(Bombay) Times of India May 30, 1994

A Passage for India

Prof. Shyam Sunder

India is in the middle of an economic revolution. Beginning July 1991, Prime Minister Rao eased the government's grip on economic activity, opened India to international capital and competition, and cut taxes and tariffs. The challenge of a market economy has invigorated the country. Prime Minister Rao and President Clinton can achieve major benefits for both countries by placing trade and investment on the top of the agenda.

The Rao government has to do more if this liberalisation is not to wither on the vine as did Rajiv Gandhi's attempt in the 1980s. The following steps need political skill and determination, and deserve U.S. support and understanding.

Tell the masses: Most Indians do not read the English language media used by the elite to discuss liberalisation. Until the 1960s, the political cadres explained the government's socialist policies to the masses. Nobody has explained the structure of an open economy to the people. Uncertain of popular support, the Rao government shies away from tough choices. A grass roots information campaign in India's sixteen languages is needed to generate such support. India's largely rural, illiterate voters have repeatedly surprised the pundits by their political sophistication and pragmatism. Trust them.

Develop a new political compact: In an open democratic system, parties jockey for political advantage. Legitimate political parties must honour certain boundaries in this competition. During the first 40 years of India's independence, virtually all parties agreed to a big economic role for the state. A new political compact is emerging as both the Bhartiya Janata Party on the right and the Marxist government of the state of West Bengal have come to support elements of liberalisation. Investors value stability. To attract capital and investment, India has to assure investors that its political system is committed to an open economy, free from the vagaries of elections.

Befriend neighbours: India's stormy relations with Pakistan are an infected wound of a divided polity. If India and Pakistan were to live in peace would there still be a reason for their separate existence? Pakistan's fear of losing its identity, and the dynamics of its military-political system, keeps the wound festering. Prime Minister Rao must find a way to heal this wound, and form a South Asian common market. He has already cut India's defence spending to 2.5 per cent of its gross national product. With co-operation from the world's arms merchants, and some luck, he might succeed.

Decentralise: A few good men in commerce, finance and industry ministries are not enough. The federal government holds most of the power, and the bureaucracy of the federal, state and local governments has not changed its ways. Nineteen million government employees are afraid of the change, and obstruct liberalisation. After a 25 per cent cut in their numbers, public employees must be educated in their proper role, empowered to carry it out, and paid well.

Allow industrial exit: The government's programme to divest from industries producing non-strategic private goods is blocked by employee resistance to layoffs and closures. Even private firms that employ more than 100 people must obtain government permission to close down. This permission is never granted. Prime Minister Rao could buy employee co-operation by sharing the economic pie with them. For example, government could distribute the shares of such organisations to the employees, give them freedom to resell the shares, and remove the restriction on layoffs and closings. Control of these firms will soon shift to more efficient management.

Use of employment in lieu of social security has weakened the work ethic in India's overstaffed offices and factories, hidden real unemployment and the need for retraining, and weakened incentives to search for real employment. It is cheaper to pay the surplus employees to retrain, even stay home, than to have them distract others at wortk

Control deficit: Prime Minister Rao could save money by cutting state bureaucracy, eliminating state subsidies to farmers, consumers, and industries, divesting state enterprises that produce non-strategy goods, and reducing defence outlays through better neighbourly relations. This will bring the deficit down to levels that can sustain a stable economy at a low inflation rate.

Reduce transaction costs: India's government expanded to do things governments cannot do well, while the services only governments can provide deteriorated. Cost of transactions rose. For example, India has a comprehensive system of law and courts, but it is slow and corrupt. Government officials often demand bribes at every step. Poor regulation makes it costly to trade in Asia's oldest stock exchange at Bombay. Government can promote prosperity if it sticks to its knitting.

Invest in infrastructure and education: After half a century of independence, 45 per cent of its population remains illiterate. Shortage of electric power due to mismanged generation and distribution inflicts a huge economic loss. Prime Minister Rao should invest in infrastructure and education and reap high returns.

Policy making in large democracies is often slow and contentious. Indian and U.S. leaders should understand each other's decision making and help realise the full potential of India's economic revolution.

(The writer is the Richard M. Cyert Professor of Management and Economics at Carnegie Mellon University, Pittsburgh, USA).