Management of Development in the Newly Emerging Global Economic Environment

T Krishna Kumar

Economic reforms have not delivered the goods even after five years. This is because they are not suitably designed for our country's specific needs and conditions. What we need to do is to return to the drawing boards and get back to planning, the Mahalanobis way, was indicated in this paper.

I
Introduction

INDIA is now in a mid-course with its economic reforms. These economic reforms are examined with three different perspectives by the people, who can likewise be grouped into three groups. First, there are those who argue that going for economic reforms with the IMF loan and the conditionalities is the only solution and that 'There Is No Alternative' – the TINA group. Second, there are those critics, mostly the left-oriented, or those leaning towards the left, who argue that 'There Is the Alternative' of self-reliance and not taking foreign assistance with the strings attached. Let us call this group the TITA group. Finally, there are those who adhere to the view that 'There Is a Middle Alternative'. Let us call them the TIMA group.

The ideologies and the logical bases of the first two groups are quite well known. There is no such clear explanation on why the third group prefer the middle path. This is mainly because this group of people consists of three subgroups. There are those who endorse the reforms unconditionally in private, but profess a preference for the middle path in public, as they are quite convinced of the adverse impacts of the reforms on the poor. There is another subset of the third group who prefer the middle path just because they fail to approve either the right wing reforms or the left wing alternative. Finally, there is a sizeable subgroup within the third group that strongly advocate a middle path because they do have a theoretical or logical basis for their stand which is based on the real situation, people's preferences, and institutional constraints. Their approach is not utopian or ideological but practical and strategic. I would like to place myself in this last subgroup of the third group.

What I propose to do in this paper is to present a logical framework that would justify a middle path and use that framework as the basis to judge the successes and failures of the reforms undertaken so far, and also indicate the steps we need to take in order to consolidate the gains already made and to mitigate the adverse impacts.

The euphoria about the economic reforms that is so widely prevalent today has led many people to ignore the role of the state and even to blame Nehru and Mahalanobis and their strategies and plans for the economic conditions prevailing just prior to our launching the reforms. This, in my opinion, is not justified. To the contrary, I shall argue that the slow pace with which we are reaping the benefits of the reforms is because of our neglect of planning. One must distinguish between the plan as a strategy and planning as the approach to arrive at such a strategy. Plan strategies depend on ideologies and attitudes, and the prevailing circumstances, both domestic and external. These prevailing circumstances include our internal strengths and weaknesses and the opportunities and threats that the external world offers us. As will be explained in detail later, what Mahalanobis bequeathed to us is a legacy of scientific approach to planning for development. This legacy is relevant even today but under an entirely new set of attitudes and preferences, and under a new global economic environment. One should not abandon the scientific approach to planning, just because the old planning strategies are inappropriate in the present circumstances. It is some times said that free enterprise market mechanism and planning do not go hand in hand. It must be noted that the concept of planning introduced by Mahalanobis is nothing but the concept of corporate planning that most of the large corporate organisations adopt, except that this process is supposed to be used at a macro-level instead of at the level of a corporation.

This paper is organised as follows. As history offers important lessons, some episodes of economic history and the lessons one can learn from them are presented in Section II. The present global economic scene is presented in Section III. A conceptual framework for management of development in a global economic environment is presented in Section IV. In writing this section, I owe an intellectual debt to the contributions made by Ragnar Frisch, P C Mahalanobis, Jan Tinbergen and Sukhamoy Chakravarty, all pioneers in quantitative economic policy. In Section V, I outline a strategic planning approach to planning for development of a country. This framework is used in Section VI to comment on what was wrong with the reforms already introduced and suggest the next steps for reforms.

II
Some Lessons from World Economic History

Economic history evolves in a systematic way. The rate of change of output of any sector in a country depends on six factors: (i) the initial conditions, such as the initial level of stock of capital, which may itself depend on initial levels of output of that sector and some other sectors, (ii) the flow of other productive resources into the sector, (iii) the production technology, (iv) external trade, (V) the institutional structures under which the resources are transformed into output, employing the technology, and (vi) the demand for the output.

People play very important roles in economic activity. It is their attitudes and preferences that determine the choice of technologies and the demand. It is their attitude towards work that determines the productivity. It is their attitude and preferences that shape the economic and other related institutions. People also form expectations of the future and they also set societal norms, and act according to those expectations and norms. Whenever the actual outcomes deviate from either their expectations or from the societal norms they adjust their behaviour so that such deviations are narrowed down in subsequent periods. Whenever such deviations are large, between peoples' expectations and actual realisations or between the outcomes and the societal norms, people try to bring in changes in the institutional structures. This adaptation of the system to changes takes place differently and at different pace in different societies, possibly because of differences in their cultures.

World economic history offers us some interesting lessons on such adaptations of different societies at different times. What I propose to do in this section is to trace some episodes of history which offer lessons to

us regarding what position we should take on the issue of economic reforms.

From Mercantilism to Two World Wars

In the early 17th century, Amsterdam had become a major trading centre for international trade and a major centre for financial capital. The Dutch were then mostly middlemen such as traders, brokers, and bankers and not manufacturers. The Dutch mercantilists were the ones who pioneered international trade by financing the venture capital through the formation of shipping companies by raising the equity capital. This is how the Dutch East India Company was formed. It is also worth noting that in the mercantilist economic system it is such international trade, and the state's control over it, which generated the state revenues in bullion (gold and silver). The state not only controlled trade but it also promoted such trade through advancing the venture capital. The British government giving political and financial support to the British East India Company is one such example. The economic history of the mercantilist period clearly demonstrates that international trade played a key role in the growth and prosperity of the nations in that period.[1]

Economic growth and prosperity are caused both by technological innovation and international trade. International trade opens up new opportunities to sell goods, and thereby it generates an incentive to increase production. Such increases in production can take place either by new entrants into the field of production, or through the realisation of economies of scale, or through technological progress, or any combination of these. One might say that it was the prosperity arising from international trade of the mercantilist period which must have triggered the technological innovations. It is these technological innovations that triggered further international trade and so on, in an ever expanding spiral which explain the growth of the world economy.

