Reforms and after

Barely a year away from the next general elections, popular attention seems to be focused upon the political world. Business India felt that this was a good time to take stock of the reforms that the Rao government had initiated in 1991 and make some assessment of the tasks that need to be done

We therefore invited six eminent economists to a panel discussion on the subject against the backdrop of a specific agenda: the role of regulation and free markets in the Indian economy's reform process. The panel was chaired by S.L. Rao, director-general of the National Council of Applied Economic Research (NCAER), New Delhi. It included Indira Rajaraman of the National Institute of Public Finance & Policy, Pulapre Balakrishnan, Bharat Ramaswami and Shubhashis Gangopadhyay — all faculty members of the Indian Statistical Institute, New Delhi — and Subir Gokarn of the Indira Gandhi Development Research Institute, Bombay.

The discussion ranged for over an hour, and the main points that emerged were the following: corporate performance has been picking up, but there was an opinion that this growth was not reflected in higher employment within the organised private sector. It was also felt that there was little attempt by the government to institute mechanisms to encourage corporate accountability and that corporate growth was therefore taking place in a "regulatory vacuum."

The panellists

S.L. Rao: Rao is the director-general of the NCAER, New Delhi

Indira Rajaraman: Born on 28 August 1947, Rajaraman has a PhD from Cornell University, US, and is currently RBI chair professor at the NIPFP, New Delhi.

Bharat Ramaswami: Born on 25 November 1960. He has a PhD from the University of Minnesota, US, and is assistant professor at ISI, Delhi at present.

Pulapre Balakrishnan: Born on 4 April 1955, and has a PhD from Cambridge University, England, and is currently a professor at ISI, New Delhi.

Shubhashis Gangopadhyay: Born on 25 November 1957 and has a PhD from Cornell University, US, and is working as a professor at ISI, New Delhi.

Subir Gokarn: Born on 3 October 1959. He has a PhD from Case Western University, US, and is currently an associate professor with the Indira Gandhi Institute of Development Research, Bombay.

Others disagreed; it was pointed out that there is little evidence to show that the organised sector was ever a major source of employment either in India or abroad, that, in fact, growth in employment emanated principally from the unorganised non-formal sector. The second area of disagreement, or qualification really, related to the regulatory 'vacuum' when it was suggested that in our endeavour to evolve norms of corporate accountability, we might just be choking off a natural process of corporate growth or contraction. One participant suggested that we needed flexible regulatory, or rather enabling, institutions.

The next topic on which there was debate was the issue of productivity in industry. While there was a rough and ready consensus that one could not, as yet, discern a trend in overall productivity increases there was debate on the importance of this concept as a measure of growth. The participants tended to emphasise on an increase in domestic fixed capital formation, and therefore investments, as a more substantive indicator of growth rather than productivity.

One other main area of discussion was sickness in industry and the exit policy.

There were some refreshingly different views on this subject. One participant flagged it off by suggesting that sickness and exit policy were not related; that the former was the result of the lack of a market for managers. It was also said that sickness therefore affected not just existing companies but start-up ones as well. In ideal conditions, a market for managers would allow for the mobility of the inefficient managers out of, and an inflow of efficient ones into, sick companies

There was a general consensus that FIs and banks had, unlike in Japan and Germany, abysmally failed to prevent sickness in firms even though they were strongly represented on the boards of directors. From here to a disapproval of the manner in which boards of directors generally function was but a small step.

In general, it was felt that even though the reforms were on the right track, there was a profound incapacity to comprehend the optimal choice of markets and regulation. For example, speculation was driven underground where it is very difficult to monitor the activity. If such activities were allowed, regulatory bodies would be able to monitor observable variables better. At another remove, it was pointed out that the RBI was powerful enough as a regulatory mechanism to be given autonomy and that the banking department of the finance ministry could therefore be closed.

The main excerpts from the discussion follow:

Corporate performance

Subir Gokarn (SuG): On the positive side, gross profits and operating profits have improved, in the last year in particular. Net profits have increased even more substantially, nearly one-and-a-half times gross profits. But one of the negative aspects of this performance is that the government is not getting its share of the cake; the tax liability of the corporate sector is declining. Maybe it's better tax planning by companies, but it's not helping the government's kitty very much. The corporate sector is now responding very well to reforms after the initial horror stories one heard. It is rising to the task, there is a lot of innovation, multinational competition is being met head-on. So there is a positive response by companies to the unshackling of industry.

