained by the casual approach now adopted towards the entire planning exercise. The process of economic liberalisation unleashed in 1991 and pursued vigorously by successive governments has eroded the very base of planning.

According to the Planning Commission, the focus of the Ninth Plan can be described as 'Growth with Social Justice and Equity'. The specific objectives listed in the Plan were as follows:

(*i*) Priority to agriculture and rural development with a view to generating adequate productive employment and eradication of poverty;
(*ii*) Accelerating the growth rate of the economy with stable prices;
(*iii*) Ensuring food and nutritional security for all, particularly the vulnerable sections of society;
(*iv*) Providing the basic minimum services of safe drinking water, primary health care facilities, universal primary education, shelter and connectivity to all in a time bound matter;
(*v*) Containing the growth rate of population;

(*vi*) Ensuring environmental sustainability of the development process through social mobilisation and participation of people at all levels;

(*vii*) Empowerment of women and socially disadvantaged groups such as Scheduled Castes, Scheduled Tribes and Other Backward Classes and Minorities as agents of socio-economic change and development;

(*viii*) Promoting and developing people's participatory institutions like Panchayati Raj institutions, cooperatives and self-help groups;

(*ix*) Strengthening efforts to build self-reliance.[16]

In line with the liberalisation process unleashed in 1991 and the shift of Eighth Plan from directive to largely indicative plan, the Ninth Plan argued that ***"Our development strategy must be oriented to enabling our broad based and varied private sector to reach its full potential for raising production, creating jobs and raising income levels in the society. A vigorous private sector, operating under the discipline of competition and free markets will encourage efficient use of scarce resources and ensure rapid growth at least cost. Our policies must therefore create an environment which encourages this outcome."***[17] ***In this changed scenario, the Ninth Plan called for a 'reorientation' in the role of the State with the focus of its attention shifting from regulating and controlling the private sector to increasing its participation in social development especially in rural areas. Therefore the development strategy of the State in the Ninth Plan focused on creating the necessary economic and social infrastructure to enable the unhindered operations of the private sector.*** Thus the State decided to pay specific attention to the provision of power and energy, and the development of roads, ports, railways, telecommunications, municipal services, etc. In rural areas, economic infrastructure included irrigation, rural roads, organised rural markets etc. In addition to the development of infrastructure, the State also endeavoured to provide basic services such as health care, education and safe drinking water to majority of the population, especially in the rural areas. In the industrial sector, the strategy was to further liberalise and unshackle the private sector operations and substantially cut down bureaucratic and governmental interference. As far as public sector enterprises are concerned, the policy of disinvestment was continued. On the external sector front the strategy included (*i*) dismantling of quantitative restrictions and reductions in import tariff rates, (*ii*) taking urgent steps in removing the factors constraining export growth and using exchange rate policy to support the export effort, and (*iii*) initiating steps to increase the flow of foreign investment in the Indian economy. As far as the issue of capital account convertibility is concerned, the Ninth Plan was correct in advocating 'cautious approach' as volatile short-term capital movements could play havoc with the country's economy as has been clearly demonstrated by the experience of East Asian countries during recent years.

In the financial sector, the Ninth Plan emphasized the role of financial reforms particularly banking sector reforms and capital market reforms. The Plan also advocated reforms relating to insurance and pension funds. It felt that the latter are natural sources for long-term capital and can thus be usefully deployed in the financing of infrastructure which needs long-term funds. The Plan correctly pointed to the dangers of continuing with unsustainable fiscal deficit year after year. In this context, it advocated the adoption of a long term fiscal policy with a clear time path for reducing the fiscal deficit to a sustainable level. Particular emphasis needs to be placed on reducing the revenue deficit which, however, can be achieved only if there is a willingness to take difficult decisions like improving tax revenues and cutting down non-Plan expenditure.

While advocating more space for private sector activity in the production sector and freer operation of market forces, the Ninth Plan justified government intervention in those areas where the markets either do not exist or where they can lead to outcomes which may be deleterious when seen in a broader national and social perspective. ***The Plan delineated the following three areas where markets are likely to be imperfect, and hence, State intervention desirable : (i) quality of life of the citizens; (ii) generation of productive employment; and (iii) regional balance.***

In a meeting held in January 1997, the National Development Council (NDC) had approved a growth target of 7 per cent per annum for the Ninth Plan. However, keeping in view the low rate of growth of 5.0 per cent in GDP at factor cost for the year 1997-98 (the first year of the Ninth Plan) and 6.8 per cent in the year 1998-99 (the second year of the Ninth Plan), the ***Planning Commission scaled down the targeted rate of growth in the Ninth Five Year Plan period as a whole to 6.5 per cent per annum.*** The revised macro-parameters consistent with the revised target are presented in Table 25.2.

TABLE 25.2. Macro Parameters for the Ninth Plan (1997-2002)

	Eighth Plan	*Ninth Plan*	*Post Plan*
1. Domestic Savings Rate (% of GDP at market price)	23.8	26.1	27.2
2. Current Account Deficit (% of GDP at market price)	1.1	2.1	2.6
3. Investment Rate (% of GDP at market price)	24.9	28.2	29.8
4. ICOR	3.7	4.3	3.9
5. GDP growth rate (% per annum)	6.8	6.5	7.7
6. Export growth rate (% per annum)	11.9	11.8	14.5
7. Import growth rate (% per annum)	11.7	10.8	15.9

***Source*:** Government of India, Planning Commission, *Ninth Five Year Plan, 1997-2002* (Delhi, 1999), Volume I, Table 2-4 (a), p. 54.

As is clear from this Table, attainment of the growth rate of 6.5 per cent per annum in the Ninth Plan depended on a fairly sharp increase in the investment rate of about 3.3 percentage points above the Eighth Plan average, while keeping the ICOR at a level somewhat higher than in the Eighth Plan. The increase in investible resources by 3.3 percentage points was to come mainly from domestic sources, 2.3 percentage of the required 3.3, and the remainder of about 1.0 percentage point from external savings. The ICOR was assumed to rise from 3.7 in the Eighth Plan to 4.3 in the Ninth Plan as investment in infrastructure would have to be increased for sustaining growth in the post-Plan period.

The public sector outlay in the Ninth Plan was kept at Rs. 8,59,200 crore at 1996-97 prices. This represented a step up of 48 per cent and 33 per cent in real terms over the anticipated Plan expenditure and the approved Plan outlay respectively of the Eighth Plan. The share of Centre's Plan was Rs. 4,89,361 crore (57 per cent) while that of States (including Union Territories) Rs. 3,69,839 crore (43 per cent). As far as allocation of total public sector outlay among different heads is concerned, 25.1 per cent (i.e. one-fourth) was earmarked for the energy sector. This was considered to be necessary due to the reason that energy is one of the most important inputs required for sustaining the processes of economic and social development. Transport and communications is another sector which provides the necessary infrastructure for economic and industrial development. Accordingly, this sector received 19.6 per cent (almost *one-fifth*) of public sector outlay. The allocation to industry and minerals was just 8.1 per cent. Agriculture (including agriculture and allied activities, irrigation and flood control, rural development, and special area programmes) received 19.4 per cent (*i.e.* almost *one fifth*) of public sector outlay.

The Tenth and Eleventh Five Year Plans

The Tenth Five Year Plan commenced on April 1,2002 and covered the period 2002-03 to 2006-07. However, the Plan document was released almost one year after the commencement of the Plan.

The Tenth Plan arrived at a GDP growth rate of 8 per cent per annum. The macro parameters required to achieve this growth rate were laid down as follows : (*i*) domestic savings rate : 26.8 per cent per annum ; (*ii*) current account deficit : 1.6 per cent per annum; (*iii*) investment rate : 28.4 per cent per annum; (*iv*) ICOR (incremental capital-output ratio) : 3.58 ; (*v*) export growth rate : 12.4 per cent per annum; and (*vi*) import growth rate : 17.1 per cent per annum.[18]

In addition to the 8 per cent growth target, the Tenth Plan also identified the following specific and monitorable targets :

1. Reduction of poverty ratio by 5 percentage points by 2007 and by 15 percentage points by 2012;
2. Providing gainful and high-quality employment at least to addition to the labour force over the Tenth Plan period;
3. All children in school by 2003; all children to complete 5 years of schooling by 2007;
4. Reduction in gender gaps in literacy and wage rates by at least 50 per cent by 2007;
5. Reduction in the decadal rate of population growth between 2001 and 2011 to 16.2 per cent;
6. Increase in literacy rate to 75 per cent within the Plan period;
7. Reduction of infant mortality rate to 45 per 1000 live births by 2007 and to 28 by 2012;
8. Reduction of maternal mortality rate to 2 per 1000 live births by 2007 and to 1 by 2012;
9. Increase in forest and tree cover to 25 per cent by 2007 and 33 per cent by 2012;
10. All villages to have sustained access to potable drinking water within the Plan period;
11. Cleaning of all major polluted rivers by 2007 and other notified stretches by 2012.