But history also shows that engaging in international trade is not without its problems. The Dutch and English traders soon found that when they were competing individually with each other in overseas trade, which involved investing huge capital on risky voyages over troubled waters, they had to incur heavy losses. This competition and the associated losses led to co-operation and the formation of shipping companies. One kind of institution that could not succeed gave rise to the formation of another that could. International trade thus resulted in forming new institutions, and opening up new successful opportunities in place of the unsuccessful ones.

Industrial revolution engulfed the economic activities in Europe and North America. The first country to benefit from the industrial revolution was Britain. The additional industrial employment that was generated in Britain due to the industrial revolution could be supported in terms of wage goods only through increased agricultural productivity. This was so because even when the industrial revolution was taking place Britain was under the spell of mercantilist policies that restricted imports of foodgrains and provided subsidies to the farmers. It was this situation that was responsible for technological innovations in agriculture. It was this condition that had brought about a change in the institutional arrangements for the distribution of landholdings. Fragmented landholdings were replaced by land consolidation through the enclosure movement which facilitated commercialisation of agriculture. It is true that some of the small farmers could not benefit from this land consolidation scheme of the enclosure movement. They had to leave agriculture and seek industrial employment in urban centres. The rapid industrial expansion did provide much better prospects for the small farmers who were so displaced.[2]

The historian Alvin Toffler had argued that in order that a business organisation be successful it should be adaptive [Toffler 1986]. An organisation should adapt its organisational structure, institutional mechanisms, and day to day operations, to the changing environment. Such adaptation should not be too fast, as the changes in the environment could be only transitory while the adaptation contemplated is more lasting; it should not be too slow either, as the other organisations that adapt fast may have head start advantages. The corporation must first assess whether the changes that are occurring in its environment constitute a long-term trend or a transitory component. Once it is sure that the changes are based on long-term trends it should adapt itself quickly to such trends.

Whatever Toffler said about a business organisation is equally true for an entire nation. If one examines the economic history at the time of industrial revolution and see why Britain and North America had better industrial growth than other parts of Europe it becomes quite clear that Britain and North America adapted their institutions to cope with the economic changes brought about by the industrial revolution, while the other countries did not. Both Britain and North America broke away from the mercantilist policies. Britain repealed the Corn laws in 1846 and advocated free trade. By this move Britain had accepted a challenge of industrial competition and took advantage of the agricultural imports for introducing widespread specialisation through economies of scale. Britain forced free trade regime on other European countries also through the Anglo-French Treaty of 1860 and other similar bilateral agreements with other European countries.[3] In the earlier phase of industrial revolution, the other European countries were slow in adapting their institutions to cope with the changes required for the full exploitation of the industrial revolution. The same kind of explanation can be given to explain why North America industrialised faster than Soviet Russia, although both of them had similarities such as vastness of the country, rich natural resources, etc.

The industrial supremacy that Britain enjoyed in the initial phases of industrial revolution and thereafter was soon lost and Germany had dominated the industrial growth in Europe. This was due to the fact that Germany had the advantage of starting its industry with both new and proven or the best practice technology, while Britain could not easily scrap and replace its old plant and equipment.[4] The industrial countries' exports to the underdeveloped countries were limited by the latter's capacity to import. Underdevelopment thus put constraints on exports and growth of the industrialised countries. Most of the trade of manufactured goods was therefore among a small group of industrialised countries, and these industrialised countries competed vigorously for the markets in the underdeveloped countries. Free trade among such nations led to a keen competition which affected the national interests. The European countries started abandoning the free trade regime and started imposing trade restrictions by the last quarter of the 19th century following the great depression of 1873.

International trade also has another adverse consequence. Since all countries were governed by the gold standard, until the great crash of 1929 – trade between countries gave rise to propagation of shocks or business cycles from one country to another. Some of the reasons for the world depression in 1929 are (i) optimistic expectations regarding world demand which was supposed to be met through international trade, accompanied by a non-realisation of such expectations, and (ii) a failure of the banking system, when several borrowers defaulted on their loans simultaneously.[5]

Post-War World Economic History

The post-war period gave a different pattern to the world economic scene. European capitalism was threatened by the Oriental capitalism of Japan and by the Communism of the Soviet Union and other socialist countries of eastern Europe. While the 18th and 19th century wars were mainly localised, as for example the Sino-Japanese wars or the wars between the European countries for control over their colonies, the first and the second world wars brought other countries into the war arena. This was

mainly because of the wider spatial linkages established as a result of industrialisation and international trade. The US emerged as a major industrialised country that played a significant superior role in both the wars. US took the threat posed by Russia as a threat both to its political and economic power. Through the Marshall Plan and NATO, the US government sought the co-operation of other industrialised capitalist countries to wage a cold war against the Soviet Union.

The Bretton Woods convention is a good example of generating an institutional response by nations to the emerging challenges posed by economic and political trends. Although the Bretton Woods convention was open to several member countries of the League of Nations, the industrialised European and North American countries played a significant role in shaping the two multilateral agencies founded during that convention, viz, the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) or the World Bank. A more detailed account of this aspect is presented in Kumar (1993). The US government, in particular, played a key role in shaping these two institutions. An examination of the history of the Bretton Woods will reveal that the economic rationale for them was provided by Britain, through the ideas advanced by Keynes, while in establishing these institutions the US government saw both a political and an economic opportunity for itself. Keynes realised the need for an international currency and an international central bank. This international bank, according to Keynes' proposal, would perform more or less the same functions in a world economic environment that a central bank of a country does in a national environment control the international liquidity to stabilise the world prices and the exchange rates, and to control foreign direct investment and capital mobility through adjustment of exchange rates and interest rates. What Keynes conceived was an institutional framework for world economic policy co-ordination.