The one problem I see with the corporate sector is that it is moving to open competition in the absence of a regulatory system governing corporate behaviour, accountability to the environment, to consumers. It's growing in a vacuum; companies are cutting corners to make more money. All this wouldn't have happened if a regulatory system was in place. For too long we have allowed command controls to govern corporate behaviour. We do not have market-friendly, market-consistent systems to replace the old licensing system.

"We have not gone far enough in capital markets. There is no regulation on insider trading, we have done nothing about depositories, paperwork still remains time-consuming. There is talk of corruption among regulators"

S.L. Rao

The other negative aspect of corporate performance is that it has not been matched by increases in employment. From an overall viewpoint of development, one would have expected an increase in jobs. But I do not see this happening. It may come with a lag when the small sector picks up, but that would only delay the upward movement of employment growth. Just to give you an example: Enron in Maharashtra entailed a huge investment, but its initial job creation stood at 175.

With regard to the stockmarket, the overall aspects are very good. Reforms have moved fairly consistently, regulatory systems are at least in place. The only problem that can corrupt the process is the threshold of entry into the market which is far too low, way behind what it should be. According to a study of emerging markets by the IFC (International Finance Corporation), which compiles data on 60 to 70 countries every year, India accounts for 10 per cent of market capitalisation and less than 10 per cent of volume of trade, but accounts for around 50 per cent of the companies listed. So the average size of the company is small compared to those in other emerging markets.

The result is a regulator's nightmare because simply monitoring listed companies, evaluating those that want to be listed — there are 100 to 150 companies being listed on the Bombay Stock Exchange every month — makes a mockery of all the good intentions of regulators. The numbers tend to wipe out the capability of this regulator.

S.L. Rao: You've raised a number of issues. First, employment. The question is whether one should expect employment to rise in the organised sector, or would it come as secondary and tertiary effects in the economy?

Second, about investments and productivity increases in the corporate sector. I am not aware of data showing a remarkable increase in either. Small studies by the All-India Management Association don't suggest that a majority of companies have increased productivity. Some of the top companies, with increased capacities and new technologies, may experience a rise in productivity. But there is no discernible trend of an overall rise in productivity in the past four years.

I do not share your optimism that we have gone far enough in the capital markets. There is no regulation on insider trading, we have done nothing about depositories, paperwork still remains time-consuming. There is talk of corruption among regulatory authorities; so how will one regulate the regulators? If you bring in the same bureaucracy of old as is being done today — Controller of Capital Issues as SEBI chief, retired Central government officials joining SEBI. Is this how our regulatory system should be manned? I think we should spend some time on these issues.

Subhashis Gangopadhyay (SG): Subir's point of a regulatory vacuum is a pertinent one. I read a little while ago about ice-cream companies being bought over by Unilever. Now, this clearly violates monopoly and restrictive practices. But, on the other hand...

Rao: May I interrupt here? You raise this issue of ice-creams. Now, it is true that Indian ice-cream quality standards are abysmally low. The entry of foreign companies should witness an improvement in standards. Besides, ice-cream manufacture is labour-intensive, so there is the employment angle too....

SG: That is precisely what I was going to say. When we are trying to evolve a regulatory mechanism, we ought to keep in mind that it would be extremely dangerous for us, it would take us back 40 years, if we were to outline what should be happening in each industry. In this sense, a regulatory vacuum may not be all that bad.

The only way to tackle this problem is to develop an institution that is very flexible. So should the ice-cream takeover be permitted; what benefits or losses will it entail? These are matters that an institution can debate. There's no point in borrowing concepts from the US or the east Asian countries. We have to evolve our own regulatory institutions through a learning process, over time. That's what the Americans did. We do not need regulatory mechanisms that lay down the law so much as enabling institutions.

Rao: I suppose you are making the point that if you want a flexible regulatory mechanism, it's very important to know who you are going to appoint as....