According to the Tenth Plan, while earlier plans also had many of the above mentioned issues as objectives, in no case were specific targets set. "As a result, these were viewed in terms of being desirable but not essential. In the Tenth Plan, however, these targets are considered to be as central to the planning framework as the growth objectives."[19]

The main strategies advocated to achieve the above objectives were as follows: (*i*) disinvestment of PSUs (public sector undertakings) ; (*ii*) reforms in taxes, labour laws and administrative system; (*iii*) adoption of private partnership in physical and social infrastructure ; (*iv*) power sector reforms and removing all bottlenecks in energy, transport and water infrastructures ; (*v*) controlling Union and State budget deficits; (*vi*) removing all legal bars to the growth of agricultural trade as well as agro, small-scale and cottage industries ; (*vii*) confidence in FDI (foreign direct investment) that it would contribute to growth of industries; and (*viii*) making the economy competitive with that of the rest of world.

As far as employment is concerned, the Tenth Plan aimed at creating employment opportunities of around 29.67 million person years (*i.e.*, an increase from the base figure of 343.36 million to 373.03 million) with the help of a 8 per cent per annum growth during the plan period. ***Assuming 'business as usual' scenario (i.e. an employment growth of 1.7 per cent per annum as against a labour force growth of 1.8 per cent per annum), the Plan noted that even with as high a growth as 8 per cent, the objective of providing employment opportunities to all additions to labour force would not be achieved;*** an additional 5.62 million employment opportunities would require to be created. This, added to the base period stock unemployment of 34.85 million, would give an unemployment rate of 9.79 per cent as at the end of the Tenth Plan, an increase of 9.21 per cent at the base. According to the Tenth plan, "this arises largely due to the near jobless growth character in many sectors of the economy especially in the organized sector, and even in some of the unorganized sectors including some small scale industries."[20]

Keeping the above facts in view, the Tenth Plan advocated the adoption of a development strategy which would revamp the activities in those sectors where the comparative advantage lies in a labour intensive nature of production. The Plan specified the following labour intensive sectors which would require policy intervention : (1) Agriculture and allied activities (programmes include diversion of land from cereals to pulses and oilseeds, regeneration of degraded forests and watershed development, wasteland development, development of medicinal plants and energy plantation, minor irrigation and cultivation of bamboo and manufacturing of bamboo based products) ; ***(2) Food processing; (3) Rural non-farm activities/industries*** (including Khadi and Village industries); ***(4) Small and medium enterprises ;*** and ***(5) Services sector*** (specific areas include health, nutrition, education, and information technology and communication).[21]

The Eleventh Five Year Plan commenced on April 1, 2007 and covers the five year period 2007-12. The Eleventh Plan aims at a GDP growth rate of 9 per cent per annum. The focus of this Plan is on 'Faster and More Inclusive Growth'. The Plan aims at a more inclusive growth by addressing disparities between rural and urban areas, between rich and poor States and between poor and non-poor groups. However, the strategy envisaged in the Plan largely depends on raising the rate of growth of the economy by following the same growth path based on the neo-liberal policies. For instance, the Approach Paper states, "Rapid growth has to be an essential part of the strategy since it is only in a rapidly growing economy that we can expect to raise the incomes of the mass of the population sufficiently to bring about a general improvement in living conditions."[22] The Approach Paper advocates adoption of policies that ensure that this growth is broad based, benefiting all parts of the country, and especially the rural areas. This must be accompanied by a major effort to provide access to basic facilities such as health, education, clean drinking water etc., to large parts of our population that do not have such access at present. Improved levels of health and education are, in fact, critical inputs that determine the growth potential in the longer term.

However, this unbridled faith on economic growth is unjustified. As argued by Indira Hirway, rising economic growth in the post-reform period in the Indian economy has been accompanied by deceleration and deterioration in many areas related to poverty and human development. For instance, there is a clear deceleration in the rate of decline in the incidence of poverty in the post-economic reforms period; employment growth has slowed despite a higher growth of GDP while the 'quality' of employment has deteriorated; environmental resources have been degraded and depleted; and inequalities of incomes and growth across regions and different socio-economic groups have increased. "Clearly there is something wrong with the dynamics of growth processes of the growth model that has been adopted under the neo-liberal policies."[23]

Information on plan size, growth rates and targets in Tenth and Eleventh Five Year Plans is presented in Box 25.1.

BOX 25.1. Tenth and Eleventh Five Year Plans

	Tenth Plan		*Eleventh Plan*
	Target	*Achievement*	*Target*
Total Plan Outlay	Rs. 8,93,183 cr	Rs, 8,13,778 cr	Rs, 14,12,711 cr
Education (% of Total Plan Outlay)	NA	7.86 (Rs. 62,461 cr)	19,29 (Rs.2,74,228)
Health (% of total Plan Outlay)	NA	5.62 (Rs. 45,771 cr)	8.71 (Rs. 1,23,000 cr)
Agriculture (% of total Plan Outlay)	NA	6.22 (Rs. 50,639 cr)	8.55 (Rs. 1,21,556 cr)
GDP growth (in %)	8.1	7.59	9
Agriculture growth (in %)	4	2.13	4
Industry growth (in %)	10	8.9	10–11
Services growth (in %)	NA	9.28	9–11
Investment rate (% of GDP)	28.41	32.05	36.72
Domestic savings rate (% of GDP)	26.84	30.77	34.84
Current account deficit (% of GDP)	1.57	1.28	1.88
Incremental Capital Output Ratio	3.58	4.3	4.1
Exports growth (in %)	12.38	24	20
Imports growth (in %)	17.13	21	23
Trade Deficit (% of GDP)	NA	7.1	16
Investment in Infrastructue	NA	Rs. 871,445 cr	Rs. 2,060,193 cr
Roads (% of infra investment)	NA	16.63 (Rs.144,892 cr)	15.25 (Rs. 314,152 cr)
Ports (% of infra investment)	NA	1.61 (Rs. 14,071 cr)	4.27 (Rs. 87, 995 cr)
Aviation (% of infra investment)	NA	0.78 (Rs. 6,771 cr)	1.5 (Rs. 30,968 cr)
Telecom (% of infra investment)	NA	11.86 (Rs. 103,365 cr)	12.54 (Rs. 258,439 cr)
Power (% of infra investment)	NA	33.49 (291,850 cr)	32.35 (Rs. 666, 525 cr)

***Source* : *Business Standard*, December 21, 2007, p.2.**

NOTES

1. Jagdish N. Bhagwati and Padma Desai, *India: Planning for Industrialisation* (London, 1970), p. 118.
2. "A study of the financing pattern of the plans during the first three Plans and three Annual Plans suggests that this is one area which is treated by the Planning Commission with utmost casualness," C.D. Wadhva, "A Critique of the Fourth Plan", in C.D. Wadhva (ed.), *Some Problems of India's Economic Policy* (Delhi, 1973), p. 138.
3. Government of India, Planning Commission, *The Fourth Five Year Plan,* 1964-74 (Delhi, 1969), p. 15.
4. V.M. Dandekar and Nilakantha Rath, *Poverty in India* (Bombay, 1971), p. 51.
5. Mahbub-ul Haq, "Employment and Income Distribution in the 1970s: A New Perspective", *Development Digest,* October 1971, p. 7.
6. J.N. Bhagwati and S. Chakravarty, *Contributions to Indian Economic Analysis—A Survey* (Bombay, 1970), pp. 6-7.
7. Ashok Rudra, *Indian Plan Models* (Delhi, 1975), p. 94.
8. *Ibid.,* p. 94.
9. C.T. Kurien, *Indian Economic Crisis,* pp. 92-93.
10. Ashok Rudra, *op. cit.,* p. 192.
11. Government of India, Planning Commission, *The Approach to the Seventh Five Year Plan, 1985-90* (New Delhi, 1984), p. 1.
12. *Ibid.,* p. 1.
13. Government of India, Planning Commission, *Eighth Five Year Plan, 1992-97,* Volume I (Delhi, 1992), p. 8.
14. *Ibid.,* p. 9.
15. Government of India, Planning Commission, *Ninth Five Year Plan, 1997-2002,* (Delhi, 1999), Annexure 3.2, p. 178.
16. *Ibid.,* p. 2.
17. *Ibid.,* p. 3.
18. Government of India, Planning Commission, *Tenth Five Year Plan,* 2002-07, (Delhi, 2003), Volume I, Table 2.7, p.30.
19. *Ibid.,* p.6.
20. *Ibid.,* p. 145.
21. *Ibid.,* Box 5.1, p. 147.
22. Government of India, Planning Commission, *Approach Paper of the Eleventh Five Year Plan,* 2007-12 (Delhi, 2006), p. 1.
23. Indira Hirway, "Where is Gender in Eleventh Plan Approach Paper ?" *Economic and Political Weekly,* August 12, 2006, p. 3465.