The US government seems to have shaped these two institutions to further its own economic and political objectives. It wished to rebuild Europe after the war, but it realised that the private bankers would not come forward to lend overseas without government guarantees. This reluctance is based on the interwar experience that led to the great crash of 1929. Even the government guarantees would have little significance if the country were to go into another depression. The U S government saw in these two institutions a means of safeguarding the US private investment in overseas projects to rebuild the war ravaged Europe. The scheme was supposed to work like this. The US government would borrow from the private banks, through long-term government bonds issued as a part of its open market operations, and invest those funds abroad through the two multilateral agencies. The surplus savings in the US were thus permitted to be employed for rebuilding Europe to serve both its economic and political objectives.

The US government also saw in this scheme a way to safeguard the value of the US dollar even in the event of its current account of the balance of payments running into deficit. A capital outflow so created would increase the demand for the US dollars. Such an increase in demand for dollar would maintain the value of the dollar *vis-a-vis* an international currency. The US did not accept Keynes' suggestion of having an international currency. US wanted the IMF to fix the exchange rates of all currencies relative to the US dollar, whose value relative to gold was fixed at US $34 per ounce of gold.

The quality revolution in Japan and the rising consumer sovereignty in the US were responsible for the US to develop a huge trade deficit with Japan in the late 1960s and the early 1970s. By the beginning of 1971 the US dollar was thus in trouble because of these deficits. While such a bilateral problem demanded only a bilateral solution, such as devaluing the dollar, the US government made it a multilateral issue by advocating a departure from the fixed exchange regime. Such a move would make other countries also devalue their currencies. This way the US dollar, while losing ground against the Japanese Yen, would gain against other currencies, thereby minimising the resulting losses to US.

At about the same time the US government started giving massive economic and military aid to Israel. This had forced the Arab countries to think of radically different ways by which they could counter the American move. This had led the Arab countries to form the Organisation of Petroleum Exporting Countries (OPEC). OPEC then decided in 1973 to raise the oil prices with a dual purpose; first, such a hike in oil prices would jolt the US economy which is very much dependent on imported oil, and secondly, it would generate the extra revenue they need for defence expenditure. It is this hike in oil prices that created a worldwide phenomenon of balance of payments crises for the oil importing countries. This global view about the balance of payments crises facing the developing countries was described earlier in Kumar (1993). It should be noted that this crisis could not be prevented as there was no multilateral institution to co-ordinate or regulate economic policies to restrain the member countries from raising the prices of critical commodities without adequate justification.

Many countries that faced the balance of payments crises had to approach the IMF for assistance. While the oil importing developing countries were still trying to cope with the problem of oil price hike of 1973 there was another hike of oil prices in 1979. Some of the oil importing developing countries, such as some of the Latin American countries, found it impossible to meet their debt repayment obligations. In August 1982 Mexico took the drastic step and declared its bankruptcy. This had created a chain reaction that had to be stopped by the IMF by renegotiating the earlier loans. To safeguard the investments of the multilateral agencies in such countries the IMF had developed a policy package. These policies have subsequently been used as conditionality clauses in preparing the loan instruments. These conditionality clauses were used as opportunities by the US government, to propagate its political and economic philosophy and to promote its trade in goods and services with the borrowing countries. This is how privatisation or reduction of the role of the state, liberalisation of trade in goods and services, formed the major components of the IMF's conditionality clauses.

III
Present Global Economic Scene

The cold war came to an end with the disintegration and the disappearance of the Soviet Union. The west Asia peace accord is in place. The prominence of defence industrial production is gradually declining and the industrial countries are gradually diverting more and more of the resources from defence production to the production of peace-time goods and services. The industrialised countries are experiencing a low population growth. People in these industrialised countries are reaching a certain degree of saturation in their demand. These countries are therefore eagerly looking for markets in the developing countries.

Laws against environmental pollution, laws on occupational safety, minimum wage laws, etc, are forcing the industrialised countries to incur high costs of production. The same goods and services can be produced at less cost in the developing countries employing the old and environmentally unfriendly technologies. The private industries in the developed countries are therefore looking for opportunities for shifting the manufacturing to the developing countries. The higher quality of life demanded in the industrialised countries is responsible for higher wages in those countries. There is therefore a tendency for the skilled labour to move from the developing countries to the developed countries, while there is an opposite tendency for the capital to move from the developed countries to the

developing countries. In other words there is now a tendency for mutual exchanges of the factors of production which will generate secondary and tertiary interactions between these two types of countries.

The European countries formed a European Union with a common central European Bank and with the possibility of even having a common currency. A concern of the North American countries regarding the economic superiority of Japan and unified Europe have prompted them to come together and form the North American Free Trade Area (NAFTA). We thus see all over the world a phenomenon of linkages, leading to both competition and co-operation.

The experience of the developing countries that borrowed from the two multilateral agencies is quite mixed. Some countries, such as the sub-Saharan African countries, failed miserably and gone into debt traps and famines – as in the case of Ethiopia. Some other Latin American countries, such as Brazil, Chile and Mexico, are alternating between episodes of bad and good performance. Countries in the east Asian region such as South Korea, Taiwan, Hong Kong, Singapore, Thailand, Malaysia, and Indonesia have performed very well. While the management professionals seem to be obsessed with their quest for an answer to the question, 'Why some corporations succeed while others fail?', the economists have not paid adequate attention to a similar question, 'Why some countries succeed while others fail in coping with economic crises?' Some tentative answers to this question were offered by me earlier, basing those arguments on the rational expectations hypothesis of the new school of New Classical Macro-economics [Kumar 1994a]. It is quite useful to repeat them here in very simple terms with-out using too much of the economics jargon.

