

Chapter 32

DIRECTIONS FOR REFORM

The process of economic reforms has now been in progress for ten years. There have been substantial achievements in the period, with India moving into the list of the ten fastest growing countries in the world. The consensus on reforms has deepened as successive Governments belonging to different political parties have pushed forward the reform agenda. However, new challenges have also arisen. The pace of reduction of poverty is less than what was hoped. The acceleration of growth has not been uniform across States. The fiscal position of the Centre or the States remains precarious. The pay increases implemented on the basis of the recommendations of the Fifth Pay Commission, which in fact, went beyond the Commission's award has imposed a heavy burden on the governments particularly in the states. Steps to restore fiscal stability are urgently needed. The process of reform is also not complete. Continuing reforms are needed in various sectors of the economy and also in the administrative apparatus. The second generation of reforms should constitute a programme of action aimed at preventing another major economic crisis and should stimulate rapid economic growth in the country during the new century. In what follows an attempt is made to outline a programme of reforms for the country embracing the multitude of sectors encompassing it.

Fiscal Stability

2. The incurring of heavy fiscal deficits has led to a huge public borrowing programme by the government of India in recent years resulting in a heavy interest payment burden. The interest payment burden as a proportion of net tax revenue of the central government is expected to be 69.3 percent according to 2000-01 budget estimates. This is an indication that the public borrowing programme in India is becoming unsustainable.

3. The need to bring down the levels of deficit financing in the central budget is well recognised. The problem with a high level of fiscal deficit is that it ultimately results in a low levels of public as well as private investment in the economy. It leads to low levels of public investments since the increasing interest payment burden resulting from high fiscal deficits ultimately results in a low level of plan expenditure. At the same time, a high level of fiscal deficit can also result in crowding out of private investment in productive ventures. Some of the reforms that are required to tackle the problem of fiscal and revenue deficits include mobilising more resources through taxation, increase in user charges of services provided to the public, controlling the growth of non-plan expenditure and working out programmes for down-sizing of government.

4. In the field of taxation, there is a need to ensure better compliance and check tax evasion. The tax administration needs to be modernised both in its attitude as well as its physical facilities. There is need to introduce modern concepts of information technology, computerisation and cost effective

administration. Tax administration should be made accountable through the system of reward and punishment. There should be strict implementation of tax laws and all tax related disputes need to be decided in a definite time frame.

5. The tax laws in the country need to be simplified and made easily comprehensible to the public and simultaneously a great deal of the exemptions and deductions that are built into our tax structure should be done away with. What is required is a simplified tax structure covering a large base with few exemptions and deductions combined with tax rates that are low and reasonable and what the public considers as just. This is the best recipe for a buoyant, progressive and development oriented tax structure. Buoyancy in the tax system should be in-built and follow as a result of overall development in the economy rather than as a result of higher rates of taxation.

6. The present tax structure with multiple tax rates needs to be replaced by a more transparent structure such as a Value Added Tax (VAT) which does not have a cascading effect. In view of India's commitment to gradually reduce custom duty rates to international levels, it is imperative to introduce the VAT system in a time bound manner.

7. **Reforms in State Finances:** The financial crunch faced by the state governments is more acute than that faced by the central government. Failure to contain the rising wage bill, evasion of taxes, unsustainable interest liabilities and reluctance to raise additional resources are some of the main causes. The combined net losses of State Electricity Boards has crossed Rs.10,000 crore. The additional fiscal burden on account of pay revision is roughly estimated to be about Rs.20,000 crore per annum on the state governments.

8. With very little own funds and decelerating central assistance, states have been depending more and more on high cost borrowings for financing their plans. As a result, the interest burden has been mounting. One aspect of the economic reforms has been increased reliance on market forces and private investments. The available statistics on private investments since 1991 indicate that they have been flowing mainly into those states which are more developed with better infrastructure and relatively efficient administration. The official aid flows from bilateral and multi-lateral agencies also show a similar trend of favouring more developed states. These are clear signals of diverging growth prospects of developed and developing states which do not augur well for the Indian economy and polity.

9. Some of the measures that need to be implemented by the states in this connection are:

- States must augment their tax and non-tax revenues. The tax/SDP ratio must be raised through rationalisation of tax structure and improvement in tax administration.
- Non-tax revenues can be substantially increased by revision of user charges on public services.
- The growth of non-plan revenue expenditure needs to be arrested and the efficiency and accountability of public expenditure needs to be enhanced.

- In particular, there is an urgent need to control the fast-growing burden of subsidies by ensuring that these are transparent and closely targeted.
- State level public enterprises must also make their due contribution to the resource mobilisation efforts of the states. Restoration of the financial health of SEBs, and improvement in the functioning of SRTC are necessary.

Financial Reforms:

10. The next phase of reforms in the banking sector should lead to
- Strengthening the foundations of the banking system,
 - Streamlining procedures, upgrading technology and human resource development, and
 - Appropriate structural changes in banking.

The reduction of Non Performing Assets (NPAs) in the banking system has to be accorded top priority to restore the banking sector's health to prepare it for the emerging capital account convertibility scenario. It is necessary to reduce the NPAs by ensuring that fresh advances do not become non-performing assets. Reduction in NPAs could be facilitated through high quality credit approvals and also by strong programmes of asset recovery.