CHAPTER

26 INDIA'S FISCAL AND MONETARY POLICIES

Objectives of Fiscal Policy in India
• Growth Performance of the Economy • Fiscal Policy and Equity
The Fiscal Imbalance and the New Fiscal Approach
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In a system of indicative planning reliance on fiscal policy as an instrument of development is considerable. The Planning Commission had stated in the Seventh Plan, ***"Through it (fiscal policy) the government creates and sustains the public economy consisting of the provision of public services and public investment; at the same time it is an instrument for reallocation of resources according to national priorities, redistribution, promotion of private savings and investments, and the maintenance of stability."***[1] Thus fiscal policy has a multi-dimensional role. It particularly aims at improving the growth performance of the economy and ensuring social justice to the people. Like fiscal policy, monetary policy is also an arm of economic policy and thus its objectives are no different from the overall objectives of economic policy. According to C. Rangarajan, ***"Broadly speaking, the three major objectives of economic policy in India have been growth, social justice, implying a more equitable distribution of income, and political stability."***[2] In this chapter, we shall analyse both fiscal and monetary policies in terms of these fundamental objectives.

In particular, we shall discuss the following questions:

- What are the objectives of fiscal policy in India? How for has the fiscal policy succeeded in achieving these objectives?
- What have been the important features of fiscal imbalance? What policy measures were adopted by the government to restore fiscal balance?
- What is fiscal responsibility? What are the main features of the FRBM Bill?
- What are the main features of the monetary policy of the RBI? How does RBI control credit?
- What is reserve money and what is money multiplier?
- How effective has been the monetary policy of the RBI in achieving its objectives?

OBJECTIVES OF FISCAL POLICY IN INDIA

Fiscal policy in India always had two major objectives, namely, improving the growth performance of the economy and ensuring social justice to the people.

Growth Performance of the Economy

Fiscal policy influences growth performance of an economy mainly in two ways. In the first place, it affects growth by influencing the mobilisation of resources for development. Secondly, it exercises its influence by improving the efficiency of resource allocation.

Fiscal Policy and Resource Mobilisation. India has not done well in terms of tax effort. In 1950-51 when the planning process was initiated the tax-GDP ratio was as low as 6.3 per cent. Since then it rose slowly for four decades and stood at 15.8 per cent in 1991-92. During the ***liberalisation phase of 1990s the tax-GDP ratio declined to 13.4 per cent in 1998-99 due to sharp reduction in tax rate.*** However, during the last few years tax- GDP ratio has risen again and was 16.8 per cent in 2005-06. For a poor country like India which started its development effort with a very low per capita income and has recorded a sustained rate of growth this record in mobilising tax revenue is not very encouraging. In India, all the major direct taxes, such as personal income tax and corporation tax have recorded buoyancy greater than unity. However, in recent years buoyancy of Union excise duty and customs duty has been as low as 0.84 and 0.77 respectively. Obviously this has not enabled as much mobilisation of resources through taxation as one would normally expect in the conditions prevailing in India. It has to be admitted that there remains some scope for raising additional tax revenue in the country. In India, reveue collection from direct taxes is about 5.0 per cent of GDP. Amaresh Bagchi contends, ***"Rough calculation based on available data suggest that the 'tax gap' (the difference between potential revenue and the actual collections) is still quite large and PIT (Personal Income Tax) is able to capture only about 50 per cent of its potential."*** The Kelkar Panel report on direct taxes has revealed that the number of people who file returns showing an annual income greater than Rs. 10 lakh is only 54,000 in India consisting of more than one billion people.[3] Moreover, ***incentive provisions in the tax laws have enabled many prosperous companies paying handsome dividends to get away without paying any tax.*** If the government eliminate these highly questionable incentive provisions, revenue collections from corporate tax would increase substantially. Finally, the government will have to show the required will to ***tax agricultural incomes*** which presently remain outside the taxation net. Moreover, ***tax revenue may increase steeply if the government musters courage to target black income which is as large as 40 per cent of GDP.*** In Arun Kumar's opinion, "If the entire black economy is converted into white, India's growth would get boosted to 10 per cent, all educated youth would get jobs. The additional tax collection of about Rs. 3 lakh crore would leave a fiscal surplus."[4] But this is not an easy proposition because it would require stringent measures against the most influential sections of the society, such as the corporate sector, business community, stock brokers, land mafia, professionals, bureaucrats and politicians.

Apart from tax revenue ***other important aspects of resource mobilisation are generation of non-tax revenues, restricting of current government expenditure and raising of surpluses of public sector enterprises.*** Each of these need careful analysis for assessing the government's effort in respect of resource mobilisation. However, for want of space we shall focus on trends in overall public savings which can be justifiably considered as an appropriate index of resource mobilisation effort.

Since the Fourth Five Year Plan the Planning Commission has been explicitly laying down targets for public savings rate for the terminal year of the respective Five Year Plan. On comparing the actual rates with these targeted rates one is inevitably led to the conclusion that public savings performance has fallen markedly below planned levels in the past three decades. In 1980-81 the rate of public savings relative to GDP was 3.4 per cent which in any case was very low. Over the period 1998-99 to 2002-03, the rate of public savings relative to GDP was negative. Though it turned positive thereafter, it was only 1.2 per cent of GDP in 2003-04 and 2.0 per cent of GDP in 2005-06. ***The unsatisfactory performance of the public savings during the past two and a half decades is attributable to weakness in mobilizing revenues, rapid growth in government expenditures and failure of public sector enterprises to generate adequate surpluses.*** At the Central level, the pre-tax profits of public enterprises showed a return of around 5.0 per cent of the capital invested in them in a number of years (it was only 4.7 per cent in 1999-2000 though it picked up thereafter and was 12.1 per cent in 2005-06). At the State level, the performance of the public sector enterprises is far more disappointing. Both the State Electricity Boards and the State Road Transport Undertakings have been incurring heavy losses for quite some time.

In India, fiscal policy has been used for providing both special incentives for private savings and encouraging investment in specified areas like housing. As a result of these policies in case of the last three Five Year Plans, the actual private savings rate has exceeded the Plan target.

The failure of the fiscal policy in India is perhaps the most conspicuous in its inability to prevent the growth of black economy. The studies which have attempted to quantify the size of the black economy indicate that in the recent years the government has suffered heavy losses on account of tax evasion. This revenue loss to the government has reduced the built-in elasticity of the tax system. The black economy has also constrained the resource mobilization effort through large scale leakages of funds from development projects and other programmes. This black income has a general tendency to lower down the savings propensity as its common outlet is consumption expenditure on "luxury services". The use of black income for accumulation of real or financial assets is often avoided because it carries far greater risks of detection and penalty.

Fiscal Policy and Allocational Efficiency. ***Fiscal policy also influences growth performance of an economy through its effects on the allocation of resources. An efficient and rational allocation of resources will obviously be helpful in raising the rate of economic growth.*** Therefore, if fiscal policy favourably affects the efficiency of resource allocation, then in the process, growth performance of the economy is bound to improve. An indifferent fiscal policy adversely affecting the efficiency of resource allocation on the contrary retards the productive activity and thereby results in lower rate of economic growth.