Some countries, such as the African countries, suffered from severe shocks of balance of payments deficits. These shocks were caused by both high prices for oil imports and by the volatility in the exchange rates. Their economies are not capable of coping with the problem due to their general economic backwardness, political instability, and because of lack of adequate concern from the governments of the developed countries to find a more permanent solution to the problem. Countries such as Mexico, Chile, Brazil, etc, had solved their balance of payments deficit problem only temporarily through transfers in the capital account by taking external loans, through foreign direct investment coming into their countries, and through inflow of financial capital. Capital mobility, both physical and financial, is guided by people's expectations. Whenever such expectations are optimistic there are major investments and there are capital inflows. Whenever such expectations are pessimistic there is a capital flight away from the country and there is a decline in investment. The mixed performance of the Latin American countries can thus be explained by this phenomenon of people forming both optimistic and pessimistic expectations at different points in time.

People will form optimistic expectations only if the economic reforms take place in a politically stable and predictable environment, and if the reforms pay adequate attention to building the social and physical overhead capital such as education, health, transport, communications, power, etc. In the absence of these favourable conditions the expectations turn out to be pessimistic. It is to be expected that growth of an economy is dependent on the investment and investment is dependent on the investment climate. If the people have optimistic expectations then the investment climate is good and the investment and growth will be favourable. On the other hand if the expectations are pessimistic then the investment climate is bad and the investment and growth will be poor. It is this logic that explains why some economies were successful with reforms while others are unsuccessful.

The developed countries are quite cautious of their imports and at the same time they are quite aggressive in promoting their exports. The developing countries are hopeful of achieving rapid growth through the economic reforms. What each country does or what it should do depend on what the other countries do.

In view of the emerging situations of competition and co-operation described above the most important question to ask is: where do these developments lead us to? Are the current events likely to lead us to a global crisis such as the one that took place in 1929 and soon thereafter? How can we summon the services of economic science to foresee the future course of events and to take the necessary corrective steps? Is there a need for an institutional or organisational reform to design and implement such policy? These issues are discussed in the following sections.

IV
A Conceptual Framework

The global economy is now characterised by extensive global linkages. These extensive global linkages have resulted in massive opportunities for international trade. These trade opportunities also generated opportunities for competition as well as co-operation. Such competitive behaviour between nations might result in a solution that can be improved, in the sense of yielding larger benefits at least to one nation without in any way reducing the benefits to the other nations, by introducing the possibility of co-operation between some of the nations.

The global economic evolution can therefore be regarded as an evolutionary n-person competitive game, where the number of players in the game, viz, n, has to be determined on the basis of a co-operative game to be played by all the nations, the co-operation giving rise to the formation of coalitions such as the customs unions or free trading areas, etc. As a result of the evolutionary nature of economic environment the players must come to an agreement on the rules of the game, viz, the institutional mechanism under which such game is to be played. GATT, along with the international financial system and the international legal system constituted such an institutional system until recently. These institutions had to undergo a reform through the formation of the World Trade Organisation, and by having a new round of GATT with significant changes. A nation playing an evolutionary game of this nature should not only choose a strategy at any given instant, but it should also pay attention to choosing its strategies in shaping the rules of the game, so that in a competitive environment the rules actually chosen turn out to be more beneficial to it than several other feasible rules. The nation also should reassess, from time to time, to which coalition it should belong, basing its decision on the changing global scenario.

The international economic order now allows capital mobility between nations and it permits the exchange rates to be flexible. Capital mobility depends on the real interest rate differentials and the exchange rate depends on the domestic and world inflation rates. The fiscal and monetary policies of each country affect its own real interest rates and inflation rates. Hence, if all the nations wish to make the best use of this international economic order it is absolutely necessary to bring about a policy co-ordination. Such macro-economic policy co-ordination is already taking place in the European union and it is also needed at a much larger scale between all nations that are major participants in the world trade. The existing institutional set up does not permit a fruitful policy co-ordination. There is thus a need for creating a new international institutional mechanism for macro-economic policy co-ordination. This is particularly so if we wish to avoid exchange rate volatility and to avoid transmission of depression from one country to another, and to avoid what one might expect the current developments might lead us to another major world economic crisis.

The IMF, the World Bank, the United Nations and a group of dedicated international scholars must develop alternate global planning models, such as the ones Mahalanobis developed for a single country. I had made this suggestion earlier [Kumar 1993]. These global models must be dynamic and interactive general equilibrium models,

In such a model the economic growth of any country depends on factors, both domestic and external, some of which affecting growth positively, while others affecting it negatively. It should be the objective of global planning to increase the growth of all nations as much as possible. Nations compete with each other for resources and growth. The global growth equilibrium must be chosen, therefore, as a Nash equilibrium, a well known equilibrium concept in n-person non-co-operative game theory. In such an equilibrium each country's growth strategy is the best alternative to the best alternative chosen by all the other countries.

