The Observer of Business and Politics



# Reverses on the reform front

**Continuing structural weaknesses and their aggravation will exact their toll on the economy, leading to our downgrading below investment grade. Whether this will help build consensus in favour of reforms is also doubtful, says Uttam Gupta.**

STANDARD and Poors Corporation (S&P) and the Japan Bond Research Institute (JBRI), have decided not to improve India's sovereign rating. For long term foreign currency loans, India is rated BB and BBB by the two agencies respectively.

In S&P's assessment, the strong points of the Indian economy relate to improvement in productivity and efficiency, particularly in the export sector, increase in the forex reserves and broad political support for economic reforms. The weak points include persistent budget deficit, inflation, high debt of the government (both internal and external) and virtual absence of any attempt to undertake structural changes.

The assessment of the rating agency is based on the 1994-95 performance, when the trade deficit was about $2 billion and there were substantial inflows through the FIIs and GDR route. During the current year, the data for the first quarter reveals a despondent picture. Imports have increased by about 38 per cent, much higher than growth in exports at about 28 per cent. As a consequence, the trade deficit during the first quarter is almost double that of April-June, 1994. With the momentum of growth in imports likely to be maintained during the rest of the year, the trade deficit during 1995-96, is bound to be much higher (MOF puts this at about $5 billion).

With foreign exchange inflows through the FIIs and the GDR route already on the down trend and servicing of the external debt slated to increase sharply by about $2.5 billion, the overall BOP position during the year will be under severe pressure.

The situation will only deteriorate as bulk imports are set to rise steeply vis-a-vis the bleak possibility of maintaining export growth even at the existing rates in view of emerging protectionist trends in importing countries and continuing infrastructural bottlenecks on the home turf.

India has also received good marks for the GDP growth of 5.3 per cent during 1994-95 although short of the target of 5.6 per cent. This was possible mainly because of the good performance in agriculture, due primarily to the benevolence of the weather god. The constant neglect of investment in agriculture will inevitably show up in low growth or even a decline under adverse weather conditions. Moreover, sudden decontrol of phosphatic and potassic fertilisers resulting in steep price increases will affect soil fertility and crop productivity in the medium to long run. This is bound to have adverse effect on the overall GDP growth.

Political consensus on reforms may have some appeal even as all parties are talking in the language of liberalisation. But the critical point is what they do on the ground and not just what they talk. A JBRI study aptly summarises the ground realities: "The bureaucratic structure and public sector mainly, have become bloated while various vested interests remain entrenched".

These are the forces which have checkmated our progress towards structural adjustment and have even brought into disrepute the good policy initiatives. The fiasco on the power front is an example.

In the telecommunication sector, the story is no different. With the Bill for setting up of the Telecom Regulatory Authority of India (TRAI) having been withdrawn and the Supreme Court rider that licences cannot be given till TRAI is set up, privatisation plans are in a limbo.

On restructuring of PSUs, recently, the parliamentary standing committee had recommended divestment up to 51 per cent of the government's share holding in PSUs. But there is no guarantee that this sensible advice would be heeded. Even the PM is reported to be disinclined towards the government relinquishing control of the public sector.

In the financial sector, consideration of the Malhotra Committee report has been put on the backburner. In the banking sector, meaningful reforms are still hanging fire. Although, private banks have been allowed, through the licensing route, the government has ensured that banking in private sector develops at snail's pace. Lending rates have been deregulated, but, these are only upward flexible. Flexibility in fixing deposit rates continues to be denied to the banks. Besides, schemes like loan/interest waivers continue to threaten the viability of the banks.

On the tax front, the story is not very different. Tax collections have not shown the desired buoyancy. Large scale evasion continues. Besides, enormous sums remain locked as arrears on account of ambiguities in definition/classifications. Neither is there any significant progress in rationalising and simplifying the tax laws nor, in strengthening enforcement and improving tax compliance.

On subsidies, initially the government showed some dynamism to check their growth. But the process was short-lived. The revised estimates for 1994-95 and the budget provisions for 1995-96 show the subsidies on a comeback trail, but without any focus. Far from addressing the core issues of increasing production and consumption, the sole objective is to gain political mileage.

Added to these are a spate of social assistance schemes which will cost the exchequer about Rs 5000 crores. In fact, the very first batch of the supplementary grants for 1995-96 of about Rs 1672 crore passed by the parliament in the monsoon session, were intended to fund these schemes only.

With regard to fiscal deficit, except in 1991-92, the government effort fell short of the target by substantial margins. Whereas, during 1994-95, at least it had a framework for discipline through the MOU with RBI, for the current year the government has thrown even this to the winds.

The upshot is that the continued structural weaknesses and their aggravation will continue to exact their toll on the economy. That this will, in turn, lead to our downgrading even below investment grade is a foregone conclusion. But the more crucial question is whether it will help build consensus in favour of reforms. The answer is clearly in the negative.

Presently, our industries are exposed to competition because of lowering of import duties and removal of non-tariff barriers. This is despite inherent handicaps due to high interest rates, power tariffs, administered prices of basic inputs, railway freight and high capital cost due to delayed approvals/clearances. And all because the government remains unreformed. How long can the industries put up with this situation? Unless remedied, it will not be long before even they will start demanding heavy protection from imports.