Among the various instruments of fiscal policy perhaps ***tax policy is the most important determinant of the efficiency of resource use.*** Therefore we shall examine if over the years it has not excercised any negative effects on the productive activity. During the first four decades of economic planning the reliance on commodity taxation had increased and it accounted for around 84 per cent of the tax revenue in 1990-91. However, during the 1990s the trend was reversed and the ratio of indirect tax revenue to total tax revenue declined to 66.0 per cent in 2005-06. Among the indirect taxes, the perponderant role has been played by customs and excise duties at the Central government level and the sales tax at the State government level. ***These indirect taxes have been generally levied mainly on revenue-raising considerations and have sometimes resulted in efficiency losses.*** The case of customs duties is particularly mentioned to prove this point. In recent years, a number of studies have revealed that the structure of customs duties along with restrictive controls have provided effective protection to a number of industries and as a result there has been unnecessary loss of efficiency in resource use. However, recently in the light of the recommendations of the Chelliah Committee, some corrective measures have been undertaken and by lowering down the import duties unwarranted protection to the industries has been withdrawn. The policy of levying taxes on inputs in the past had led to the problem of "cascading" of tax and interest costs and distorted the incentive structure for investment and production. It has also adversely affected the competitiveness of exports. By rationalising the excise duties structure in recent years, an attempt has been made to rectify the situation.

Since the beginning of economic planning there has been proliferation of non-departmental public enterprises. Investment in them over the various plan periods has been massive, yet they have failed to generate the expected amount of surpluses. This has raised serious doubts about their efficiency level. These enterprises have been set up to realise objectives other than the maximisation of private profit. Therefore, it would be wrong to evaluate their performance on this criterion. Nevertheless, the studies at the enterprise, sub-sector and sectoral levels suggest that the efficiency of resource use in public sector enterprises is not altogether satisfactory.

Fiscal Policy and Equity

It is often doubted whether India's fiscal policy conforms to the principle of equity. During the first four decades of economic planning the share of direct taxes in total tax revenue had fallen from 40 per cent to 16 per cent which made India's tax structure less equitable. However, during the 1990s the trend was reversed and thus in 2005-06 direct taxes accounted for 33.7 per cent of the total tax revenue. H.H. Hinrichs has pointed out that in the course of development in most countries the share of direct taxes in the total tax revenue has shown a tendency to increase.[5] It is thus surprising that the trends in India have been just opposite to the trends witnessed in other countries. R.J. Chelliah has tried to provide an explanation for the outlier Indian experience. In his opinion, the share of direct taxes is expected to rise with the increase in per capita income only after it has reached a certain minimum level and then grown at a fairly high rate.[6] This explanation is not altogether correct. In India, in spite of all its pretensions, the government has been reluctant to put the major burden of economic development on the relatively rich by raising the share of direct taxes in the total tax revenue.

Even on the progressivity of personal income tax it is difficult to pass judgement in this country. In terms of nominal rates this tax is certainly progressive. But who can deny that there is a large undisclosed income in the country on which no tax is paid. This income is mostly in the hands of industrialists, traders, land mafia, professionals, bureaucrats and politicians. Therefore, the sharpness of progression in nominal rates does not guarantee that the principle of equity in personal income taxation will not be violated.

Indirect taxes are generally believed to be regressive. The study of tax incidence by R.J. Chelliah and R.N. Lal, however, does not support this view. This study shows that indirect taxes as a proportion of household expenditure record a steady increase with a rise in expenditure levels.[7] However, an important study by E. Ahmad and N. Stern raises serious doubts about the validity of Chelliah and Lal's study. Ahmad and Stern found that certain indirect taxes are progressive but this is not true of all taxes. Moreover, for urban areas the burdens of most of the indirect taxes were found to be proportionate to expenditure levels.[8]

For assessing the equity implications of the fiscal policy it is also necessary to analyse as to who benefits from public expenditure. For India so far no comprehensive study has been made on this aspect of the fiscal policy. Taking a partial view some economists have recently argued that the poverty alleviation programmes reflect the intentions of the government. However, this way of looking at the issue is not correct. The fact of the matter is that the benefit of most of the government expenditure has hardly reached the poorest of the poor.

THE FISCAL IMBALANCE AND THE NEW FISCAL APPROACH

On account of growing burden of non-development expenditure the fiscal situation deteriorated throughout the 1980s and assumed crisis proportions by the beginning of 1991-92. ***Throughout the 1980s all the major indicators of fiscal imbalance largely reflected that it was on the rise.*** The process of macro-economic stabilisation undertaken within a neo-liberal framework brought about a shift in the approach towards the measurement of fiscal imbalance. ***Following the US budgetary practices the concept of fiscal deficit has come into use. It is measured by the difference between total government expenditure over government revenue and grants and thus reflects the total resource gap. This measure of deficit has been adopted by the IMF as the principal policy target in evaluating the performance of countries seeking assistance.***[9]

Some other indicators used to measure fiscal imbalance are the ***revenue deficit*** and the ***primary deficit. The revenue deficit is defined as the difference between revenue expenditure i.e., those government expenditures which do not result in capital formation, and current revenues. The primary deficit is the fiscal deficit less interest payments.***

The Fiscal Imbalance

The trends in various indicators of combined fiscal imbalance of Central and State governments since 1980-81 are given in Table 26.1. From this table it is clear that between 1980-81 and 1989-90 the revenue deficit of the Central and State governments rose substantially. The combined revenue deficit of the Centre and State governments rose from 0.38 per cent of GDP in 1980-81 to 3.21 per cent in 1989-90. This fact suggests that the fiscal situation was under mounting pressure throughout the decade long period from 1980-81 to 1989-90. In this period the combined gross fiscal defict of the Central and State governments rose alarmingly. From 7.50 per cent of GDP in 1980-81, it rose to 8.87 per cent in 1989-90. However, primary deficit which was 5.44 per cent of GDP in 1980-81 declined to only 4.65 per cent in 1989-90.

Fiscal Correction

Such a fiscal situation being unsustainable required immediate corrective measures. Interest payments on accumulated debts constituted about 29 per cent of the total revenue expenditure of the Central government. In fact, in 1990-91 interest payments had eaten up 39.1 per cent of the total revenue collections of the Central government. The situation could deteriorate further in future and the government could fall into a debt-trap, had it not decided to deal with it firmly by checking expenditure and abandoning the policy of growing reliance on public borrowing.

Since the State governments did not undertake the task of fiscal correction seriously, we shall analyse the efforts of the Central government only to reduce financial imbalances. The regular Budget of the Central government for 1991-92 was presented to Parliament on July 24, 1991. It took some major steps to correct the fiscal imbalance. It envisaged a reduction in fiscal deficit from 6.6 per cent of GDP in 1990-91 to 4.8 per cent in 1991-92. Though the burden of achieving reduction in fiscal deficit of this order fell heavily on expenditure side, the Budget contained some proposals for raising additional revenue. After the Budget for 1991-92 was

TABLE 26.1. Combined Deficits of the Central and State Government Deficit (per cent of GDP)

Years/Period	*Revenue Deficit*	*Gross Fiscal Deficit @*	*Primary Deficit @*
1980-81	0.38	7.50	5.44
1985-86	1.88	7.98	4.87
1986-87	2.44	9.89	6.47
1987-88	2.89	9.15	5.48
1988-89	2.92	8.51	4.61
1989-90	3.21	8.87	4.65
1990-91	4.20	9.42	5.03
1991-92	3.35	7.02	2.27
1992-93	3.17	7.00	2.13
1993-94	4.25	8.26	3.25
1994-95	3.67	7.07	1.91
1995-96	3.19	6.54	1.57
1996-97	3.56	6.38	1.25
1997-98	4.12	7.27	2.13
1998-99	6.35	9.02	3.67
1999-2000	6.22	9.47	3.81
2000-01	6.60	9.51	3.57
2001-02	6.99	9.93	3.68
2002-03	6.63	9.56	3.09
2003-04	5.76	8.48	2.05
2004-05	3.67	7.51	1.36
2005-06	2.66	6.71	0.94
2006-07 RE	2.05	6.41	0.79

RE Revised Estimates

Source: (i) Reserve Bank of India, *Handbook of Statistics on the Indian Economy, 2006-07* (Mumbai, 2007). Tables 246 and 248.

passed, the Government imposed a 5 per cent cut on the expenditure provisions contained in the sanctioned Budget estimates for 1991-92 of all Ministries/Departments.