There is a 220-year old economic thought, due to Adam Smith, that the scope for specialisation, and for economies of scale and scope, are limited by the extent of the market demand. Extending this thought to the global planning model described above it becomes evident that world economic growth is constrained by the growth in world demand. The recent recessionary trends in the developed countries can be explained by this phenomenon of constraints imposed by the world demand. World demand consists of two parts, demand by the developed countries and the demand by the developing countries. Both are constrained, but by different factors. In the developed countries it is not the income that is constraining the demand. It is, instead, the low growth of population and the scarcity of time needed to consume goods and services which constrain the demand. In the developing countries, on the other hand, even though the population is growing quite rapidly the incomes are not growing adequately. The income distribution is also becoming worse, which has the tendency of increasing the savings and lowering the consumption. Thus it is the low income and poor income distribution that are constraining demand in the developing countries. World demand can therefore be increased only by increasing the levels of income in the developing countries. Thus, the development of developing areas is mutually beneficial to both the developed and developing countries.[6]

I propose that it is within this framework that India should develop its own development strategy under the newly emerging global economic and political environment. I also wish to reiterate [see my earlier paper Kumar 1994b] that this is essentially the same framework that Mahalanobis used for developing the perspective plans for India's economic development. This framework, when used in the conditions prevailing at the time of India's independence, gave rise to a set of development strategies that our country successfully followed in the 1950s and the 1960s. Now in a radically different economic and political environment, both at home and abroad, we need to apply this same framework for determining India's plan strategies.

There are quite a few of our countrymen who unconditionally, unthinkingly, and wholeheartedly support the Occidental reform package. These are the people who wish to submit themselves to the pressures and tactics of the other powerful players in this global economic game, and they thereby seem to close the options either for forming co-operative arrangements or for creating a new set of rules of the game that are more beneficial to us. There are also those who on the other hand, argue either for no reforms at all or for the old alternatives. These are the people who are turning a blind eye to the realities confronting the country. The policies they suggest are of very little practical relevance. They are not viable in a vibrant global economy that is unfolding itself.

The framework I suggested above, and the strategies I shall outline in the next section constitute what one may call a 'Middle Path', the only path that is best suited to us.

V
A Strategic Planning Approach to Designing Economic Reforms

Strategic planning , corporate planning, total quality management, etc, are the terms that are widely used by the management professionals. It is these terms that I wish to use in order to outline a design for a proper reform strategy.

At a time when management as a science was yet to develop Mahalanobis took the concepts and the tools of business management to the problem of managing the economic development of an entire country! Mahalanobis' concept of development planning is nothing but the management of economic development. Methods of formulating and solving the problems aimed at improving the system performance were developed and applied during the second world war, and soon after these methods were generalised and applied to improve the performance characteristics of business organisations. This was termed an operational research approach then, and general systems approach, later. The latest variants of this approach are incorporated in the concepts of strategic management, corporate planning, and total quality management. This approach consists of the following components:

(i) An enunciation of a management philosophy that guides us in setting up the major objectives and goals,
(ii) generation of widespread belief among the people in such a management philosophy,
(iii) formulating the objectives and setting the goals according to the management philosophy,
(iv) an understanding of how the system works by collecting the necessary information,
(v) identification and listing of the endogenous factors that serve as the system's internal strengths and weaknesses,
(vi) scanning of the external environment to generate long-term and short-term future scenarios of that external environment,
(vii) identification and listing of those factors, exogenous to the system, which should be regarded as threats, and those other exogenous factors which should be regarded as opportunities,
(viii) to examine if the existing institutional structures are adequate to cope with the changes or trends taking place both within the system and outside the system, and to design alternative institutional structures that are required, or to modify the existing institutional structures,
(ix) identification and listing of factors that are controllable, along with an assessment of the cost of exercising such controls,
(x) an assessment of the impact of alternate strategies on the system performance, ranking of alternate strategies, and choosing the best possible strategy,
(xi) to recognise the importance of people who play different roles in the system and to seek their co-operation through incentive compatible signals.

Nehru and Mahalanobis had enunciated a development philosophy of achieving a socialistic pattern of our society with rapid economic growth by not aligning with any superpower in the world. The management philosophy need not be petrified for all times. It needs modification once in a long while when the evolution of the system warrants such a modification. As some degree of socialistic pattern of society has already emerged and as there is no meaning to the concept of non-alignment now, with the disintegration of the Soviet Union, it is high time that our country revise its management philosophy. I wish to suggest that we now adopt as our development philosophy restrained or moderately controlled welfare capitalism. I must explain what I mean by some of these terms. The words restrained and welfare are related. It is the concern for the welfare of the vulnerable sections of the society that should be the guiding principle for moderately restraining the free market forces.

Since traditional methods of war are being replaced by guerrilla wars and international terrorism, there is no virtue any more to stick to the age-old rigid stand on signing the Nuclear (Non)Proliferation Treaty (NPT). Instead, by agreeing to sign the NPT our country should seek the support of the U S government in combating international

terrorism and drug trafficking. Our country should take advantage of the successful democratic capitalism that currently prevails in US Germany, Japan and India and seek the co-operation of the other three countries in our march towards economic reforms for accelerated growth and development in the newly emerging global environment.

What we have failed to do during the last five years, or even earlier during the stewardship of the late Rajiv Gandhi when we initiated economic reforms, is to clearly articulate the new philosophy for the management of development. If we want our reforms to succeed the next most important step we need to take is to articulate our new development philosophy and generate widespread belief in, and acceptance of, that philosophy. We cannot adhere to an old management philosophy and push new strategies suggested by others that are inconsistent with the old philosophy.

We achieved some degree of growth and equity during the last four-and-a-half decades. We now realise that a more equitable distribution of a small piece of cake is no longer as desirable as going for a much larger cake, by even sacrificing just a little if necessary on the equity objective, if it can give every one a larger piece of cake. We must now set our major objective as achieving accelerated growth taking full advantage that the newly emerging global environment offers us. In so doing we must also be aware of the threats the same competitive global environment poses. One major objective therefore should be to increase our exports to the hard currency areas in order to pay for our imports from those and other countries.

There are no two views on the relevance of economic reforms. They are relevant. There are, however, different views on what form the reforms should take. I argue that the choice of the short-term economic policies and the longer term economic reforms, including the restructuring the institutional arrangements, etc, should be based on the approach described above. The sequencing of economic reforms also should be based on the above framework. The debate on economic reforms will be more scientific, meaningful, and useful if the people engaged in the debate clearly identify the exact framework they have in mind along the lines indicated above.