SG: The regulator, precisely! This also brings me to the point about government intentions in health, social services or even infrastructure. One should not assume this to mean the actual provision of goods and services by the government. What we require is for the government to develop non-market institutions that lay down guidelines for semi-markets to function.

Indira Rajaraman (IR): You mean accountability with flexibility.

SG: Right.

A new corporate tax

IR: I'd like to take up Subir's point of corporate tax contributions. We have to increase the tax base. Everyone knows that. In the corporate sector, the issue is not tax evasion so much as tax avoidance. Reliance Industries publicly reports that it is paying zero taxes. Apologists for these companies would call it deferring payment and not even avoidance, because they are taking advantage of depreciation and backward area location, etc.

This issue should be tackled not through legislation to plug loopholes. Historically, governments have found it very difficult to take on the corporate lobby. One should instead attack from the flanks by imposing a minimum corporate tax.

The base for this tax would be assets, on the assumption that one could expect a reasonable rate of return on assets. It should be a minimum tax on assets paid regardless of actuals. It would co-exist with the corporate income tax, not as an add-on. It would be offset against actuals.

"The corporate sector is now responding very well to reforms; there is a lot of innovation, multinational competition is being met head-on. But corporate performance has not been matched by increases in employment"

SUBIR GOKARN

Rao: But it would be payable regardless of profits. Today you do not pay corporate tax if you make a loss.

IR: That's right. You pay a minimum of 2 per cent on assets regardless of actuals. If your actuals exceed that, you pay the tax on the excess. If it is less, then you pay the minimum tax. There are various provisions to mitigate the severity of this tax like carry-forward etc. Particularly, it's a minimum payments provision.

Rao: But how can you ask companies that do not make profits to pay tax?

IR: It has been successfully introduced in Latin American countries because of the possibility of carry-forward or carry-back provisions.

Rao: Any other views on this?

SG: It sounds like a good idea because it does not affect incentives for growth, investment etc. It avoids inter-temporal distortions because companies need not worry about a current year's performance. However, implementation is the problem.

Organised sector and employment

IR: I would also like to respond to Subir's views on employment and reform. I am surprised that anyone should be unduly worried that employment in the organised sector has not kept pace with investment and profits. There is a host of countries that has grown through employment in unorganised sectors. Italy, for instance. Benetton has relied for long on small firms to supply them and it grew phenomenally on the basis of the surge in the unorganised sector.

Pulapre Balakrishnan (PB): Any data on overall performance to substantiate this?

IR: I do not have any macro-level data. But garment exports have grown through the unorganised sector where jobs are farmed out.

Rao: I think that the trend today is in farming out jobs, and this is evident in the corporate sector — using the informal sector for the manufacturing sector. But I can't see the employment-output ratio improving.

In any case, I do not think that one should expect the organised sector to provide more jobs. It has not done so in the past and it is doubtful if it will do so in the future.

PB: That's the case in the US too; on account of flexible production.

SG: Yes, and with an increasing tendency to cut down on corporate flab, what can one expect?

Rao: Subhashis, can you comment on what's happening in productivity in industry? It's only now that capital is moving with investments after sitting in the capital market for a period. Can we now expect an improvement in productivity trends? Or will it take more time?

SG: Well, if one looks at employment first, it seems incorrect to focus on employment per unit of capital. It's far better to view this in terms of scale of operations. And I think we are moving in the right direction. But Bala will have something to say on this....

Investment and productivity

PB: Well that's a puzzle here. The capital goods industry grew at 24 per cent last year. But it is very striking that during the entire reform process, year after year, aggregate fixed capital formation in India declined! In every successive year!

Now this is worrying from two points of view. One, growth comes from investment; in fact, contrary to what people believe, in most east Asian economies, including Korea, growth has come principally from investments rather than spurts in productivity. In fact, in Singapore, total factor productivity growth is virtually zero. So the low rates of investment in India are worrying.

Secondly, if money is not going into investment, where is it? Is it just sloshing around in the capital market? This is a puzzle. Somehow, it seems to me that the private corporate sector is not putting its money where its mouth is. Every time Manmohan Singh presents a budget, industry is all agog with excitement. They always say they are being treated well. So why are they not investing for the future?