These measures enabled the government at the Centre to reduce fiscal deficit from about 6.6 per cent of GDP in 1990-91 to around 4.7 per cent in 1991-92. The Budget for 1992-93 aimed at reducing the fiscal deficit from 4.7 per cent to 4.1 per cent of GDP. However, this objective could not be realised. The actual fiscal deficit in this year was around 4.8 per cent of GDP. The fiscal deficit was at this level in 1997-98 also but rose thereafter to 5.4 per cent of GDP in 1999-2000, to 5.7 per cent of GDP in 2000-01 and further to 6.2 per cent of GDP in 2002-03. Since 1997-98 two factors contributed to increasing fiscal deficit. First, reduction in tax rates adversely affected tax revenue. Second, non-developement expenditure continued increasing due to casual approach of the government. There was, however, a steady decline in fiscal deficit-GDP ratio subsequently as a result of the enactment of Fiscal Reforms and Budget Management Act (FRBM Act) in August 2006. The fiscal deficit of the Central government stood at 4.1 per cent of GDP in 2005-06 which fell further to 3.7 per cent in 2006-07.

Interest Payments. Interest payments which contributed most to the fiscal imbalance have continued to rise. According to Raja J. Chelliah, "the net interest payments by the government can be reduced by bringing down the gross interest payments or by increasing the income from the government's investments. It does not seem feasible to increase the latter. It is, therefore, necessary to find ways of reducing the gross interest payments by the government."[10] Chelliah is right in his assertion that the government must find ways to reduce interest payments, but the government seems to be complacent about it. This is clear from the fact that interest payments of the Central government rose from Rs. 26,596 crore in 1991-92 to Rs. 59,478 crore in 1996-97 and further to Rs. 1,46,192 crore in 2006-07. Presently the government has no other option except to effect reduction in the existing stock of debt. Since it is now possible to retire a part of the external debt due to comfortable position of foreign exchange reserves, debt reduction need not be confined to internal debt. The resources for liquidating a part of the internal debt can be raised by disinvesting in public enterprises and selling a part of vast real estate that the government owns in the country.

Non-Interest Expenditure. In India, although there is some scope for raising tax revenue the liberalisation

approach of the government would deter it from doing so. According to Chelliah, it is not feasible to plan for a buoyancy in tax revenues of more than 1.1 or so.[11] Therefore, ***if fiscal deficit is to be brought down the growth of all the major categories of non-interest expenditure has to be slowed down considerably.*** In some cases it is both desirable and feasible to effect reduction in the expenditure. From this point of view experts now particularly mention subsidies, capital assistance to non-viable and inefficient enterprises, government's consumption expenditure related to staff and defence expenditure.

In 1990-91 major subsidies added up to Rs. 12,158 crore. In principle though the government decided to cut down subsidies, in practice it failed to do that, as they rose from Rs. 9,581 crore in 1990-91 to Rs. 53,463 crore in 2006-07. The government eliminated the export subsidy by 1992 but is finding it difficult to cut down the fertiliser and food subsidies due to resistance from the fertiliser industry and the big farmers' lobby. In future the government will have to muster the political will to eliminate fertiliser subsidy. As far as the food subsidy is concerned, it was drastically pruned in the Budget for 2000-01. It has now been decided that in future food subsidy would be provided to the weaker sections of the society only.

The government has reduced budgetary support to the plan investment by public enterprises. In future non-viable public enterprises should be closed down and other loss making enterprises should be advised to revise their pricing policies to wipe out their losses. Regarding the government's consumption expenditure related to staff, there seems to be no choice except to reduce it. Over the years the government has over-extended itself and there is now considerable overstaffing in government departments. The government will have to find ways and means to shed the surplus staff. Meanwhile, austerity measures must be imposed on all government personnel.

Containment of the growth of defence expenditure involves some security risk. Nonetheless, it is generally agreed that there is considerable scope to enhance the cost-effectiveness of the defence expenditure. In case this task is undertaken earnestly, then there is no reason why at least in the short run, defence expenditure on revenue account cannot be kept constant in real terms.

Themes of the 'New Fiscal Policy'

In the broad framework of the economic liberalisation approach of the recent years, the major themes of the fiscal policy have been concretised in this country. There is broad agreement on these themes and they can be summarised as follows.

"1. A systematic effort ***to simplify both the tax structure and the tax laws;***
2. A deliberate shift to a regime of ***reasonable direct tax rates, combined with better administration*** and ***enforcement,*** to improve compliance and raise revenues;
3. The fostering of a ***stable and predictable tax policy environment;***
4. ***Greater recognition and weight given to the resource allocation and equity consequences of taxation;***
5. More reliance on ***nondiscretionary fiscal and financial instruments*** in managing the economy, as compared to ad hoc, discretionary physical controls;
6. Concerted efforts to ***improve tax administration*** and reduce the scope for arbitrary harassment;
7. Growing appreciations of the ***links between fiscal and monetary policy;***
8. ***Fresh initiative to strengthen methods of expenditure control.***"[12]

Fiscal Reforms Programme for States

With a view to improving their fiscal position, many State governments have also undertaken fiscal adjustment programmes. Even prior to the Twelfth Finance Commission (TFC) recommending enactment of FRBM Act as a pre-requisite for States to claim the benefits under the Debt Waiver and Relief Facility, a few States had already enacted their FRBM Acts. TFC's Debt Consolidation and Waiver Facility has a two-stage benefit scheme as incentive to the States: *first,* a general scheme of debt relief applicable to all States, which provides for consolidation of Central loans (from Ministry of Finance) contracted by States till March 31, 2004 and outstanding as on March 31, 2005 for a fresh term of 20 years at an interest rate of 7.5 per cent, prospectively, from the year in which they enact FRBM Acts; and *second,* a Debt Write-off scheme (after consolidation of Central loans) linked to fiscal performance, subject to the following conditions:

(*i*) Enactment of FRBM Act (required, in any case, for debt consolidation),

(*ii*) Reduction of revenue deficit every year starting from 2004-05, when compared to the average of the preceding three years (i.e., 2001-02, 2002-03 and 2003-04). In the process, if revenue deficit is eliminated completely by 2008-09, the State gets the full benefit of waiver,

(*iii*) Reduction in revenue deficit should be equal to at least the interest rate relief on account of consolidation, and

(*iv*) Containing fiscal deficit/GSDP (Gross State Domestic Product) ratio at the 2004-05 level in all the subsequent years.

TFC has estimated that if all the States eliminate revenue deficit by 2008-09, the amount of debt waiver would touch Rs. 33,205 crore. To traverse on a credible path of eliminating revenue deficit by 2008-09 and to bring down the fiscal deficit to 3 per cent of Gross State Domestic Product (GSDP) and achieve other targets of TFC, States are required to draw up their own 'Fiscal Correction Paths'. So far, 23 States have enacted their FRBM Acts and 21 States have drawn up their fiscal correction paths.

BOX 26.1. Fiscal Imbalance and the New Fiscal Approach

Central Government's Fiscal Imbalance in 2006-07

- Revenue deficit – 2.0 per cent of GDP
- Gross fiscal deficit – 3.7 per cent of GDP
- Primary deficit – 0.15 per cent of GDP
- Revenue expenditure – 12.3 per cent of GDP
- Capital expenditure – 1.8 per cent of GDP
- Interest payments – 3.5 per cent of GDP
- Major subsidies – 1.3 per cent of GDP
- Defence expenditure (revenue + capital) – 2.1 per cent of GDP

Central and State Governments' Combined Fiscal Imbalance in 2006–07

- Revenue deficit – 2.1 per cent of GDP
- Gross fiscal deficit – 6.4 per cent of GDP

Neo–classical ideology emphasises balanced budget approach. For restoring fiscal soundness–The central government introduced FRBM Bill in Lok Sabha in 2000: FRBM Act was passed in 2004.