11. The following major recommendations of the Khan Committee and the Narasimham Committee needs to be considered for implementation:

- A progressive move towards universal banking and the development of an enabling regulatory framework for the purpose is needed.
- With convergence of activities between banks and DFIs the DFIs over a period of time should convert themselves into banks.
- A DFI which converts into a bank should be given some time to phase in reserve requirements in respect of its liabilities to bring it on par with the requirements relating to commercial banks.
- There is a need for speedy implementation of legal reforms in the debt recovery areas of banks and financial institutions which should be given priority.
- Existing laws may need to be updated to bring clarity in dealing with some of the issues that are likely to emerge following the introduction of computerisation and technologically advanced communications in banking.

12. There is a need for formal accession to core principles announced by the Basel Committee for effective supervision. The proposed framework as drawn up by the committee consists of three pillars, namely minimum capital requirements, supervisory review process and effective use of market discipline. For the minimum capital requirements, the committee has proposed a modified version of the existing Accord, whereby for some sophisticated banks use of internal credit ratings for a more accurate assessment of a bank's capital requirement in relation to a particular risk profile would be allowed. The proposed second pillar would seek to ensure that a bank's capital position is consistent with its overall risk profile and strategy and would encourage early supervisory intervention. The

proposed third pillar would encourage high disclosure standards and enhance the role of market participants in encouraging banks to hold adequate capital.

13. The insurance sector in the country is in the process of being opened up to private and foreign investment. This will result in more competition, more resource availability and availability of more consumer friendly products. However, it has to be ensured that opening up does not result in a situation of over investment in this sector resulting from exaggerated demand projections as occurred in the case of the telecom sector.

Box : 1

Fiscal Reforms in the States

Fiscal reforms in the states could consist of the following elements:

1. **Tax Reforms:** A tax reform programme which includes rationalisation of tax structure is an area of high priority. It is essential to restore the buoyancy of tax revenues and increase tax/SDP ratios.
2. **Expenditure Reform:** States must initiate comprehensive expenditure reform programmes to reduce unproductive and wasteful expenditure on the one hand and improve the quality of expenditure on the other. Unwarranted rapid increases in salaries and subsidies of recent years must be curbed. On the other hand, capital expenditure and maintenance, which have been experiencing shortfalls, must be protected. Wage bill of the states needs to be closely monitored.
3. **Improvement in Fiscal Administration and Management:** Strengthening, streamlining and simplification of the tax machinery is a must to check tax evasion and promote tax compliance. It will also help to improve business environment. Moreover improved management of expenditure will ensure more efficient use of scarce funds. This will entail reforms in budgeting, accounting, internal control and audit, cash and debt management and management information system.
4. **Public Sector Enterprises Reform Including Disinvestment:** Public sector enterprises, in particular the SEBs and the SRTCs have proved to be a big drain on states' resources. States must implement reforms to bring these enterprises under professional management and run them in a commercially viable manner.
5. **Power Sector Reforms:** Power sector reforms are essential if states are to get back on the path of fiscal sustainability. SEBs are the single most important drain on states' resources. Power tariffs must ensure cost-recovery and the culture of non-payment of dues by customers to public utilities must be curbed.
6. **Improved Infrastructure:** The state of infrastructure, both physical and social, is acting as a drag on growth in most states. Infrastructure sector calls for urgent intervention if the growth process is to be accelerated and states finances are to benefit. More efficient management, higher investment and greater cost-recovery would, in general, be required in these areas. User charges for water, transport and other services must be suitably enhanced.

Infrastructure

14. **The Transport Sector :** Broad estimates of investment requirements till 2010 in the transport sector indicate that it will be necessary to increase annual investment levels to three to four times the present level in real terms. The financing of investment on this scale is a massive task. It will require a substantial increase in budgetary support to the sector, but recognising the scarcity of budget resources the bulk of the effort to meet the additional investment requirement has to come through generation of resources within the sector itself. The pricing of transport and user charges will therefore have to play a much larger role than in the past.

15. Pricing in the transport sector should conform closely to the cost of services and actual resources used in its production, having regard to scarcity values of these inputs. Subsidies in transport will have to be limited to those areas where their retention on societal considerations is overwhelmingly justified. Wherever subsidies are retained, they must be made as explicit as possible so that they are clearly identifiable to ensure transparency. The instruments of pricing, taxation and subsidy should be used to achieve desirable socio-economic objectives like development of an economically rational inter-modal mix, promoting efficiency in operations and generation of adequate resources for sustaining growth.

16. It is necessary that all the social costs must be taken into account in pricing transport services preferably through fiscal measures. While pricing should be cost-based, the policy of improving productivity should be relentlessly pursued.

17. It will be necessary to bring about major changes in our rail tariff policy in the light of the above objectives. Some subsidisation of rail tariff is unavoidable in our situation. However, the extent of subsidisation must be limited to where it is absolutely unavoidable. Large scale cross subsidisation of passenger services by overcharging certain categories of freight is not justifiable as it deflects freight traffic which should be carried by the railways to road thus preventing the railways from performing according to their comparative advantage. The railways should be corporatised and its finances should be delinked from that of the consolidated fund of India.

18. The road transport services in most cases do not cover all the costs particularly the infrastructure and external costs. In order to have optimal inter-modal mix it is necessary to incorporate these costs into transport pricing. In civil aviation, the cost of infrastructure should also be taken into account while pricing transport services.