In macro-economic terms, it's interesting that east Asian economies have investment ratios of 40 per cent, twice that of India's. We have a very long way to go.

I do not agree with the view that market-friendly policies automatically generate growth in productivity. In fact, both Germany and Japan have very strong state intervention in ensuring closer co-operation between capital and labour. It is this mediation that ensures productivity deals to which both parties agree, not out of any altruistic motives but out of pure self-interest. I do not see this government doing any active intervention on this score.

Rao: NCAER's Business Confidence Surveys show tremendous buoyancy in sales and profits; costs are being kept under control. The worrying thing is that there is little money (invested) in R&D. But management practices are improving, new products are being designed and there is better training for workers. There is a boom in quality circles. Though I'm not sure one can generalise for all industry.

Bharat Ramaswami (BR): I'd like to respond to Bala. I do not agree that capital formation is more essential than productivity. We can have increases in per capita income not on the basis of investment alone but on increases in productivity.

The fact that better managed firms can raise capital with better pricing, that is at lower cost, is more profound than the notion but investments are declining. Efficient use of capital is getting to be a practice, and for me this is a good sign.

Finally, I do not think that corporate savings rates are going down...

Rao: In fact, there is a slight improvement...

BR: Now, Bala used a phrase: money is sloshing around. Surely, this money too is having some real effect; companies are either retiring debt or investing in other firms. It will show up somewhere, sometime.

"When we are trying to evolve a regulatory mechanism, we ought to keep in mind that it would be extremely dangerous, it would take us back 40 years, if we were to outline what should be happening in each industry"

SHUBHASHIS GANGOPADHYAY

Sickness and exit policy

SG: There is a commonly held view about sickness in industry and the exit policy. I would like to put forward a different viewpoint. One of the issues connected with exit policy in India is the labour policy. There is an argument that workers can be fired for a number of reasons, but not for economic reasons. Labour is therefore not treated as an input in this sense. To me, this spells an increase in the cost of labour. Firms do not get sick because the cost of certain inputs are high. Firms do not *start up* because costs of inputs are too high, profitability is affected. In this sense, I do not think it's a good idea to link sickness with labour.

To view sickness in industry, one ought to look at the capital market, which should ideally act as a market for management; so it should play a very important role in developing a good exit and entry system for managers. Now, liberalisation allows the exit and entry of firms. So one assumes that a sick firm should be allowed to fold up. But that's not how it happens.

Firms are not single entities; they consist of assets and managers. When a firm gets sick, it should be able to shuffle around its managers. Assets have to be managed so that the best managers are allowed to come in and the most inefficient ones asked to leave. I do not see this happening here. Labour cannot be fired, so managers are expected to take this high cost into account. To be able to get rid of sickness in industry, one must develop a market for managers. Managers have to be placed in a competitive environment. This is very important for new entrants in industry. Unfortunately, this is not part of the government's agenda.

Rao: You made an observation once that sick companies have a high component of debt to equity. Now, the lack of an exit policy has allowed the debt to continue; the fact that sickness comes about when you erode your net worth and not when you cannot pay your bills has allowed these companies to continue forever.

With the new provisions for banks and financial institutions on non-performing assets, a change is discernible. Companies are no longer being given loans. Second, within the private corporate sector, there is a restructuring with debt coming down in favour of equity. In the public sector, debt continues because, by and large, enterprises are not allowed to restructure in favour of equity.

FIs and company sickness

SG: But in many developed countries, debt plays a major role in the capital formation of companies.

The other, to me related, point is that in Germany, for instance, over 70 per cent of the banks are owned by locals, and not the federal governments. These banks play an extremely important role in the development of a market for managers. In this respect, Indian banks have failed.

The debt-equity ratio itself is not as important as the role that institutions that fund such companies, either as creditors or equity holders, play in determining the way the assets of a company are managed. In India, financial institutions and banks have been the largest funders of companies, but their role in preventing sickness has been negligible.

If this country had a favourable labour policy, FIs and banks could have been permitted to haul up managements that ran companies to the ground; they could have been allowed to change managements that failed to foresee crises that their firms could face. That's how the market should have worked. But we have, in our desire to protect labour as we saw fit, allowed inefficient managers to continue to rule the roost. In the US, the capital market controls errant firms; in Germany, banks provoke bad managements into taking new decisions, investing in new product lines, so as to improve bottomlines. In India, the capital market has not yet developed to play this role. FIs and banks have, but they have failed miserably to prevent sickness.