FRBM Act is anti democratic:

1. Revenue deficit to fall to zero by March 2009.
2. Fiscal deficit to be reduced to 3 per cent of GDP by March 2009.

FISCAL RESPONSIBILITY IN INDIA

In the 1990s, with the resurgence of the neo-classical ideology, balanced budget received axiomatic acceptability at the international level. Since most governments failed to pursue this policy voluntarily, it was suggested that the fiscal balance should be restored by imposing legal responsibility on the government. The fashion of legal restraints on government fiscal behaviour was set by the United States, where in the mid-1980s the Balanced Budget and Emerging Deficit Control Act (Gramm-Rudman-Hollings Act) required a steady decline in the federal government's deficit to zero within a stipulated and fairly short time-frame. Such a legal binding on government in fiscal matters is extreme by any standard. Nevertheless, besides the USA, some other countries have opted for such an extreme measure and a few other countries preferred to pursue balanced budget policies without legal stipulation. India opted for the legal course in 2000 after having failed to restore fiscal balance for about a decade.

The Fiscal Responsibility and Budget Management (FRBM) Bill

The Committee on Fiscal Responsibility Legislation was thus constituted on January 17, 2000 to look into various aspects of fiscal system and recommend a draft legislation on fiscal responsibility of the government. It was announced in the Budget for 2000-01 that the government intended to create a strong institutional mechanism embodied in Fiscal Responsibility Act to restore fiscal discipline at the level of the Central government. Accordingly, the Fiscal Responsibility and Budget Management (FRBM) Bill 2000 was introduced in Lok Sabha in December 2000.

The FRBM Bill attempted to fix up responsibility on the government to strengthen the framework for adopting a prudent fiscal policy and paves the way for accomplishing macro-economic stability. The preamble to the Bill states its objectives as:

"To provide for the responsibility of the Central government to ensure inter-generational equity in fiscal management and long-term macro-economic stability by achieving sufficient revenue surplus, eliminating fiscal deficit and removing fiscal impediments in the effective conduct of monetary policy and prudential debt management consistent with fiscal sustainability through limits on the Central government borrowings, debt and deficits, greater transparency in fiscal operations of the Central government and conducting fiscal policy in medium-term framework and for matters connected therewith or incidental thereto."

The third assumption is also incorrect. ***The external vulnerability depends more on capital and trade account convertibility and the perception of international finance rather than fiscal discipline. Therefore, capital flight may begin at a time when fiscal deficit is low.*** The higher fiscal deficit may not necessarily cause external crisis. In this country we have managed to build large foreign exchange reserves despite the fact that the fiscal deficit has not come down.

Having convincingly shown that the assumptions of the Fiscal Responsibility and Budget Management legislation are theoretically incorrect, C.P. Chandrasekhar and Jayati Ghosh conclude that the restraining measures under the FRBM Bill (now FRBM Act) "are both unwarranted and unnecessary, and if implemented they would actually be substantially detrimental to the material interest of most of the Indian people. This is because such measures would not only force deflation on the economy, but also involve reductions in public expenditure to meet these very severe criteria, so that public expenditure which is important and necessary for growth and welfare would not be made."[20]

MONETARY POLICY OF THE RESERVE BANK OF INDIA

Aptly defining the RBI's monetary policy, S.L.N. Simha states, "The Reserve Bank's responsibility is not merely one of credit restriction. In a growing economy there has to be a continuous expansion of money supply and bank credit and the central bank has the duty to see that legitimate credit requirements are met."[21]

The Chakravarty Committee has emphasised that ***price stability, growth, equity and social justice, promoting and nurturing new monetary and financial institutions have been important objectives of monetary policy in India.*** The difficulty in formulating and implementing monetary policies arises from the trade offs among various objectives which need to be evaluated on a continuous basis. This cannot be done independently by the RBI. The RBI's monetary policy has to subserve the national economic and social objectives as enunciated from time to time in the Five Year Plans. This puts an unusual constraint on the monetary policy options of the RBI. The inflationary pressures in India have often warranted a check on growth of money supply, but the need to prevent the adverse effects of restricting the flow of bank credit on economic growth has dissuaded the RBI from taking action on a scale warranted to achieve the desired stability in prices. Thus in a country like India the thrust of monetary policy cannot be restricted to regulation of money supply alone. Nonetheless, it has to be admitted that the price stability and economic growth should be the two basic objectives of the economic policy in India and regulation of money supply is necessary to achieve these objectives.

Y. Venugopal Reddy has however remarked, "In India, monetary policy has always emphasised the objectives of price stability and growth. What this, in effect, has meant in practical policy setting is formulating a balance between the two objectives depending on the evolving situation but in the broad context of keeping the inflation rate within a reasonable bound."[22] Thus, in Reddy's viewpoint, price stability as such cannot be the objective of monetary policy. He, in fact, emphasises the point that the RBI at best should attempt to maintain the rate of inflation within a reasonable limit which, according to C. Rangarajan, is 6 to 7 per cent per annum. The Chakravarty Committee (RBI 1985) had suggested that the target should be 4 per cent. Interestingly C. Rangarajan has cited this recommendation approvingly on various occasions[23].

In order to ensure RBI's complete control over the supply of money and credit, it has been given exclusive power to issue currency notes. For judging how far the RBI has succeeded in achieving this objective, one has to know the relative importance of various types of money in circulation in the country. In certain countries, the legal tender money (coins and paper money) is the predominant medium of exchange. In other countries the place of legal tender money is relatively secondary and most payments are made through cheques. Whereas the former type of monetary system is to be found in France, the latter is to be found in England and the United States. The nature of the monetary system in India due to predominance of legal tender money thus resembles the French monetary system rather than the British or the American.

In India, presently both currency notes and cheques are used for payment purposes — coins constitute a very small part of money supply in the country and they are now used for making small payments. At end-March 2007 the total money supply (M_1) in the country was Rs. 9,65,195 crore. M_1 is money supply in the narrow sense. It includes (*i*) currency with the public, (*ii*) demand deposits with banks, and (*iii*) other deposits with the Reserve Bank of India. The last one is a very small component of M_1 and is thus not considered in any monetary analysis. At end-March 2007 the amount of currency with the public was Rs. 4,83,471 crore and demand deposits had amounted to Rs. 4,74,228 crore. The currency with the public and the demand deposits with the banks thus accounted for 50.1 per cent and 49.1 per cent of the money supply (M_1) respectively. Other

deposits with the RBI were only 0.8 per cent of M_1. Nowadays a broader concept of money supply, that is M_3, is used. M_3 includes M_1 and time deposits with banks. At end-March 2007 the amount of M_3 was Rs. 33,10,278 crore of which time deposits with the banks were Rs. 23,45,083 crore.

In monetary economics control of money supply usually refers to control of the supply of currency and deposit money.

CONTROL OF CURRENCY BY THE RESERVE BANK OF INDIA

By control of currency we generally mean the control over the supply of currency notes and coins. As mentioned earlier, coins constitute a very small part of money supply in the country and special measures are not needed to regulate its quantity. Regulation of the quantity of currency notes is, however, very important and the RBI enjoys monopoly power to issue them. There is a separate Issue Department in the RBI for issuing currency notes. The RBI can issue any amount of notes on the basis of reserves maintained in the form of gold bullion, foreign securities, rupee coins, rupee securities and Treasury bills. The only condition that has to be satisfied is that at no time the gold and foreign exchange reserves should fall below Rs. 200 crore, of which gold reserve must always be of Rs. 115 crore. This system of note issue inherently suffers from inflationary tendency.

The mechanics of note issue is rather simple. When the RBI wants to issue currency notes, it generally transfers either foreign securities or rupee securities or both from the Banking Department to the Issue Department. It has to be mentioned in this context that the amount of note issue will be equal to the amount of securities received by the Issue Department from the Banking Department. The RBI is empowered to issue notes also on the basis of reserves maintained in the form of Treasury bills. When the RBI pursues contractionary policy, it reverses the above process. The securities are transferred from the Issue Department to the Banking Department, and the currency notes of an equal amount are withdrawn from circulation. The success of the RBI in regulating the supply of currency has been doubted by many. It is argued that the rampant inflation over the years is a distinct indication of its failure in this regard. Some other economists contest this view and hold the government responsible for the inflation. In their opinion, as the RBI is completely subservient to the government, it could not pursue an independent policy when the government recklessly indulged in deficit financing under various Plans.

In the USA, the central bank (the Federal Reserve System) is an autonomous institution and is thus the sole monetary authority. The situation is, however, different in India. The RBI which is the central bank in this country is not a completely autonomous monetary institution. It is under a statutory obligation to lend any amount of money that the Central government decides to borrow from it. Though the State governments are not empowered to borrow from the RBI, they nonetheless draw unauthorised overdraft from the RBI with impunity. The role of the RBI as the monetary authority has thus been undermined by the government. ***In practice, there are two monetary authorities in this country. These are the Central government and the RBI. Between these two, the Central government is more powerful.***

THE RESERVE MONEY (RM)

In order to understand the role of the various monetary institutions and the government in determining the supply of money, it is necessary to understand the concept of the reserve money and the money multiplier process.