19. The bulk of resources for financing the development of the transport sector should come from generation of internal resources and borrowings or through private sector participation. In sectors traditionally funded by the states such as roads, it is essential to explore innovative avenues for mobilisation of resources. The levy of tolls on roads where tolling is possible would provide an additional, albeit, limited source of funding. It is, therefore, necessary to

implement indirect user charges in the form of a cess on petrol and diesel which are the principal funds used in the transport sector - the proceeds to be earmarked for the development of roads. A step in this direction has already been taken.

20. The basic infrastructure with a few exceptions is in the public sector. Efforts should be made to involve the private sector in provision of these basic infrastructure facilities as well. In fact, in the port sector, initiative has already been taken to involve the private sector. In case of airports, it is proposed to involve the private sector through long term lease route.

21. Road construction will remain in public domain to a large extent. There is a niche for private sector participation in development of roads where the traffic densities are extremely high but the total scope for private sector investment in roads is likely to be limited. There is much greater scope for private investment in bridges and bypasses. In order to involve private sector in development of highways, the public sector funds should be used in the form of equity and/or grant so that the project may become more attractive for the private sector.

22. **Power Sector:** Reforms in the energy sector should start with the restructuring of State Electricity Boards. Unbundling the SEBs and separating generation, transmission and distribution into separate corporations will make it possible to monitor efficiency levels in each activity and also to create appropriate incentives for efficiency in each area. Unbundling will also make it easier to allow entry of private sector operators in each area in a suitable manner which ensures competitive efficiency. Accordingly several states have already initiated power sector reforms along these lines.

23. Reform of the power sector would be greatly aided by the establishment of independent regulatory agencies responsible for setting tariffs and regulating power purchase agreements. The Electricity Regulatory Commission Act, 1998 provided the legal basis for setting up of a commission at the central level with separate commissions at the state level.

24. The state governments may embark on a gradual programme of private sector participation in distribution of electricity. The process of private participation should be initially in one or two viable geographical areas covering both urban and rural areas in a state and the state may extend them to other parts gradually. The situation regarding induction of the private sector in distribution will vary from state to state. The nature of generation plants and the pattern of loads will have a bearing on the timing and scope of this policy reform. There is a strong case for privatising distribution in order to reduce high level of theft and pilferages. A beginning can be made by mandatory privatisation of distribution in urban areas with population of one million and above.

Box-2
Power Sector Reforms in Madhya Pradesh

Total installed capacity of thermal and hydroelectric power in Madhya Pradesh as on March, 1998 was 3,814 MW with additional allocation of 1,773 MW from central sector power stations. The gap between electricity demand and available generation capacity is widening, and the present peak demand-supply gap is estimated to be about 1,300 MW. Madhya Pradesh has an extensive transmission and distribution network; however, the state's large size and its low population density make the cost per consumer of expanding the network among the highest in India.

The financial performance of the Madhya Pradesh State Electricity Board (MPEB) has rapidly deteriorated, and the entity is increasingly relying on budgetary subsidies to achieve the 3% minimum rate of return on net fixed assets stipulated in the Indian Electricity Supply Act. The financial problems are mainly due to low tariffs for agriculture and domestic sectors, which together raise 11% of revenue while consuming almost 50% of the energy. MPEB incurs annual losses of more than Rs.1500 crore on account of sale of subsidized electricity to agricultural consumers alone, of which it receives a subsidy of about Rs.400 crore from Government of Madhya Pradesh and the rest through cross-subsidization, particularly high tariffs on industrial customers.

Government of Madhya Pradesh envisages fundamental reform of the power sector. Overall objectives of the reform include (i) achieving commercial efficiency; and improving viability of the sector; (ii) increasing operational efficiency through enhanced competition, managerial autonomy, and higher accountability; and (iii) creating an enabling environment for private sector participation. Government of Madhya Pradesh plans to open up power generation to the private sector, including for co-generation plants and captive generating units, and envisages new public generating stations in competition with private sector generators. Power distribution may be decentralised into manageable zones that operate as independent profit centers, and would be open for private sector interest through a transparent, competitive bidding process. Although private sector involvement is envisaged, reform of transmission will focus on commercialisation of operations in addition to upgrading and strengthening the existing substation structure.

25. **Telecommunications:** The telecom sector witnessed some fundamental structural and institutional reforms during the first phase of economic liberalisation and deregulation. The reforms pending in the sector are:

- Tariff re-balancing with the objectives of cost based prices, transparency of subsidies and better targeting and help operational efficiency of the operator.
- Opening of Internal telephony
- Convergence of services and single license regime.
- Ensuring full functional freedom to corporatised DOT.

26. **Postal Services:** Postal service continues to be a government monopoly. This is one of the areas which have been left untouched by the wave of liberalisation initiated in the early 1990s. However, there exists ample scope for liberalisation of postal services without affecting the role of the government sector. The important areas requiring attention in the near future are:

- Postal services have to be made self-financing in the long run as subsidisation cannot continue indefinitely. To achieve this, major policy initiatives regarding pricing of postal services including postal stationery and minimizing costs have to be initiated. Eliminating subsidy provided on various services in a time bound manner will have to be an important element of the strategy. This may require more frequent revisions of the postal tariffs. To effect this, the Postal Board needs to be given due autonomy.
- The century old Indian Postal Act, 1898 still regulates the provision of postal services in the country. The Act provides the Department of Posts the monopoly over certain services. No private sector operator is allowed to carry out this work. The Act is ill-suited to meet the requirements of modernisation and liberalisation of the sector and needs to be replaced by a more forward looking Act.
- Except for the courier services, private sector participation is virtually non-existent in the sector. It has adversely affected the pace of expansion and quality of services. The private sector participation will not only provide the financial resources required for rapid expansion of the services but also lead to vast improvements in the efficiency and quality of services due to competition. Some of the areas that could be opened to private sector participation without affecting dominant role of the government are:
 - a) Opening of new post offices in urban areas through licensed postal agents.
 - b) Printing of postal stationery.
 - c) Sale of stationery through licensed agents on franchise or commission basis.
 - d) Processing of bulk mail.