For instance, if the reforms for India are designed by the IMF staff it can be concluded that those reforms are based on their perception of: (i) what our development philosophy ought to be, (ii) how our economy works, (iii) what we ought to believe as our opportunities, and what we ought to believe as our threats, and finally (iv) what institutional changes we ought to believe as necessary. If the reforms are developed by our own resident economists, who by residing in India bear both the pleasures and pains of living in India, then the strategies they design can be expected to differ significantly from those designed by the IMF staff. To argue that there are no differences in perceptions and objectives between these two groups is, to put it very mildly, being hypocritical. This close relation between the observer and the observed and between the designer and the designs is very important in this debate on economic reforms.

We cannot delink the circumstances under which our country had to go to IMF for a loan to cope with the serious balance of payments problem and the reform package that we subsequently adopted, mainly under the behest of the IMF. If at all there is even a slight doubt that we did compromise our country's interests under pressure from the IMF we should seriously consider the feasibility of our country repaying the IMF loan to give ourselves a greater freedom in designing a modified set of economic reforms. This option should not be easily ruled out. If the sovereignty of our country is at stake we should be able to arouse the patriotic feelings among our people, particularly the women, who hold in their personal possession gold jewellery worth billions of dollars, to come forward to make personal sacrifices, if necessary, to enable our country to take drastic steps in this direction. That such a thought is not to be brushed aside as impractical is supported by the fact that India's private gold holdings are valued at more than 80 billion US dollars [Venkitaramanan 1992]. A proposal to this effect was first made by my colleague Atul Sarma (see 'Why Not a Gold Bank as an Alternative to IMF Loan?' by Atul Sarma, *Hindustan Times*, New Delhi, August 7, 1991).

No country can, however, formulate its economic problems and design its strategies in isolation, ignoring the political and economic competition and threats posed by the other countries. This does not, however, mean that each country should take such competition and threats as unavoidable, unalterable, and given. Each country should try its best, through competition and co-operation, to alter those threats in order to minimise the losses such threats might inflict.

VI
What Is Wrong with Economic Reforms in India and How to Redesign Them

An appraisal of the performance of the Indian economy under reforms must be carried out using the framework given in the previous section. The economic reforms being adopted in India are not based on the specific strategies that would have emerged had the IMF developed a global planning model as described in Section IV. Neither are they based on development strategies that India would have arrived at if it had used the framework described in the previous section. This has resulted in a mismatch between the reforms actually designed and implemented and their sequencing, on the one hand, and the reforms and their sequencing that would have emerged if our country had designed the reforms independently using the approach cited above.

In order to assess the impact of the post-1991 stabilisation policies and economic reforms it is necessary to recall the circumstances that led us to major crisis in the spring of 1991. While this issue has been widely discussed in the literature Basu (1993), Bhagawati (1993), Bhagawati and Srinivasan (1993), Joshi and Little (1993), Kumar (1992), Kumar (1993), Mallick and Kumar (1995), Nayyar (1993), and Patnaik and Chandrasekhar (1995) it is useful to highlight the major antecedents to the crisis.

By the end of 1970s India's savings rate had reached as high a rate as 20 per cent. The savings investment gap being narrowed India seemed to face the second gap, the foreign exchange gap or the trade gap. Major components of India's imports then were: industrial intermediate goods (such as parts and equipment), fertilisers and chemicals, capital goods, crude oil and petroleum products, and precious stones and jewellery which were needed to process them for value added jewellery exports. Both India's production and its exports were constrained by these components of imports. India went to IMF for a loan in 1981 to slacken the trade gap. The foreign exchange reserves so received were not utilised properly. They were used partly to meet the deficit in government's revenue expenditures. The prospect of facing the general elections in 1984 with an IMF loan on its back was considered to be a serious political problem. The government decided to return the IMF loan. It was then forced to borrow commercially at non-concessional rates of interest. In the post-Bretton Woods environment of flexible exchange rates this meant external borrowing at very high risk.

The liberalised environment for capital goods imports prompted the public sector enterprises to import capital goods against commercial borrowing abroad. The commercial borrowing were in hard foreign exchange currencies such as US dollars, British pounds, Japanese Yen, and German marks. This must be examined against the background that 20 per cent of our country's exports then were to the Soviet Union and its east European allies, whose currency exchange rates registered a high degree of volatility in the late 1980s. At the same time India's exports to the western developed countries also declined due to widespread recession in those countries. As India

borrowed hard currencies at high commercial rates of interest, and did not change its pattern of trade away from the communist bloc of countries, India's creditworthiness had gone down. This low credit rating was also responsible for massive withdrawals of foreign exchange balances from the non-resident Indians. These NRI remittances at that time constituted a major source of interest payments on foreign loans. These developments led to a major crisis of confidence for Indian rupee in the foreign exchange market. This picture, which was already very gloomy, was further aggravated by the Gulf war and the decision of the Indian government to repatriate Indians based in Iraq and Kuwait at the government's expense.

From the above description of the events and circumstances it is very clear that the crisis India faced in the spring of 1991 is not due to any major domestic crises. It is mostly due to imprudent borrowing from abroad and mishandling and mismanagement of foreign reserves. If India used the IMF loan of 1981 wisely with transparency, and with the prime intention of closing the trade gap, and if it reoriented its export trade, the crisis would not have arisen. If India had gone for the economic reforms in 1981, boldly and with a determination, and if it did not return the IMF loan things would have been entirely different today. People all over the world would have been talking of India's roaring (Gir) Lion instead of talking about the Asian Tigers and Cubs. Let us remember the warning sounded by Santayana, "Those who do not remember the past will be condemned to repeat it".