The Reserve Money and Money Multiplier

The reserve money is often referred to in monetary economics as high powered money, basic money, primary money or monetary base. The ability of the banking system to create deposit money depends on the amount of reserve money available and the portion of it which public holds in the form of currency. In India, the reserve money represents those liabilities of the RBI and the government which are considered to be eligible as reserves to be held by banks for the purpose of deposit money creation. Generally, currency liabilities of the RBI and the Central government are considered eligible for being held as bank reserves to support deposit money creation. While the currency liabilities of the RBI consist of currency notes (excluding one rupee notes) the currency liabilities of the Central government consist of rupee coins and notes and small coins. Coins are not the liability of the RBI. The RBI performs only the task of issuing them on behalf of the government. Currency liabilities of the RBI and the government are thus the sum total of currency with the public, banks'

reserves consisting of cash with banks and bankers' deposits with the RBI and 'other' deposits with the RBI. 'Other' deposits with the RBI are liabilities of the RBI to the non-bank sector and are thus in their character equivalent to currency with the public. They are very much relevant to deposit money creation. Hence, in India, ***the components of the reserve money are: (i) currency in circulation (ii) bankers' deposits with the RBI and (iii) other deposits with the RBI.*** In India, currency in circulation is the biggest component of the reserve money. The share of currency in circulation was 63.0 per cent in the total reserve money on March 31, 1991. It rose to 71.1 per cent on March 31, 2007. Bankers' deposits with the RBI is the other important component of the reserve money. Its share in the reserve money was 36.2 per cent on March 31, 1991. It, however, declined to 27.8 per cent on March 31, 2007. 'Other' deposits with the RBI is a relatively smaller component of the reserve money. It accounted for 1.1 per cent of the reserve money on March 31, 2007.

Since 1990-91 there has been a rapid growth of the reserve money which, in turn, created conditions for rapid expansion of the money supply. The reserve money increased at an average rate of 14.2 per cent per annum over the fifteen year period from 1990-91 to 2005-06. In this period, while average rate of increase in the currency with the public was 14.7 per cent per annum, the bankers' deposits with the RBI rose at an average rate of 9.6 per cent per annum.

Having discussed the concept of the reserve money, its various components and the rates at which it has grown since April 1991, it would be pertinent to explain the roles of various monetary institutions in its creation. In India, currency consists of currency notes and coins. Currency notes constitute the bulk of the currency in circulation and are being issued by the RBI. In contrast, coins and one rupee notes which are being issued by the Central government constitute a very small portion of the amount of currency in circulation. This fact leaves the impression that the RBI is the major monetary authority in this country. This, however, is not correct. In the formal sense, the RBI is the currency notes issuing authority. But since it is under a statutory obligation to buy all the Treasury bills which are being offered to it by the Central government, the latter has become the real monetary authority in the country. The bankers' deposits with the RBI are not made voluntarily by the banks. Their amount depends on the statutorily determined cash reserve ratio and the amount of demand and time liabilities of the banks. Hence, banks' role in creating reserve money is rather passive. They, however, remain a major monetary institution by virtue of being the creator of deposit money. The ability of the banking system to create deposit money depends on the amount of reserve money and portion of it which the public holds in the form of currency. Thus bank reserves have a residual character. Another factor which determines the ability of the banking system to create deposit money is deposit multiplier, which depends on the currency-deposit ratio and the required reserve-deposit ratio.

On simplifying assumptions that (*i*) banks' earning assets comprise only loans to commercial borrowers, and (*ii*) there is no dearth of demand for bank loans at the prevailing lending rate of interest so that banks remain fully loaned up, it is possible to compute deposit multiplier. The currency-deposit ratio in India was 0.18 on March 31, 2007. If we assume that the required reserve-deposit ratio can be taken to be the same as the statutorily stipulated cash reserve ratio, then its value would be 0.06 for March 2007. Once we know the values of currency - deposit ratio and reserve - deposit ratio, we can easily find out the deposit multiplier. The deposit multiplier is computed as follows:

$$\text{Deposit multiplier} = \frac{1}{c + r}$$

where c is currency–deposit ratio, and

r is reserve–deposit ratio.

Hence, the deposit multiplier in India for March 2007 was

$$\frac{1}{0.18 + 0.06} = 4.17$$

The deposit multiplier is a major determinant of deposit money. Therefore, the money multiplier relating reserve money to money supply is influenced by the deposit multiplier. The other factor which influences the money multiplier is the currency-deposit ratio.

The currency - deposit ratio in India was 1.53 in March 1951 (deposits in this computation represent aggregate deposits which are defined as demand deposits plus time deposits). Since then it has steadily declined to 0.18 in March 2007. This steep fall signified the growth of bank deposits resulting from the rapid growth of banking facilities. The broad money multiplier[24] had, therefore, risen from 1.55 in March 1952 to 4.79 in March 2007.

CONTROL OF CREDIT BY THE RESERVE BANK OF INDIA

In India, the legal framework of the RBI's control over the credit structure has been provided under the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949. The RBI has been empowered to use almost all the traditional instruments of credit control under the former; the latter has given it additional powers to use some other direct methods of credit regulation. If we consider the combined legal provisions under the two Acts we find that the RBI's powers to control the banking system are fairly comprehensive. Like any other central bank, the RBI resorts to bank rate manipulations, open market operations, reserve requirement changes, direct action, rationing of credit and moral suasion. Apart from employing these traditional methods of credit control, it directly influences commercial banks' lending policy, rates of interest, form of securities against loans and portfolio distribution.

However, the RBI's control over the supply of credit is rather weak in spite of the wide powers enjoyed by it. The main reason for this appalling state of affairs is the underdeveloped character of the Indian money market. The traditional sector which includes indigenous bankers and moneylenders as the constituents, is completely out of its control. Whatever limited success the RBI has achieved in the past is mainly on account of its control over the modern sector of the money market. In the following pages we shall consider the effectiveness of various techniques of credit regulation in India.

The Bank Rate Policy

The RBI, like all other central banks, is empowered to use bank rate as an instrument of credit control. The effectiveness of the bank rate policy depends mainly on three factors: (*i*) that the commercial banks in the country should not be averse to availing rediscounting facility from the central bank; (*ii*) that banks do not maintain any excess cash reserve against deposits and thus if extraordinary demands are made by the depositors, they have no option except that they rediscount bills from the central bank; and (*iii*) that banks must hold adequate quantity of such credit instruments which will be rediscounted by the central bank as per the legislation. Last two conditions are not satisfied in India. In the first place, the commercial banks in India are not much dependent on the RBI for financial assistance. Secondly, in the absence of a well organised bill market they lack adequate quantity of eligible bills which can be rediscounted from the RBI. Proper organisation of the various components of the money market is a prerequisite for the success of the RBI's bank rate policy.

The bank rate was 10 per cent during the 1980s. It was raised to 11 per cent effective from July 4, 1991 and further to 12 per cent effective from, October 8, 1991. This was believed to be necessary to counteract the inflationary pressure. However, under the conditions that prevailed in India, the bank rate changes were not a very efficient method to regulate the supply of credit and money. This limitation of the bank rate was often underlined by the experts in this area. Making his observations on the effects of the RBI's bank rate changes on the Indian money market and the amount of credit, B.Rama Rao, a former Governor of the RBI, had stated, ***"The increase in the bank rate was intended to be a warning signal, for apart from its psychological effect, I doubt if under Indian conditions a slight increase of the rate can have any appreciable influence on inflationary situation."***[25] H.V.R. Iyengar who was also Governor of the RBI was quite sceptical about the role of the bank rate in this country. He stated that "in a planned economy which has a large public sector of investment and where government have a battery of powers of direct regulation of investment, the efficiency of bank rate changes is far less clear than it is in industrialy advanced countries with a 'free' economy. But it would be fallacious to argue that changes in bank rate are out of place in Indian conditions."[26] Suraj B. Gupta asserts, "the experience in India....is that even as an instrument for controlling only the amount of bank borrowings, the bank rate is not very efficient. The most important reason is that by varying merely the bank rate, the RBI cannot vary the interest rate differential between the lending rates of banks and the cost of borrowed reserves — the factor which determines the extent of profitability to banks from borrowings."[27]

The situation has, however, changed since the introduction of economic reforms in the early 1990s. As a part of financial sector reforms the RBI has taken steps to strengthen the bank rate as a policy instrument for transmitting signals of monetary and credit policy. It now serves as a reference rate for other rates in the financial markets. With this new role assigned to the bank rate it has been brought down to 6.0 per cent per annum in phases.