Social Sectors

27. **Education:** Towards the end of the 20th century, the country made some progress in improving literacy rates. But a great deal still needs to be achieved on this front. Where the target of total literacy has already been achieved, there is a need to improve the quality of school education. Where full literacy is still an elusive goal, efforts need to be redoubled to achieve results. The infrastructure for both primary education and adult literacy programmes need to be strengthened in these regions.

28. In the field of higher education, efforts should be made to recover the full costs of education from the students who can afford to pay. The fees charged in

our higher educational institutions need to be increased and the students from the poorer families should be supported by a scheme of scholarships.

29. An innovative scheme that is being implemented in the country is the scheme for providing autonomy to colleges. The kind of large scale reorganisation of the system of under-graduate education is not likely to succeed without providing autonomy to colleges. The programme of restructuring courses, introduction of vocational programmes and examination reforms cannot succeed unless there is provision for teachers to participate effectively in these areas, and the unit of operations is brought to a manageable size. For this purpose, the programme of autonomous colleges will have to be pursued vigorously.

30. The field of technical education and research in the country should in its human resource development programme provide greater incentive to merit by recognising and rewarding young talent and original initiative. The educational system should be broad based and flexible and include provision for multi-point entry. It should encourage creativity and innovation in experimental work by introducing problem/process-oriented laboratory exercises.

31. A concerted effort should be made to raise resources from non-traditional sources such as industries and other commercial concerns, which are making use of highly qualified and trained manpower produced by the institutions of higher education. Such an effort would greatly reduce the present financial burden on the central and state governments. The funds from industries and other business houses could be tapped by (a) introducing such courses of studies and training programmes that are relevant to the needs of industries for increasing productivity, (b) undertaking consultancy research projects, the findings of which would be conducive to reorienting the industrial sector for increasing its profitability, (c) providing appropriate tax incentives to commercial undertakings for making contributions to recognised institutions of higher and technical education.

32. With the advances in information technology, the emphasis is bound to gradually shift towards continuing, life-long education in a learning society. The educational system would also have to be learner-oriented rather than teacher-centered. Some learning could take place in virtual schools. There would have to be greater emphasis on open learning through the IGNOU and similar other institutions.

33. The costs of books and journals have been rising for various reasons while the proportion of expenditure on maintenance of libraries has been declining. It is being increasingly argued that by networking, particularly in the context of development of library resources, between several libraries, savings can be effected in relation to scarce financial resources, including scarce foreign exchange. The idea of networking of libraries providing shared access to journals and books available in libraries located in the same region needs to be encouraged by providing necessary infrastructure support.

34. **Health:** In the health sector, there needs to be a total commitment to:

- improve access to and enhance quality of primary health care in urban and rural areas through an optimally functioning primary health care system.
- appropriate strengthening of the secondary and tertiary care institutions.
- improve efficiency and build up effective referral linkages between existing primary, secondary and tertiary care institutions.
- development of human resources for health, adequate in quantity, appropriate in quality, with proper programme and people orientation.
- effective implementation of provision of food and drug safety.
- enhance research capabilities and strengthen basic, clinical and health systems research.

35. In the health and family welfare sector policy initiatives are also required in the following areas:

- a. Primary health care is an essential basic service and there needs to be a total commitment to make it available free of cost to all based on their needs.
- b. Several states are trying to evolve appropriate mechanisms for cost recovery from people above poverty line for diagnostic and therapeutic services in secondary and tertiary care settings. These measures need to be strengthened.
- c. In family welfare programmes centrally defined methods and specific targets for contraceptives are to be abolished. Need assessment and fulfillment should become the key element of the revised strategy.

36. **Environment:** The following policy initiatives are desirable in regard to the environment sector:

- Information, dissemination and public awareness on environmental issues is essential for dealing with the mounting environmental problems. Informed citizens can contribute immensely in abatement of pollution.
- The present system of subsidies in electricity, fertilizer and water sectors encourages overuse of scarce natural resources and leads to inefficient resource allocation. The problem of nitrification, salinity and water-logging is essentially on account of under-pricing of these scarce resources. Therefore, subsidy on fertilizer, electricity and water should be phased out. These savings should be channelised for the development of the environment and forest sectors.
- A comprehensive reform of existing laws and regulations which discourages private initiative on private land in areas such as farm forestry, wasteland development could be taken up.
- A comprehensive policy reform is required to encourage private initiative in solid waste disposal, farm forestry, afforestation and wasteland development. Leasing out of wastelands to the private sector at least on an experimental basis could be a good beginning in view of the severe resource constraint that has considerably weakened our efforts in realising the national target of 33% forest cover.
- Policy reforms are also called for in evolving well-defined, exclusive, secure, transferable and enforceable property rights on common property resources.

