BOOK REVIEW

Journal of Quantitative Economics, Vol. 9 No. (2), July 2011

INDIA DEVELOPMENT REPORT 2011

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Oxford University Press, New Delhi

Review by

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I. Any Development Report must contain assessment on three dimensions:

1. Assessment of the status and of achievements and failures in the light of historical experience;
2. Identification of the challenges ahead;
3. Suggestions for necessary policy initiatives or changes in the development strategy to meet the challenges.

I propose to review the IGIDR's India Development Report 2011 from the above three angles.

II. The Report consists of 18 contributions from researchers, including an Overview by the Editor of the Report, Dr. D.M. Nachane, There is a brief Preface by Dr. Mahendra Dev, Director of IGIDR. The contributors are mainly from IGIDR and a few from other research institutions. The contributions include papers on important major themes such as macroeconomic review of the Indian economy in the context of the recent global meltdown, food security, the persistence of crisis in agriculture, poverty and inequality in the age of liberalisation, industrial performance in the post-reform years, regional disparities in manufacturing growth, employment and industrial relations, auditing mechanisms and corporate governance, the performance of India's telecommunications industry, export sophistication, policy issues in response to capital inflows and the development of forex market, assessment of the outreach of banking services across the country's states, and the problems posed for growth by energy constraints, environmental concerns and natural and man-made disasters. There is also a Statistical Appendix containing a number of Appendix Tables on different aspects of the economy, prepared by the Economic and Political Weekly Research Foundation. It is note-worthy that the Appendix Tables include data from the oft-neglected Economic Censuses, for All-India and the States.

III. The Overview presents a Balance Sheet of two decades of structural reforms, mainly comparing the performance of the economy during the post-reform decade from 1993-94 to 2004-05 with that from 1983 to 1993-94. The overview as well as the various contributions in the

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This is a revised version of the Comments made at the time of the release of the India Development Report 2011 of the Indira Gandhi Institute of Development Research, Mumbai, by Dr. D. Subbarao, Governor, Reserve Bank of India, at Reserve Bank of India, Mumbai, on 11 July 2011.

Report, of course, acknowledge that the reform process has resulted in the stepping up of the rate of saving and capital formation, share of exports in GDP, the growth rate of GDP and per capita income, while overall macroeconomic and financial stability was maintained “more or less successfully” over the period. However, referring to the main findings of the contributions included in the Report, and supplementing them by those from the wide ranging literature on the subject, the overview, while recognising at the outset that “by many externally visible signs, the Indian reforms story has been a remarkable success”, critically brings out the serious threats to the economic, social and environmental sustainability of the growth process which is underway under the present reform regime.

IV. The economic sustainability is in doubt because of (i) primarily, the stagnation in the agricultural sector, (ii) only a marginally higher growth rate in the manufacturing sector after reform compared to that in the two pre-reform decades, (iii) growing scale-wise and location–wise concentration in large industry and increasing infra-structure and credit bottlenecks limiting the growth of medium and small-scale industries (iv) doubts about the sustainability of services-led growth in view of the weak backward linkages with the agricultural sector and only moderate backward linkages with the industrial sector and strong forward linkages with, reflecting its dependence on, the manufacturing sector for its own growth.

V. In this context, as correctly argued by R. Nagaraj in his contribution, the real constraint appears to be that imposed on the manufacturing sector due to stagnation of the agriculture sector restricting the demand for manufactured goods by that sector, and one should also add the supply of wage goods and raw materials.

VI. Agriculture-industry independence extends beyond these demand-supply considerations because of competing demand for productive land by the two sectors (and even by the services sector). This has created sharp tensions and conflicts between the interests of the farmers and those of industry and business-largely between farmers and big business. As this conflict brings into open the conflict between growth and equity and touches on the farmers’ livelihoods over their entire life span, it is necessary to usher in quickly the necessary legislation involving a just compensation package to facilitate transfer of land.

VII. As far as services sector led growth is concerned, while strong forward linkages of this sector reflect its dependence on the other sectors, can it also not be expected that the service sector growth, with the increasing total factor productivity in that sector, not stimulate growth of the other sectors, a` la Hirschman? Hirschman, in fact, gave the concepts of the backward and forward linkages to argue how the profits arising in the other sectors due to demand pressures of these linkages would stimulate the growth of other sectors. This process and indeed the growth of all the sectors, is being inhibited in our country, as is now widely recognised, because of inadequate development of physical infrastructure and capacity constraints in power and transport sectors.