Rao: That is a very interesting point. FIs are the largest equity holders, but their only task seems to be to prevent takeovers. They do not get involved in corporate restructuring despite having nominee directors on the boards. Your views are quite contrary to those of industry which would like FIs to stay aloof.

SG: Of course, the FIs and banks ought to leave managers to take risks, so that undue intervention does not deter initiative and risk-taking. However, when long-term decisions are being taken, FIs ought to get involved; when a firm is getting sick, facing financial distress.

SuG: But who bears the ultimate risk when a firm is getting sick? The immediate creditor may be a state financial corporation which passes on the burden to the IDBI which could pass it on to the Centre. You have a system where the risk is passed on, weakening the creditor's incentive to call the shots for corporate change. In Japan or Germany the buck stops with the banks, period. The basic issue is in determining how effectively creditors can be made to bear the risk of their investments before they begin to monitor corporate performance.

Boards of directors

BR: The other, but related, issue is the role of FIs' nominees on boards of companies. Most of them work like bureaucrats; many have to be told which company meeting they are attending because they are on the boards of so many firms.

SG: This highlights the fact that all the changes in accounting standards, on non-performing assets, etc, represent only one side of the story. How can one ensure healthy banks if they are not made to suffer a cost for their own funds? We are looking at how to monitor the outflow of funds from banks. What about making banks pay a higher price because they are making bad investments? Privatisation provides the answer.

"I am surprised that anyone should be worried that employment in the organised sector has not kept pace with investment, profits. There is a host of countries that has grown though employment in unorganised sectors"

INDIRA RAJARAMAN

Rao: One part of the reform process that has been overlooked is precisely the kind of nominees that banks and FIs place on the boards of companies indebted to them. Clearly, one can't think of directorships as jobs for the boys; you have to choose people with professional expertise and commitment.

SG: I would agree, adding only that you cannot choose the right person. Banks and FIs will be committed to finding the right person if they are forced to pay the price of their own borrowings and investment choices.

Rao: This brings me to a more general point: the quality of directors on the boards of companies. It's bad enough in the public sector, but the standard of the boards in the private sector too leaves much to be desired. The boards are not functioning as independent overseers (of managements); more like friends, one would say. Perhaps the American system where in professionals with adequate compensation are invited on to the board is the answer.

PB: I would take issue with SG on the potential of the capital market to discipline inefficient management. So far, we have looked at ownership, but the issue is one of control, especially in a country where ownership through equity is diffused and, in effect, managers call the shots. So how does one discipline them?

I am not terribly hopeful of banks and FIs playing the role of a disciplinarian because banks have been capitalised by the budget, their capital adequacy norms have been shored up to Basle committee (standards) overnight with public money! Rewarding the profligate! So the diagnosis is right, we need creditors' stake in governance. But can such banks, that have been inefficient for 30 years, do the job?

The regulatory mechanism

BR: The effectiveness of any regulatory mechanism lies in regulating a phenomenon that is out in the open, visible to all. This is not always the case.

For instance, everyone is worried about speculators, hoarders and black-marketeers. The irony is that we have no idea of what they do. So how can they government regulate such activities?

The alternative is to allow futures trading. By bringing it out on the surface, governments will get valuable information about speculative activity, the ways in which speculators operate. In the event, if the government feels that the futures contract for wheat and rice is trading at a very high price, then it can take a position saying it is going to import X million tonnes of wheat and it will reach the markets within two months, for example.

SG: That is an excellent idea, because the basic idea of a regulatory mechanism is to operate on the basis of observable

variables. The current system involves bureaucrats sending inspection teams which are amenable to manipulation, corruption. So the information the existing mechanism obtains is often distorted.
Rao: You both are saying that there is no point in stifling in natural tendency for a certain activity. It's far better to let it out in the open and observe it, manipulate it. The problem is that the government has always tried to curb activity it assumed to be undesirable, be it *badla* or forward trading.
SG: This is why an enabling institution is critical, because it can observe such activity and provide the means to regulate it.
BR: The government operates on the premise that once it has declared an activity unlawful, it will disappear. This obviously is not true, as we all know. Speculation is banned....
Rao: So it goes underground! Any other views on regulatory mechanisms?