Open Market Operations

The technique of open market operations as an instrument of credit control was developed much later. In fact, the need for open market operations was felt only when the bank rate policy turned out to be a rather

weak instrument of monetary control. Some monetary economists and bankers assert that bank rate policy and open market operations are complementary measures in the realm of monetary management. In India whereas bank rate changes have been found rather ineffective due to the underdeveloped nature of the money market, importance of open market operations has always been recognised. ***As the government securities market is fairly well developed in the country, the environment for open market operations is quite favourable.*** At present the RBI Act authorises the RBI to conduct purchase and sale operations in the government securities, treasury bills and other approved securities. The RBI is also empowered to buy and sell short term commercial bills. However, due to the absence of organised bill market in the country this provision has served little purpose. In India, since government securities are predominantly held by institutional investors, notably banks and insurance companies, dealings of the RBI in regard to open market operations are mostly confined to them.

Theoretically the technique of open market operations is superior to bank rate policy. For the success of open market operations the central bank has not to depend on the cooperation of commercial banks as it happens in the case of bank rate policy. Retaining initiative in its own hands, it can influence the reserve position of the commercial banks and thereby their capacity to advance credit. In India, where the institutional set-up is generally suitable for open market operations, the RBI should have placed greater reliance on this technique.

During the last two decades, apart from engaging itself in outright purchase or sale, the RBI has been extensively undertaking "switch operations". These operations involve purchase of one loan against sale of another or *vice versa*. The idea behind switch operations is to ensure a harmonious maturity and yield to investors. Since 1962 a new dimension of the open market operations policy has emerged. The RBI over the years has attempted to raise resources by selling government securities for meeting the development as well as defence requirements. This has resulted in the emergence of a fiscal bias in open market operations, relegating its monetary aspect to a secondary position. Over the past one and a half decades open market operations have been done to prevent unchecked expansion of liquidity through monetisation of government debt. Accordingly, the RBI's sales of the government securities have exceeded the purchases on an annual basis. The demand for the government securities was kept up during the 1980s by imposing a statutory condition on various financial institutions to invest a portion of their income or deposits, as the case may be, in the government and other approved securities. ***Now the RBI normally does not purchase any securities against payment in cash. The current policy of making purchase only in switch transactions aims at preventing unrestricted increase in liquidity.***

The Cash Reserve Ratio

The cash reserve ratio (CRR) is an effective instrument of credit control. Under the RBI (Amendment) Act 1962, the RBI is empowered to determine CRR for the commercial banks in the range of 3 per cent to 15 per cent for the aggregate demand and time liabilities. This technique of credit control was used quite often during the 1970s and 1980s for controlling inflation. In the late 1980s there was rapid growth of liquidity and thus the CRR was raised from 10 per cent to 15 per cent. For four years the CRR remained unchanged at 15 per cent.

The Narsimaham Committee which submitted its report in November 1991 did not favour use of CRR to combat inflationary pressures. In its opinion, a high CRR adversely affected bank profitability and thus pressured banks all the time to charge high interest rates on their commercial sector advances. The CRR was thus brought down from a peak of 15 per cent in 1994-95 to 8.0 per cent in 2000-01. In October 2001, it was reduced to 5.5 per cent. The final reduction of CRR was made to 4.5 per cent effective from June 14, 2003. All these reductions of CRR freed cash balances and the lendable resources of the commercial banks. Reduction in CRR in June 2003 despite inflation rate being as high as 6.5 per cent shows that the RBI no longer relies on CRR as major instrument of monetary control. The objective of policy is to reduce CRR to its statutory minimum of 3 per cent. ***Nonetheless, to check liquidity overhang in the system, the RBI raised the CRR to 5 per cent on September 11, 2004. Lately to combat inflation, the CRR has been raised to 7.5 per cent effective from November 10, 2007.*** The CRR hike is also considered to be a preemptive measure to prevent fresh inflows of funds which are likely to create imbalance in foreign exchange market.

The Statutory Liquidity Ratio

The Banking Regulation (Amendment) Act 1962 provides for maintaining a minimum statutory liquidity ratio (SLR) of 25 per cent by the banks against their net demand and time liabilities. The Amendment Act also

empowers the RBI to raise the SLR upto 40 per cent if it is considered necessary to control liquidity. Thus the RBI is vested with the power to determine SLR for commercial banks. The RBI used this power to raise SLR quite often during the 1970s and 1980s. Effective from September 22, 1990, SLR was made as high as 38.5 per cent of the commercial banks' net demand and time liabilities. The SLR remained at this level upto March 31, 1992. There were two reasons why the RBI had raised the SLR for banks. First, it reduced commercial banks' ability to create credit and thus eased inflationary pressures. Secondly, it made larger resources available to the State.

The Narsimaham Committee did not favour maintenance of a high SLR. In its opinion, the SLR had become an instrument in the hands of the government to mobilise resources in support of the Central and State budgets. Keeping in view the recommendations of the Narsimham Committee the government decided to reduce SLR in stages from 38.5 per cent to 25 per cent. ***The SLR was lowered down to 25 per cent effective from October 10, 1997 and is presently at this level.*** Thus the programme of reducing the SLR to 25 per cent as part of the financial sector reform has been successfully implemented.

Selective Credit Controls

Selective credit controls are generally meant to regulate credit for specific purposes. In a developing economy where frequent use of quantitative techniques of credit control may jeopardise development efforts, selective credit controls can be safely introduced to check misuse of borrowing facilities. The RBI, like many other central banks in various countries, has been empowered to use selective credit controls to regulate credit to specific branches of economic activities. Thus, it can prevent speculative hoarding of essential commodities and check undue rise in the prices. However, prior to May 1956, the RBI never introduced selective credit controls, though the speculative hoarding of foodgrains and essential raw materials causing steep rise in their prices warranted them.

During the four decades since 1956 the RBI relied mainly on three techniques of selective credit controls, *viz.*, the determination of margin requirements for loans against certain securities; determination of maximum amount of advances or other financial accomodation; and charging of discriminatory interest rates on certain types of advances. Apart from these measures the RBI may give directions to banks in general or even some particular bank as to the purpose for which loans may or may not be given. While introducing selective credit controls the government takes special precaution that the credit for production, movement of commodities and exports is not denied as it may have serious repercussions on the performance of the economy. The main thrust of selective controls is against speculative hoarding of essential commodities by traders.

For over 40 years, the RBI had extensively relied on the technique of margin requirements to check the hoarding of essential commodities for it causes artificial scarcities in the market and tends to raise prices. Since 1973-74 for more than two decades stricter selective controls were imposed. The Credit Authorisation Scheme introduced in 1965 was also a kind of selective credit control. Under the scheme, the RBI regulated not only the quantum but also the terms on which credit flowed to the different large borrowers. The Credit Authorisation Scheme was finally withdrawn as part of financial sector reforms.

In 1996-97 the selective credit controls were liberalised on bank advances against a large number of price sensitive commodities. They have now been dispensed with.

AN APPRAISAL OF THE MONETARY POLICY OF THE RESERVE BANK OF INDIA

We have earlier explained in this chapter that the RBI enjoys extensive powers to control the supply of money and credit. It has all the weapons of quantitative credit control like bank rate policy, open market operations, and CRR in its arsenal. It has also been armed with selective credit controls under the Banking Regulation Act, 1949. We shall now examine how effectively the RBI has employed these instruments of credit and monetary control in recent years.

In the pre-economic reform period, monetary policy in India was formulated in the context of economic planning whose main objective was to accelerate the growth process in the country. Economic planning in a country like ours leads to an expansionary fiscal policy under the compulsions of increasing demand to expand both plan and non-plan expenditures. Monetary policy under these circumstances is asked to play a difficult role. On the one hand it is required to facilitate the fulfillment of the basic objectives of planning and on the other it plays the role of a countervailing force.