The economic reforms package originated from the IMF. It is based on the neoclassical micro-economic theory and the classical or new classical macro-economic theory. The reforms are therefore based on the framework that is expected to apply equally well to all developing countries. While the structural differences between countries are often noted as important no serious effort is made to design economic reforms to suit the specific structural characteristics of the country in which the reforms are launched.

One of the fundamental reasons why the reforms have not yielded the desired results is that they were not specifically designed for our country, taking into account its strengths and its weaknesses, and taking into account the threats and opportunities it is exposed to. It is here that the framework outlined in the last two sections is quite relevant. If we wish to make good the opportunity before us we must accept the basic principles of reforms but adapt them or modify them to suit the structural features of our economy.

We have argued elsewhere [Kumar and Mittal 1995] that we must be quite cautious in thinking of exporting and or importing agricultural commodities. The trade reforms must be modified in such a way that we increase our foreign exchange earning position in terms of hard foreign currencies and minimise the use of such high value or high cost foreign currency to pay for our imports.

We responded to the IMF call to reduce our fiscal deficit. But this was done by cutting the crucial capital expenditures on essential public physical infrastructure such as power, transport, and communications. We have not bothered to do an ABC analysis of which of the government expenditure items we should cut if we were to reduce the fiscal deficit. Even today we do not have a system of examining the cost effectiveness of various government operations. Even among governments that offer the same set of services there are differences in cost effectiveness. Benchmarking and efficiency cost frontier are two concepts that management scientists are employing with good results. Our government can benefit from such steps.

Sequencing and phasing of economic reforms also do not seem to have been designed specifically to suit our country's structural characteristics. First we should have deregulated the industry and privatised a part of the public sector which should have been privatised long ago. This must have been followed by the banking sector reforms and fiscal reforms so as to reduce the crowding out of private investment by the government which was the major characteristic of our economy. During this initial phase of reforms we should have selectively permitted tariff reductions and removed import restrictions on certain capital goods and imports of material needed for export-based industries. Only after our industry is given a level-playing field should we have gone all the way for total trade liberalisation.

The strategic planning framework that is stressed in the paper when applied to the prevailing conditions in India will lead to the following type of analysis:

Given the major debt obligations facing the country in a highly competitive world economy and highly volatile foreign exchange markets our top priority should be to promote and reorient our exports. We need to increase the export earnings to repay our debts. Since the debt is in certain denominations we need to have our export earnings in those denominations. Further the exchange rates are quite volatile under the flexible exchange rate regime. These two aspects suggest that we need to reorient our exports to those countries in whose currencies we have our debt, and that we need to carefully monitor and manage our foreign exchange reserves with regard to its composition in terms of appreciating and depreciating foreign currencies.

The next step in our analysis of the problem is to examine the structure of our exports in terms of the sectors that do the major exports and the direction of those exports, viz, the countries to which we export. Having examined that then we need to look at all such industries which export to the hard currency countries. We need to see what factors constrain those exports. If the constraint is in terms of our market share, we need to explore the possibilities of increasing the market share by improving the quality of the product and by reducing the cost of production. The latter aspect, viz, reduction of cost of production, will guide us on some new policy directions. We can examine the various inputs for the production of important export goods and ask ourselves in what way the government can help reduce

NEW BOOK FROM MD PUBLISHERS OF THE HUMANITIES, NATURAL & SOCIAL SCIENCE

MYCOTOXIN INDUCED PHYSIOLOGICAL RESPONSES IN CROP PLANTS

By

K K Sinha

1996, 124p, bib, index, tables; 22x14 cm

ISBN 81-7533-016-3 Rs. 200.00

The analysis of various mycotoxins as natural contaminants and their impact on the normal physiology of these crop plants have been studied in this book.

Send your orders and write for complete catalogue to:

M D PUBLICATIONS PVT LTD

"M D HOUSE"

11, Darya Ganj, New Delhi-110 002

Tel: 3268645, 3273347, 3271378, 3285830

Fax: 011-3275542, 011-6475450, CABLE: INDOLOGY

★PUBLISHERS ★DISTRIBUTORS ★EXPORTERS

the cost of those inputs. Cost of infrastructure plays a key role in this type of reasoning.

If our country has to sustain a comfortable position in the world economy in the long run we need to generate reasonable future scenarios of the world economy and see how we can make a good niche for ourselves. Again this calls for a strategic approach outlined in the two previous sections.

I do not think we have done any serious analysis of this nature. On the other hand we seem to be having too much of unwarranted confidence in the working of the free market forces to help increase our exports. They might do so in the long run, but through planning and state intervention we might hasten the process. The slow pace of growth of exports we observe can be attributed to this neglect of strategic planning.

We have been chanting the privatisation mantra without creating the necessary institutional framework. Privatisation of power and transport sectors is a case in point. We need to create new incentive compatible institutional mechanisms, such as open competitive bidding that enable a smooth switch over from the public sector to the private sector. We must think not of reducing the role of the state but, think of giving the state a new role of enabling development and growth instead of regulating or strangulating growth and development. In fact there is only one next step, the only step, which will lead us to a promising path in the newly emerging global economic environment. This step is to prepare a strategic plan for management of economic development in the new environment along the lines indicated in the last section.