- International issues have been cropping up in the field of environment at an unprecedented rate. This phenomenon is likely to continue in the future. If the national interest is to be reasonably safeguarded, the process of making preparation for international negotiations should be made more prognostic in nature with a pro-active role being played by India. Many developing countries look forward to stewardship by India. A wider consultation with experts and the stake-holders including the representatives of industry and public should mark the very initial phase of this activity rather than when the issues have become fait accompli.
- National Accounts Statistics must include environment accounting in order that environmental concerns get integrated in our development plans. Effects of economic activities on the wealth of our natural resources must be truly reflected in our national income.

Administration

37. **Legal Reforms:** The reform programme in India will not be complete without a reform of our legal system. Basic reforms required in our legal set up fall under the following categories:

- Despite the existence of thousands of statutes on the statute books, there are areas where legislation does not exist. Examples are credit cards, automatic teller machines, hire purchase and leasing, electronic data interchanges, bio-diversity, plant and seed varieties and other areas of intellectual property.
- There is a need for a law on competition policy. Core elements of a competition policy can be found in the MRTP and Consumer Protection Acts. But these still fall short of a competition policy.
- Old and dysfunctional laws should be done away with or rewritten.
- Multiplicity of laws on the same subject needs to be avoided and the situation in this respect needs to be rationalised.
- Conflicting definitions of the same item under various laws need to be avoided.
- There is a need for simplification of the language and contents of law.
- There is a need for new legislation to carry forward the process of economic reforms.
- All pending economic legislation in Parliament should be expeditiously carried through.
- Too much of unwanted legislation may result in harassment of the public and the business community and ultimately result in more corruption.

38. **Decentralisation:** The main features of the 73rd Constitutional Amendment Act, 1992 include provisions for establishment of mandatory three/two tiers of Panchayati Raj Institutions (PRIs), regular elections to panchayats, a legal status to gram sabhas, reservation of seats for scheduled castes/scheduled tribes and women, setting up of independent state finance commissions for strengthening of finances of local bodies at all levels and constituting of independent state election commissions.

39. Article 243 I of the Constitution provides for the constitution of a State Finance Commission (SFC) to review the financial position of panchayats and to make recommendations regarding principles governing devolution of financial powers to PRIs. These provisions need to be judiciously implemented.

40. The functional autonomy of PRIs along with their financial autonomy must be clearly delineated. Even in respect of the 29 subjects identified in the Eleventh Schedule, it is necessary for the state governments to clearly identify what would be done by the three tiers of panchayats at their levels. This should be based on the rule that what can be done at the lower level should be done at that level only and not at a higher level. Detailed instructions and guidelines would have to be issued by the concerned departments to their field officers in this regard.

41. The state governments are required to constitute District Planning Committees (DPCs) as envisaged under Article 243 (Z) and (D) of 74th Amendment Act to facilitate the process of decentralised planning. DPCs. are to be set up in each district to prepare composite plans covering both urban and rural areas.

42. Principally, the 73rd Amendment has not set down in black and white an imperative for the empowerment of gram sabhas. In order to accelerate the emergence of gram sabhas as bodies to whom the PRIs are accountable, it might be essential to spell out the powers and functions of the gram sabha in great detail-articulating their role as planners, decision makers and auditors.

43. In view of the fact that panchayats will be required to play a much more important role both in terms of planning as well as implementation of development programmes and to avoid the mal-practices and misuse of powers by panchayats, a system of adequate checks and balances will have to be evolved.

44. One of the major strengths of the new dispensation is the greater participation of women and scheduled castes and scheduled tribes in the process of development through reservations in the panchayats. Once again, it may take time for these disenfranchised groups to wrest power from the existing elites. But evidence suggests that overtime these groups would have a greater role in the decision making process. Clearly there is need to build up the capacity and organisational ability of the panchayat members to enable them to perform their tasks efficiently and in a cost effective manner.

45. NGOs have been involved in the process of development for a long time. Initially, they were largely in the area of welfare but in the last decade they have been playing an active role in building up peoples' awareness and in providing support for development works and programmes. With the emergence of PRIs as institutions of local self-government, problems have arisen between these two institutions at the field level. The NGOs find it difficult to relate to the panchayats, which have a political orientation and are gaining strength in terms of overall supervision of development activities at the district and sub-district level. Yet, it is important that the NGOs and PRIs work in tandem complementing each others efforts.

Administrative Reforms

46. Many problems of government are quite old and well known. Obsession with rules rather than concern for output, promotions based on seniority rather than merit, delays and mediocrity at all levels are some of the factors inhibiting output in government.

47. A high degree of professionalism ought to be the dominant characteristic of a modern bureaucracy. The fatal failing of the Indian bureaucracy has always been its low level of professional competence. The lack of professionalism is reflected in the growing reluctance of senior civil servants to give frank and fearless advice, the inept handling of the major problems that bedevil the nation, inability to innovate and come up with imaginative solutions to the difficult questions that confront us, failure to keep abreast of modern developments and acquire new skills, slipshod approach to the preparation and implementation of projects, lack of cost-consciousness, extreme reluctance to take decisions, and above all the unpardonable neglect of routine administration.

48. Lack of concern for the poor is reflected in the way officers grade their jobs. Although the unofficial gradation of jobs varies from state to state, certain common points can be noted. Posts in the industrial and commercial departments and the corporations occupy a very high rank. These enable the officers to hobnob with industrialists and businessmen with whom he has class affinity. Next in the list would be posts which carry a lot of patronage and influence like a district charge, the departments of home, establishment, finance, etc. The lowest rank goes to jobs where excellent performance would directly benefit the poorest, such as tribal and social welfare, revenue administration, land reforms, urban slums, rural development, etc.