VIII. Stagnation in agriculture is discussed at length in the paper by Reddy and Mishra as well as in the Overview. Agricultural production, productivity and the value of output are lower for almost all crops for the post reform decade compared to the pre reform decade. Declining public investment in irrigation and related infrastructure, increase in private investment on bore wells and tube wells, leading to the tragedy of commons in the form of over drawl of underground water and declining water tables, inadequate access to formal sources of credit and consequently increasing dependence on high cost informal sources of credit, waning link between research and extension and farming leading to increased reliance on input provider for advice with the resultant supplier-induced demand for inputs have been succinctly drawn attention to. Need for technological as well as institutional change is emphasised. The need for promoting community–managed sustainable agriculture focusing on small and marginal farmers in resource poor dry and drought-prone areas is highlighted and illustrated by referring to the promising efforts of the Society for Elimination of Rural Poverty in the spread of organic pest management practices.

IX. It should be added that the equally or more necessary attempts at organising water users' associations (on the lines of Pani Panchayats) do not seem to be gathering any momentum. It needs to be added and emphasised that the need of optimal use of water is receiving hardly any attention. As water is the input which is in short supply in our country with over 60 per cent of farm land being under dry land agriculture, it is essential to stress the need to maximise the returns to crops per unit of water. Given the small size of average and preponderant number of land holdings, the social and private returns to the input in short supply, namely water, are vastly different; and it is necessary to encourage promotion of community level associations of farmers with a view to causing a shift from relatively water intensive crops such as sugar cane in Maharashtra and paddy in Andhra Pradesh to less water using crops such as coarse cereals. This simultaneously needs to be accompanied by increased public investment in irrigation, in lower level distributory systems where these have been left incomplete and in major and medium dams in areas in which irrigation potential created is much below the ultimate irrigation potential.[2]

X. There is talk about the need for a second Green Revolution. While spreading Green Revolution to the Eastern and North Eastern states will need a greater flow of institutional credit to support private investment in wells, greater research has to go into developing seeds which give a higher yield with less water. I am told that while there is considerable effort in this direction world over, there is very little science research on in this direction in our country. It is also found that yields can be greatly increased through a change in cropping practices such as adoption of mixed cropping and crop rotating. Yields can be substantially increased and inputs saved by simply leaving roots, uncut stems and bio-mass of the standing crop when it is harvested instead of the prevailing practice of ploughing these out.

XI. The stagnation in agriculture has also led to problems for food security, as underlined by M.H. Suryanarayana in his contribution in this Report. While monthly per capita consumer expenditure in 1972-73 prices has increased substantially for all deciles in every decade since 1972-73, the percentage rates of increase for the lowest two deciles in the rural areas and the lowest three deciles in the urban areas were lower in the post-reform decade of 1993-94 to 2004-05 compared to the immediately preceding pre-reform decade. Between 1972-73 and 2004-05, per capita cereal consumption shows large declines for all deciles, except for the lowest one decile, in both rural and urban areas. While the per diem calorie intake has increased between 1972-73 and 2004-05 for the lowest three deciles in the rural areas and the lowest four deciles in the urban areas, all of them and in fact about 80 per cent of the total (rural plus urban) population show calorie deficiency by the calorie norms for official poverty lines. While the author of this paper recommends a re-setting of the calorie norms, what is less recognised is that the phenomenon

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[2] Professor N. Rath has been for years emphasising the main point on which these observations are based. For his latest comments on the subject, see Rath, 2011, pp.34-39.

also exhibits the vicious circle of low energy intake, low work input, low productivity and low income.

XII. Sunil Mani's paper in the Report on Telecommunications industry shows how by stimulating the growth of a large market for telecom equipments and for various types of electronic components and semi-conductor devices that go into telecom services, this industry is "a unique example of a services industry leading to the growth and emergence of a manufacturing industry". The paper also argues that technological changes and reasonably well-implemented regulatory policies have reduced the height of entry barriers to the industry and made it extremely competitive. In turn, it also shows how the performance of the dominant public sector service provider in the industry, BSNL, improved "entirely due to the force of competition leading to efficiency gains'. Needless to say that the competition in the industry is largely oligopolistic competition, and many of us, as consumers, have suffered from the competition among the companies in this industry to capture each other's customers in rather dubious ways. Also, unfortunately, the manufacturing industry stimulated by telecom services industry is dominated by affiliates of Multi National companies, with heavy dependence on imports.