More power to the RBI

BR: Well, I'd like to move slightly off centre and suggest that it is time for the RBI to become more autonomous as a regulatory body. Not because of macro-economic reasons like combating inflation, etc, but because it has handled the balance of payments position so well. In 1991-92, with a minority government, it did a great job in reversing the downslide. It has proved to be a very confident institution, has considerable powers and there is much to be said for granting it more autonomy from the banking department of the ministry of finance. It's an institution whose time has come.
Rao: Or should one say the banking department is an institution whose time has come to go!
PB: Absolutely. There is little need for that department to have any authority over the RBI. The RBI is doing the job on behalf of the MOF anyway. Give it more power. There are many other regulatory authorities that should be given more freedom.
Rao: Just as there are institutions that should be allowed to die. Basically then, we have a consensus on three types of regulatory mechanisms. One, allow certain activities to come out into the open, better to control them; two, have a regulatory mechanism, but let the markets do as much as they can without hindrance; third, have regulatory mechanisms that are flexible enough to let the first two operate.
BR: I can suggest another. If you have to regulate at all, it is better to regulate output than input in any activity.

Devolution of power

IR: I think there is a fairly wide-spectrum consensus on the fact that the areas in which a post-reform government should move into areas like education, health and so on.

After the 73rd and 74th amendments to the Constitution, many of these functions have been placed squarely in the hands of the new local bodies that have been formed — the *panchayats*, municipalities and so on. I therefore see a very important area of focus: how will these new local bodies commandeer the resources with which they can discharge these very necessary functions?

The task of identifying new resources has been assigned to the state financial commissions which have been formed in all the states. These bodies, however, don't know where they are to get these resources from. The sheer fiscal strain posed by the formation of these bodies before they discharge any of their functions, is awesome.

To begin with, there is an establishment cost that is a sort of zero-level requirement placed upon the fiscal systems which didn't exist before. In UP alone, there are going to be 70,000 new local-level bodies because there is a three-tier structure to this whole thing. There are *gram panchayats*, then there is a middle-level *panchayat* samiti and there is a final district-level *zilla parishad*. So there is a three-tier structure to *panchayat* governance. When you have covered that establishment cost, you will then have to come to base zero in terms of simply financing the way they are to conduct their deliberations. Then, after that, you have to find resources with which they are going to educate people and make people healthy, and so on.

I cannot tell you where these resources are to magically come from, but I will only say this: it is inconceivable that in the new post-73rd, 74th amendment India, we should continue to treat agriculture as an untaxed sector. It is inconceivable that we should live with that exemption for the very simple reason that agriculture is the major activity in which this new governance is to take place.

"It is time for the RBI to become more autonomous as a regulatory body. Not because of the macro-economic reasons of combating inflation, etc but because it has handled the balance of payments position so well"

PULAPRE BALAKRISHNAN

Resources for local bodies

Rao: The kind of questions Indira has raised are very basic. She raised the question of resources at the *panchayat* levels, and the same thing applies as much to the state level. Apart from the the quantity of funds you will require, it is the quality of the delivery system that matters. And there is enough evidence to show that the governments at state levels are really unable to deliver services effectively. This is going to be even more of a problem in the *panchayats* at the local levels because of the lack of an existing bureaucracy. Maybe that is an advantage and needs to be looked at.
SG: I am a bit sceptical about the problem you were raising when you mention the 70,000-odd bodies to be developed in just in one state; about the problem of getting them funds, etc. I think that's a quite a wrong approach to take in the following sense. When we talk about delegating responsibility and power to local bodies and not having the centralised system we have had so for so long, we are assuming that the local bodies will be more accountable. The only way you can make them more accountable is to force them to raise resources from the people whom they are going to serve. If we still have to depend

on a decentralised bureaucracy that gets its funds or support from some outside organisation, I think the problems of non-implementation will continue to exist.