49. Another very important element which is emerging in the country is NGOs. There may be NGOs just making money and doing nothing wonderful, but there are also a large number of good NGOs who are working independent of government and they would after some time be very powerful and the civil services would have to compete with them. In Bangladesh, 80 to 90 percent of all development funds are spent through the NGOs. The coming years will see increasing importance of NGOs in policy making and implementation in India too.

50. A malaise afflicting the civil service generally is the instability of tenures, leading not only to a lack of sense of involvement but also to the inability to contribute effectively to amelioration of the system. In Uttar Pradesh, the average tenure of an IAS officer in the last three years is said to be as low as six months. Frequent transfers and limited tenures are playing havoc with public organisations. With very quick change in the head of the office, down the line the respect for authority gets diluted.

51. Most political manipulations succeed because of the environment of secrecy which pervades government functioning. There is no early check because decisions are taken behind closed doors. The sharing of information and making the entire system more transparent would certainly reduce the danger of the system being hijacked. There is a need to review the Official Secrets Act, and

replace it by a Right to Information Act. Rule 9 of the All India Services Conduct Rules which prevents information from being provided to an ordinary citizen should be deleted, and another rule should be added highlighting the intentions of the government in favour of transparency and stating that all such information which is generally provided by the Assembly/Parliament to a Member of Legislature, should also be provided to any member of the public including NGOs.

52. All files except those marked confidential for reasons of the security of state, should be accessible to everyone, especially those who are affected by that decision. At least in some offices, all information (say, relating to house allotment, or getting a new telephone) should be computerised, so that an applicant knows where exactly his paper is pending.

53. Conduct Rules should be amended to allow officers to write articles on current national problems, even if it means criticism of the system, without having to obtain permission from government. To begin with, Associations can be permitted to write freely on public matters, especially if it leads to minimising corruption, both political and administrative and improving the delivery system.

54. With the changing role of government the size and scale of the civil services no longer relate to the nature of functions that government can or should undertake. One should identify surplus staff, set up an effective redeployment plan, and a liberal system for exit. For the time being recruitment should only take place for functional posts, and vacant posts of secretarial and clerical staff should not be allowed to be filled. Generous golden hand-shakes have to be introduced. It is clear that reducing the size of government, ensuring more goal orientation, and stability of tenure, leading to specialisation is likely to be a time consuming process. But if the process is initiated immediately and in right earnest, the country should be able to progress in the 21st century with a vision of the future.

Some Policy Issues

55. **Expenditure Control:** The Fifth Pay Commission while making recommendation for increase in salaries of government employees had also recommended a reduction in staff strength. The second part of these recommendations still needs to be implemented. To reduce employment in government, it is necessary that posts that become vacant need to be abolished and there should be a freeze on new recruitment. Staff employed in divisions of government having surplus staff should be re-deployed to divisions where there is shortage of staff. Certain divisions in government that have become redundant need to be abolished. For instance it needs to be examined whether there needs to be dilution of government controls in the steel and cement sectors and in the pricing of drugs. It could also be considered whether organizations such as DGSD need to exist or the role of government in agricultural marketing needs to be diluted.

56. There is a need to re-prioritize plan expenditure to eliminate schemes which are of doubtful value. Detailed post-evaluation studies show that many of our plan schemes, though well intentioned, do not achieve their stated objectives,

or do so only to a limited degree making the schemes cost-ineffective. This is due to a combination of poor design of schemes and inadequate administrative capability. Unfortunately, such schemes continue to remain in operation, absorbing resources which could be deployed in other areas. A thorough re-examination of all plan schemes, with a drastic elimination of schemes which are demonstrated to be ineffective would release resources which would enable the more important and more cost-effective schemes to be more fully funded.

57. There should be control over wasteful expenditure in all government departments, PSEs, as well as autonomous bodies in terms of travel, entertainment, stationary, machinery and equipment, staff cars, telephone expenses etc. for expenditure control.

58. **Administered Pricing:** The country should try to move out of a regime of administered pricing. Public services should, wherever possible, be priced so as to cover the full costs of providing these services. Cross-subsidisation in the pricing of public services needs to be avoided to the extent possible as this is, today, a major factor contributing to the growth in government subsidies. It has to be remembered that proper pricing of services will, by generating more resources for investment, lead to better availability of these services and also lead to improvements in quality. Policy initiatives taken in this regard in the telecom and petroleum sectors needs to be further strengthened and extended to other sectors as well.

59. **Control over Inflation:** Inflation is a phenomenon which hurts the poor more than the rich. If we are able to contain annual rate of inflation within about 3 per cent, a number of economic problems which we are accustomed to routinely encounter will become less severe. For example, under conditions of comparative price stability, the need for revision of administered prices, increase in procurement price and issue price of food grains, increase in DA for government employees and so on will be felt less frequently.

60. Lower rates of inflation will be conducive to maintaining exchange rate stability and also bring down nominal rates of interest in the economy. Ultimately the most important beneficiaries will be the poor who are the most vulnerable to price rise and also the ones least protected from it. The essential pre-requisite for low rates of inflation in the country is a low level of fiscal deficit which results in a controlled growth rate in money supply.