XIII. Veeramani and Saini's paper brings out how globalisation and trade liberalisation lead to growth in intra-industry trade. Their paper documents that the foreign trade reform in India between 1990 and 2006 has consequently slowly but definitely raised the levels of sophistication in our external trade. Indeed, all countries and regions in the world appear to be moving up the product cycle, reflected by the levels of sophistication. All developing countries and regions, including India and China, have increased the percentage of varieties exported to the U.S. market. India reports a high percentage (62) of products with higher unit value compared to China in its exports in 1990 which slightly increased (to 65) in 2006, reflecting the greater concentration and increase of high value skill and capital intensive rather than low value labour intensive products in India's exports over the period (reflecting similar development of industrial and services sectors) compared to China.

XIV. The most serious threat to the sustainability of the present growth and reform process, as per the Overview to the Report, comes from the social dimensions of the outcomes. These relate to: (i) Limited impact on the incidence of poverty; (ii) Increase in inter-personal inequality;(iii) Increase in inter-regional inequality;(iv) An appreciable rise in the rate of unemployment; (v) Inadequate development of social infrastructure; and (vi)Problems of financial inclusion. I shall briefly comment upon some of these in the following paragraphs.

XV. The Overview points out that the rate of reduction in the incidence of poverty was meagre in the post-reform decade and the paper by Motiram and Vakulabharanam shows that it was lower in the post-reform decade compared to the pre-reform decade for all-India. Actually, computed as percentage of the Head Count Ratio at the beginning of each period of comparison, the incidence of poverty declined at a slightly *higher* rate of 2.2 per cent in the post-reform decade compared to 2 per cent in the pre-reform decade for *rural* India., but at a slightly *lower* rate of 2 per cent in the post-reform decade compared to 2.3 per cent in the pre-reform decade in the *urban* India. Motiram and Vakulabharnam also give data for the incidence of poverty by social groups, land holding classes for the rural areas, and by occupations for the urban areas. Incidence of poverty in 2004-05 was extremely high among the Scheduled Tribes (47.6 per cent) in rural areas and the Scheduled Castes (39.8 per cent) and Muslims (41.4 per cent) in urban areas. Of these social classes, the incidence of poverty has fallen more rapidly in the post reform decade for Muslims in rural areas and for the Scheduled Castes in urban areas. Poverty reduction in the post-reform decade proceeded at a higher pace than in the pre-reform decades for large farmers and agricultural and non-agricultural labour.

XVI. As we know, there are serious problems in the measurement of the incidence of poverty at all-India level or at the state levels, using an *average* all-India basket consumption basket, which in fact no one actually consumes. However, using this methodology, there were nearly 32.5 crore persons below the poverty line in 1983 and it increased marginally in 1993-94. That number declined by 1 crore in the post-reform decade. There were still more than 31 crore persons below the poverty line in our incredible India in 2004-05. The estimated number of the poor, based on the Tendulkar Committee's revised poverty line, would be even larger. The problem of poverty is daunting. There is need for improving the available safety nets. The implementation of NREGA should be improved by expanding its coverage through availability of more works and removing the limitation on the maximum number of days of work through the year per household but restricting the daily wage rate on these works to the states' poverty lines (appropriately indexed to poverty line inflation) so as to make scheme self-targeted for poverty removal and minimise the disruption to agricultural operations otherwise being caused by diversion of agricultural workers to NREGA works. The PDS has to be better targeted and its accessibility has to be improved by increasing the number of fair price shocks and by allowing drawl of daily rations in small quantities. Providing income supplements (through a greatly expanded and self-targeted NREGA programme, as described above) and issuing food coupons with tickets for daily provisions primarily to those who are likely to be otherwise reduced to a life of dereliction, because they are physically incapable of doing any work due to very advanced age or physical infirmity and have no other support from other members of the family, would be better than making food available at subsidised prices. These safety nets must be supplemented by measures that support small and marginal farmers and promote labour intensive manufacturing in order to quicken poverty reduction.

XVII. The authors provide evidence that while inequality measured on the basis of MPCE declined marginally in the pre-reform decade in both rural and urban areas it increased somewhat in rural areas but substantially in urban areas in the post-reform decade, thus also greatly increasing rural urban inequalities. Inequalities of wealth also increased during the post-reform decade. Moreover, as Ramaswamy's paper brings out, inter-state disparities in manufacturing activity also increased over time. They show that initial differences in urbanisation and literacy levels tend to perpetuate the differences in per capita state domestic product contributed by registered manufacturing. Availability and quality of power, quantity and quality of human capital (as proxied by average levels of schooling or literacy) and vicinity to major cities or coast line are seen to have favourably influenced the levels of per capita SDP in registered manufacturing in the states. These factors, rather than income tax or sales tax incentives, are the key policy initiatives necessary for effectively promoting a regionally balanced development of manufacturing.