Another issue related to privatisation is the so-called exit policy and the associated safety-net. Both the concepts and the choice of names evoke high negative responses from people in a country such as India. Exit policy and safety-net do not work in a large democracy with a large public sector. The word exit means throwing an employed person out of employment. The safety-net means that we are showing pity on a person we are ourselves throwing out of employment. What is more practical and feasible is the gradual privatisation of selected public sector enterprises in the initial stages. When the reforms take root then there is no problem with this issue as people themselves would prefer to leave the public sector and go to the private sector. This process would be hastened if a suitable scheme of voluntary retirement is designed for the public sector enterprises. There has to be a definitive scheme, in the initial stages, for retraining and relocating the employees of the most loss-making public sector enterprises. Such an important aspect cannot be wished away to happen by itself through market forces or through government decisions. A feasible plan of action must be prepared, and the people who are affected must be consulted and assured that the plan would offer them better opportunities. Unless we do something seriously about it quickly no restructuring or reform becomes feasible in our country as the public sector already occupies the commanding heights in terms of employment and votes.

One major achievement we have made, however, is to prepare ourselves for economic reforms, and launching some of them in some form. The basic inertia against reforms is not there any more. It is left to us now to reformulate the reforms appropriately to suit our specific needs according to the strategic planning approach outlined above.

The conclusion that emerges is rather discomforting. The economic reforms did not deliver the goods even after five years. This is because they are not suitably designed to suit our country's specific needs and conditions. Unless we wake up and do some thing quite serious we may be the victims of Santayana's warning. What we need to do is to return to the drawing boards and get back to planning, the Mahalanobis way, as indicated above in the paper.

Notes

[Based on a paper, presented at an international seminar on 'Development Planning: Relevance and Approaches' organised by Erasmus University, Rotterdam, the Netherlands, Planning Commission, government of India, and the Institute of Economic Growth, Delhi, at the Institute of Economic Growth, March 19-21, 1996].

1 One might also sound a negative note and say that such trade generated unequal gains from trade between the trading nations, and that countries such as India, West Indies, and Brazil had adverse terms of trade. But the relevant question one must ask is: what would have been the economic conditions of these countries in the absence of such trade?

2 There is a lesson for us from this historical event which took place in Britain. One must not hastily conclude that a part of a policy which displaces the poor farmers from their lands is bad without looking at the other parts of a larger policy package which provide a rehabilitation for them. The safety net scheme of the present economic reforms is supposed to be one such policy that is supposed to rehabilitate the workers displaced by the exit policy. How well this scheme is thought out and implemented is a different matter to which we return later in section VI.

3 In the later part of the 19th century also there were those who, like the present day critics of economic reforms, predicted that the protected infant industries of France and Germany would be wiped out with the imports of the British manufactured goods. History gives us an assurance that there need not be such fears. The free trade helped the more efficient continental manufacturers to modernise their equipment and plants. While the small and inefficient firms were forced out in competition, there were other opportunities which opened up by the free trade for the entrepreneurs and workers of such bankrupt firms.

4 This kind of advantage of entering the field late and reaping the benefits of the latest technology is also revealed by the post-war economic growth of Japan and also by the recent records of the newly industrialising countries. Thus, countries like India and Brazil can hope to reap similar benefits if they utilise wisely the opportunities offered to them.

5 For a detailed discussion of factors that could have caused the great world depression of 1929, one may see Galbraith (1955).

6 Mahalanobis did emphasise the need to work towards the development of the underdeveloped regions of the world to bring about peace in the world [Mahalanobis 1958, 1959].

References

Basu, K (1993): 'Structural Reform in India 1991-93: Experience and Agenda', *Economic and Political Weekly*.

Bhagawati, J (1993): *India in Transition*, Radhakrishnan Lectures, Oxford University Press.

Bhagawati, J and T N Srinivasan (1993): 'India's Economic Reforms', report to the finance minister, June.

Galbraith, J (1955): *The Great Crash*, 1929.

Horsefield, J K (1969): *International Monetary Fund 1945-1969: Twenty Years of International Monetary Fund*, Vol I: *Chronicle*, International Monetary Fund.

Joshi, V and I M D Little (1993): 'Macro-Economic Stabilisation in India, 1991-1993 and Beyond', *Economic and Political Weekly*, Vol 28, No 49, December 4.

Kumar, T K (1992), 'Forgetting to Remember', *Economic and Political Weekly*, Vol 27, No 42, October 17.

– (1993): 'Fund Bank Policies of Stabilisation and Structural Adjustment: A Global and Historical Perspective', *Economic and Political Weekly*, Vol 28, No 17, April.

–(1994a): 'The Science and Art of Self-Fulfilling Prophecies', a background paper prepared for a panel discussion on Structural Reforms and the States, 30th Annual Conference of the Indian Econometrics Society, University of Mysore, May 1-3, 1994.

– (1994b): 'Mahalanobis' Contributions to Economic Planning', *Economie Appliquee*, No 2, pp 131-151.

Kumar, T K and Ashok Mittal (1995): 'On Liberalising Agricultural Trade: A Note of Caution from India's Experience with Tea Trade', *Economic and Political Weekly*, Vol 30, No 48, December 2.

Mahalanobis, P C (1958): 'Industrialisation of Underdeveloped Countries: A Means to Peace', *Bulletin of the Atomic Scientists*, Vol 15, pp 12-17, also in *Sankhya*, Vol 22, pp 173-82.

–(1959): 'Problems of Economic Development in India and Other Underdeveloped Countries in Relation to World Affairs', *Bulletin of the International House of Japan*, Vol 3, pp 10-15.

Mallick, S K and T K Kumar (1995): 'Macro-Economic Adjustment in India: Policy and Performance in the Recent Years', *Journal of Indian School of Political Economy*, Vol 7, No 1, January-March, pp 44-68.

Nayyar, Deepak (1993): 'Indian Economy at the Crossroads: Illusions and Realities', *Economic and Political Weekly*, Vol 28, No 15, April 10.

Patnaik, Prabhat, and C P Chandrasekhar (1995): 'Indian Economy under 'Structural Adjustment'', *Economic and Political Weekly*, Vol 30, No 47, November 25.

Toffler, Alvin (1986): *AdaptiveCorporation*.