61. **Interest Rates:** The fiscal correction underway in the country should result in a reduction in both the short-term and long-term interest rates in the economy. If the Indian industry is to become competitive, it is necessary that their costs of borrowing are brought down to internationally competitive levels. As regards credit needs of the small scale and priority sector is concerned, it has to be recognised that the primary requirement of these sectors is to ensure availability of credit - subsidised rate of interest is only a matter of secondary importance. Today while most interest rates have been aligned in their movement with the bank rate, interest rates relating to small savings and provident funds remains outside this bench mark. There is a need to correct this anomaly as well.

62. **Privatisation:** One of the measures adopted to garner resources to reduce the fiscal deficit, in recent years is the disinvestment programme. The disinvestment programme in the case of public sector enterprises should not be seen as a measure of merely augmenting the resources of the central government. Attempts should be made to provide genuine autonomy to the public sector undertakings and to reduce the influence of the administrative ministries in their day-to-day functioning. There is a need for creating a disinvestment fund from out of the proceeds of disinvestment of PSEs for technological upgradation of PSEs in order to make them competitive. In addition attention has to be paid on the training/retraining and redeployment of the employees affected by the privatization of PSEs. There is also a need to create a social security fund for the protection of retrenched employees.

63. The process of disinvestment in the public sector should continue and attempts should be made for genuine privatisation of public sector undertakings. The government should withdraw from sectors where private investment is forthcoming and is likely to be more efficient. The scarce revenue of the government should be utilised to create the right atmosphere for growth and development by investing in the infrastructure and social sectors and in rural development.

64. **Exit Policy:** One aspect of the present trends in industrial development is the possibility of jobless growth. Even though labour is cheap in India, stringent labour laws persuade the Indian industry to economise on employment of labour. Labour laws in India are such that even industrial undertakings which have surplus labour find it difficult to restructure their undertakings by shedding excess fat. Conditions such as these can lead to a situation in Indian industry where production growth is taking place but this does not result in significant employment generation. Thus arises the need to reform labour laws and also introduce an exit policy for labour.

65. It has to be kept in mind that introduction of an exit policy should go side by side with introduction of some kind of unemployment insurance scheme. Appropriate safety nets have to be introduced to ensure that restructuring in Indian industry is least painful to the persons adversely affected and social costs are kept to a minimum. Unit level employers and employees can be asked to contribute an agreed percentage of the wage bill/wages to create a corpus fund for providing unemployment insurance.

66. **Competition Policy:** There is an urgent need for articulating a National Competition Policy (NCP) in India. The NCP should fully reflect the national resolve to accelerate economic growth, improve both the quality of life of the people of the country and the national image and self respect. The NCP should integrate into the economy, those vast multitudes who at present exist at the periphery. The competition policy should aim to bring about a spirit and culture of competition among enterprises and economic entities to maximise economic efficiency and to protect and promote consumers' interest and society's welfare and improve our international competitiveness.

67. **Research and Development:** Another aspect of industrialisation in India that needs to be commented upon is the role of science and technology and research and development. In order that Indian industry remains competitive in world markets, there is a need for greater investment in R and D in the domestic industry. There is no dearth of scientific talent in India. The need is to provide appropriate motivation and incentives to our scientists and technologists to innovate and develop new products which cater to the consumer needs. The scientific laboratories in India should become centers which reward innovation and creativity as against experience and seniority. The scientists and technologists in the country will have to play an important role in making India an industrial super power in the new century.

68. **Globalisation:** Indian industry is today facing the challenge of globalisation. Within the domestic economy native businessmen have to face the competition from the multi-nationals. In addition they also face competition from imported goods. Under the WTO regime this type of competition cannot be avoided. The domestic industry has to improve its competitiveness and efficiency and face up to the challenge of globalisation. We should use the WTO regime to our advantage by tapping overseas markets, technology and raw materials. Indian industry certainly has the wherewithal to face up to the challenge of globalisation. Adopting of the country's agricultural policies to the requirements of the WTO regime will pose a major challenge. Restrictions on imports of various agricultural commodities will have to be removed and these need to be replaced by appropriate tariff barriers within prescribed limits.

69. **Taxing Agriculture:** Powerful arguments have been raised for and against introducing agricultural income tax in India. The absence of this tax results in inequity in the income tax scheme as a whole. Within the rural sector, the non-introduction of this tax favours the rich agriculturists against the poor. But revenue realisation from an agricultural income tax may be inelastic considering the lower rate of growth of the sector as compared to other sectors of the economy. Further with the rapid rate of growth of population and the consequent fragmentation of land holdings, the economic surplus originating in this sector is not likely to expand fast resulting in low buoyancy of the agricultural income tax. Today, several inputs such as water, electricity and fertilizers are being provided to the farmers at highly subsidised rates. The subsidy on these accounts largely accrue to the rich farmers as compared to the low and marginal ones. Given this, it may be more feasible, in the beginning, to mobilise more resources from the farm sector through gradual reduction in subsidies, and proceed to introduce a full fledged agricultural income tax at an appropriate time in the future.