XVIII. The Overview brings out the disturbing fact that the unemployment rates have been much higher in 2004 compared to those in 1993-94, that is at the beginning of the reform period. Unemployment rates in rural and urban areas for males as well as females, measured by usual principal status, current weekly status and current daily status all show increases. As is well-known, unemployment rates are much higher in urban areas compared to those in rural areas, because of large disguised unemployment in rural areas. Increase in rural unemployment rates shows non-availability of work in agriculture even when people are seeking it, with significant increases in seasonal unemployment and sharp increases in under-employment. More recent data will show the extent of impact of NREGA. Sharp increases in female unemployment rates in rural areas shows the pressure on women to seek work. In urban areas, there is increased pressure on women as well as greater keenness on their part to find work opportunities.

XIX. Employment growth was slower in both organised as well as unorganised sectors in the immediate aftermath of reforms, but grew at a much faster annual rate of 2.9 per cent in the following five year period. Employment elasticities of output sharply increased during this five year period compared to the pre-reform decade in agriculture and mining and quarrying but sharply declined in electricity, gas and water supply, construction, transport, storage and communications and community, social and personal services. In the rest of the sectors, the elasticities remained unchanged or declined only slightly. On the whole, this reflects the impact of revival of investment in irrigation as far as agriculture is concerned and restructuring of public sector and privatisation. The overall employment elasticity has gone up slightly to only 0.48, which means in order to increase the growth of employment further the following need to happen: (i) Overall growth rate has to be kept high (ii)Agricultural growth has to be stepped up, (iii) Investment in physical infrastructure (roads, including all-weather roads in rural areas, power, irrigation and rural electrification, ports, schools and healthcare centres and dispensaries in rural areas) can provide a boost to construction sector and basic industries, raising employment growth;(iv) Skill upgradtion through greater emphasis on poly-techniques and vocational training institutes; (v) Providing incentives for industries to reduce the growing capital intensity and to adopt labour intensive techniques; (vi) Expanding NREGA.

XX. D'Souza and Bhattacharjee analyse the employment scenario and industrial relations in their paper. They express surprise about the fact that though the percentage of workers available for work increased over the period from 1993-94 to 2004-05, the real wages increased from 1993-94 to 1999-2000 for regular workers and thereafter they stagnated for males and declined for females. Similarly, the real wages for casual workers increased in rural areas but at a slower rate during 1999-2000 to 2004-05 than in the earlier period from 1993-94 to 1999-2000. Real wages for casual workers in urban areas also declined in the more recent period.

XXI. My reading of the development in regard to the behaviour of unemployment rates and wage rates in the two sub-periods is somewhat different. The real rate of interest (proxied by the real lending rate for SBI) for the period from 1993-94 to 1999-2000 averaged to 7.7 per cent. It declined to an average of 5.63 per cent for the period from 1999-2000 to 2004-05. Growth of equity market, facilitated by tax concessions on dividends and long term capital gains and partial opening up of the equity market for foreign portfolio investment, also lowered the cost of capital to the corporate sector. These developments (and possibly some other factors as well such as deregulation, provision of better infrastructure and a more efficient financial sector – factors, which D'Souza and Bhattacharjee aptly recognise as the re-organisation effects of liberalisation) led the private sector to *increase* (and not reduce, as mentioned by the authors) the capital intensity. Measured by its net fixed capital output ratio, the capital intensity of the private sector increased from an average of 2.16 in the first period to an average of 2.44 in the second period. The public sector lowered its capital intensity from an average of 5.88 in the first period to an average of 5 in the second period in the process of re-structuring, probably also reducing its regular employment or not increasing it. The incremental fixed capital output ratio (for public and private sectors, taken together) shows an even sharper increase. This, as well as the shift towards employment of workers with higher skills, necessitated by the heightened capital intensity of production, and the natural growth of labour force over the period, led to an increase in the unemployment rate during the second period compared to the first period, as, for example, measured by the current daily status. The increase in unemployment rate led to a decline in the real wage rates for regular salaried as well as casual male and female workers in urban areas. Real wages for regular male workers in agriculture as well as non-agriculture and for females in non-agriculture also declined from the first period to the second period, while those for females in agriculture increased negligibly.[3]

XXII. As the authors observe, there was a decline in employment in large firms between 1998 and 2004. They point out that there was a rise in employment in the small firms and an increase in the proportion of the self-employed. However, if one looks at the data from the Economic Censuses, provided in one of the Appendix Tables of the Report, one finds that the average number of workers per enterprise in 2005 was less than two in rural areas and less than three in urban areas. There is reason to suspect that much of this kind of employment may simply be, in fact, disguised unemployment.