IR: I hope what I said is not misconstrued to mean that we have to hand things out to local governments. I thought I stressed that we have to look for incremental resources which bodies can raise locally from the agriculture sector particularly. There is no question that accountability has to go hand in hand with local representation. Of course, it's very, very difficult to visualise the amount of resources which can be raised locally across the board; there is a fantastic amount of heterogeneity, of course. In Haryana local resources can be raised, and in tribal regions it's very difficult. I fully agree with you that if we are going to have local government leaning on the state and the state leaning on the Centre, we have solved nothing.

SG: Right, we agree on that. And where I want to go from there is the following: I think no economist would say that the government has no role to play when there are some 300 million plus people who are living below the poverty line.

Rao: Can we just stop for a moment? I am sure we all agree that your market really is not a full answer to Indian problems; we are addressing a business readership, and we don't want businessmen to get away with an impression that the government can just back out of everything.

SG: That's right. So in that sense certainly the government's role will be very important in social sectors as well as infrastructure, two clear cases where the markets tend to fail. When we have very skewed income distribution, the possibility of market failure is that much higher. So the debate is not on where the government should intervene. The point of dispute is how the government should intervene and I will stop by saying that for the past four or five years what we have seen in the current government reform package is a negation of this problem completely.

The government has reduced taxes, reduced tariffs, all of which have helped it collect more revenue. It has allowed multinationals to come in and there is a debate on whether this reduced step together with delicensing have reduced the power of the government.

The government has to pay a price for liberalisation, like having a smaller government, cutting down government wastage, not interfering in whether Enron should come up or not. It is in these areas that the government has not done much in terms of liberalisation and that is the direction we should proceed towards. To really reduce the government's role in economics.

Land reforms

SuG: Could I respond to Indira's points? Maybe I am flogging a dead horse. I think in talking about local government and its effectiveness, we have to get back to the issue of land reforms which more or less seems to be dead. I would say that one of the reasons why most attempts to institute any kind of effective local self government, particularly in the rural areas, have failed is because of the hindrance that the political structure of the rural economy has placed on this process. To visualise a major role for these institutions, now virtually displacing what has become a centralised process of resource allocation and management of resources, without attempting to tackle the political structure that has been holding up this process would get us back to a level of relatively ineffective functioning. So I think there are some basic issues in agriculture that precede attempts at administrative reform.

"I do not agree that capital formation is more essential than productivity. We can have increases in per capital income not on the basis of investment alone but increases in productivity"

BHARAT RAMASWAMY

Rao: Could you expand on that a little bit?

SuG: Well, we have a highly unequal pattern of landholding. Attempts to deal with that have generally failed, and for a long time now we have not had any significant policy on land reform and the role it has to play in the liberalisation process. If I could just make a reference to the development experience of the east Asian countries. Virtually all of them went through a very effective process of land reform some years before they were able to launch on to their growth rates.

Rao: In the context of the decreasing size of landholding in India and the new pressures from corporate farming in horticulture, floriculture, etc, is there a direction we can see land reforms heading?

SuG: I think for a long time to come the bulk of agricultural activity is going to be in foodgrains and corporatisation in horticulture; commercial farming is only a trend. One can see pockets becoming big and affecting the local economy, but the bulk of agricultural activity will be in foodgrains and small farms. That pattern is still a long way from changing.

BR: I think the issue of land reforms is a dead horse and I don't think that there is any point trying to revive it. All of us are aware of the politics of the situation and there is really no point to it. Secondly, as Rao said, I think to an extent demography is taking care of it; the average landholding is very small and has declined further. I understand your point, Subir, if there is an initial division of assets which is egalitarian, then it certainly helps in the formation of local institutions and also in furthering political participation by everyone.

On the other hand, we haven't had any real experience with local institutions, so it is unfair to jump to the conclusion that they will not work. I think a verdict is still to come in. Regarding the decentralisation of power and resource allocation, the point that Rao made about corporate farming: I don't know why we assume that for horticulture and speciality crops which need new technology and also funds on the scale that are not employed by farmers, corporate ownership of farm land is necessary. I don't understand this because contract farming has worked in India and certainly contract farming will be preferable to corporate ownership on distributional grounds. If there is a problem you should try to fix the problems with contract farming. I really don't see any need to change our laws regarding corporate ownership in agriculture.