70. **Public Distribution System:** As regards the public distribution system, the objective of targeting the system towards the genuine poor should be more vigorously pursued. Ultimately food subsidy should be restricted to cover only the population below the poverty line. For the people above the poverty line who have the purchasing power to buy food, the requirement is only to ensure

availability of food grains at a stable price in the market. There is no need to extend food subsidy to this population. To make the programme of targeting the PDS more effective, the practice of using the ration card as an identification card by the administration for various purposes needs to be given up. The role should be assigned to voter identity cards in the future. Many people get ration cards issued only to establish their identity before the administration. There are also several plan schemes in operation which are in the nature of welfare or income transfer schemes where distribution of foodgrains is involved. Such schemes could be merged and some sort of convergence among these schemes all serving the same purpose could be evolved.

71. Items other than rice and wheat need to be excluded from the purview of the PDS. Sugar supplied through PDS is a factor which draws many well to do families to fair price shops. Thus excluding sugar from the PDS will be a self-targeting proposition. Kerosene oil is also a commodity supplied through PDS and intended for the poor. But this is an item where there occurs large scale illicit diversion where the benefits meant for the poor are cornered by miscreants. Subsidy on kerosene should be gradually phased out and alternate avenues for marketing need to be explored for this commodity. While subsidy is restricted only to rice and wheat under PDS there is a need to retain the viability of fair price shops. To ensure viability of fair price shops, it may be desirable that the fair price shops be permitted to sell commodities other than rice and wheat within their premises at full market prices.

Box-3

Food Subsidy in Tamil Nadu

The Tamil Nadu Civil Supplies Corporation (founded in 1972 and converted into a public limited company three years later) is vested with the following functions: (1) acting as a wholesale agent of the government to procure and distribute all commodities – rice, wheat, sugar and edible oil – with the exception of kerosene; (2) running retail outlets; (3) taking delivery of central pool allocation of rationed items from time to time; (4) supplying commodities to the various welfare schemes such as nutritious noon meal scheme in schools, Sri Lankan refugees, foodgrains for SC, ST, BC, MBC hostels; and (5) making open market purchases. The public distribution system (PDS) is a mammoth operation because it has under its control 24,905 fair price shops.

The subsidy provided to the Tamil Nadu Civil Supplies Corporation has increased from Rs 181 crore in 1980-81 to Rs 1000 crore in 1997-98. The reason for this phenomenal rise is the increase in the difference between the cost of procuring rice and the price at which it is sold. From hardly Rs 0.40 per kilo in 1979-80, this difference has reached Rs 6.35 in 1996-97.

Box-4

World Bank on Poverty Reduction in India

A World Bank Report on reducing poverty in India notes that India has reduced the percentage of population living in poverty since 1970s, but progress has been uneven overtime and across states. There is some stagnation in this regard at present. The report says that accelerated, labour intensive development in the states is needed to reduce poverty, particularly in the poorest four states (Bihar, Uttar Pradesh, Orissa and Madhya Pradesh). These states constitute almost 40% of the population and have been a heavy drag on the efforts to reduce poverty and on national economic and social development. Speeding up India's development will depend heavily on better performance in these states.

Accelerated development in the states will depend on more public and private investment to speed growth, improve efficiency in the use of investment, and improve human development. In general terms, efforts will be needed to improve governance and institutions, for example, strengthening transparency, increasing accountability in service delivery, reducing opportunities for discretion, and improving expenditure management and tax administration. Physical and social infrastructure need improvements, which will entail supporting reforms in state finances, power and irrigation, and the regulatory framework in general. Such reforms and development spending will create an investment friendly environment to attract private capital that is needed for growth according to the World Bank.

Summary

72. While in 1991 a severe balance of payments crisis had led to a series of economic reform initiatives, today, almost a decade later, a domestic financial crisis affecting the central and state governments is again leading the way towards a programme of second generation reforms. This time the reforms have to embrace all sectors of the economy and cover the central and state governments.

73. In the financial sector, there is a need to bring down the fiscal deficit and also the rate of inflation and interest rates. The fiscal deficit has to be brought down both by augmenting revenues and also by curtailing government expenditure through measures like reducing subsidies and downsizing of bureaucracy. The financial crisis affecting the state governments is more severe than that affecting the center. But the basic reforms that are required are similar in both cases - resource mobilization efforts and austerity.

74. In the infrastructure sector, there is a need to attract more private capital while maintaining the momentum of public expenditure. Private initiative will not be forthcoming until the services are appropriately priced to cover the full cost of operations. In the meantime, there is a need to set up regulatory mechanisms which will oversee measures such as pricing of services and other issues. Reform measures in the infrastructure sector would include dismantling of administered

pricing mechanisms and avoiding the practices of cross-subsidisation wherever possible

75. The industrial sector in India will have to adopt itself to the challenges posed by the WTO regime. A competition policy will have to be introduced. Reforms in labour policy is also necessary. Industrial policy will have to promote private initiatives from domestic as well as foreign investors while the role of the public sector will diminish.

76. The public distribution system will have to be made more focused through better targeting. It may be advisable to restrict the coverage of PDS to rice and wheat only. The emphasis under PDS should shift from provision of food subsidy to stabilization of food prices.

77. The social sector will also see new initiatives from the side of private capital. In education the target should include achievement of full literacy and improvements in the quality of higher and technical education. In the health sector, while the access of the poor to public health facilities needs to be improved full costs should be recovered from those who can afford to pay. Environment accounting should become an integral part of the plan process. In this regard, the focus on the international dimension should not be lost.

78. Decentralisation and globalisation are among the processes that will shape the new century. Initiatives by the local bodies, NGOs and women need to be encouraged. The process of institution building should be backed up by administrative and legal reforms without which the second generation of reforms will be incomplete.