XXIII. The authors challenge the reformists' argument that existing restrictive labour laws have restricted the employment potential of the reforms from being materialised. They argue that the percentage of workers covered by the labour laws is any way very small between 2 or 3 per cent, or a little higher, and that the bargaining power of labour now is much reduced and labour have even acquiesced in the restructuring process. They point out, on the other hand, the need for improving labour legislation to strengthen the social security provided to labour, particularly in the unorganised sectors. These are useful insights. In a large measure, increased dependence on casual and contract workers may be a result of the industry's attempt to reduce total wage costs including social security benefits. Even so, the existing labour legislation may still be one of the factors restricting the growth of larger enterprises and regular employment, to which the existing labour legislation would apply.

XXIV. The paper by Rupayan Pal and Rajendra Vaidya constructs an index of state or region-wise outreach of banking services and find that whereas the policy guiding setting up of new bank branches in unbanked areas before reform encouraged correction over time in the branch concentration in states with larger extent of initial outreach, the tendency after the abandonment of this policy has been for the outreach to get more and more concentrated. The paper thus brings out the growing regional disparity in the provision of banking services, an aspect of financial exclusion. In a way, it complements the finding of Ramaswamy's paper on the growing state-wise disparity in registered manufacturing activity, since banking began to follow business after introduction of the new bank branch policy and privatisation of banking (sometimes with excessive concentration of bank offices of competing banks). I have two comments on this interesting paper. First, it would have been better to use the percentage of inhabitations with at least one bank office instead of the number of bank offices per 1000 sq. kms. as a measure of geographic penetration. Second, it should always be remembered that such indices which

[3] See Dev, 2008, p.186 for real wage data.

aggregate a number of different characteristics or indicators often lose the insights offered by these individual indicators for policy purposes in the process of aggregation. The authors may, for example, want to reflect on the insights brought out by the extremely interesting charts showing the behaviour of the various indicators over time and may even consider comparing these for the different states.

XXV. Issues relating to corporate governance are attracting considerable attention these days. An important aspect of corporate governance involves the need to institute mechanisms and regulations to improve the reliability of the statutory financial statements to be placed in public domain by the companies. Low reliability of companies' financial statements weakens the link between earnings and firm valuation, distorts investor decisions and increases transaction costs in the capital market. The integrity of the auditing process in the country came into question, for example, in the Satyam episode. Independence of the auditors from client companies and of the audit committees in the companies from the management are critical in ensuring the accuracy and reliability of the information provided in the companies' financial statements. In a very useful exercise, Jayati and Subrata Sarkar bring out the gaps and weaknesses in the present auditing procedures in the country by comparing them with the stricter standards introduced in the United States after the Enron debacle in that country.

XXVI. Reddy and Nathan examine in detail the question of energy insecurity in India. Energy is likely to be a major constraint on our growth. The authors assess the extent of energy insecurity, the supply-demand gap and the investment cost of attempting to meet the requirement. They suggest a number of policy measures for improving energy security in the country.

XXVII. V. K. Sharma's paper addresses the important question of the conflict between the growth process and the protection of environment and the eco-system, which of late is coming to occupy the centre stage of policy debate in the country. The paper emphasises the need for strengthening the legislation as well as the judicial process involving environmental issues. While government regulation is essential to protect the environment, delays in decision making in environmental cases is seriously impeding the growth process.

XXVIII. Nirmal Sengupta addresses the question of man-made and natural disasters and attempts to measure the economic loss imposed by natural disasters. Nearly half of the economic loss caused in India by natural disasters is due to floods. It has nearly doubled from 1950-79 to 1980-2008, measured at constant prices. By comparison, the economic loss caused by droughts has been smaller by comparison and was reduced by about 25 per cent over the period.

XXIX. While the Overview and most other papers in the Report focus on issues relating to the long term sustainability of the reform and growth process, maintaining macroeconomic stability is a major prerequisite of it. The papers by Chndrasekhar and Ashima Goyal address the question of macroeconomic stability and hence naturally policy issues having bearing on long term as well as short term considerations. While Chandrasekhar's main focus is on considering how US policy decisions contributed to the global meltdown of 2008 and how the challenge was faced by India's policy makers, that review is preceded by a review of the immediate prospects for the growth in the major sectors of the Indian economy, which the readers are likely to find to be of interest. It draws attention to "the declining share of small and marginal farmers in total credit despite their increase in total agricultural production". While one would not agree with his optimistic observation, based on data on increase in employment in the factory sector during the last three years ending in 2007-08 that “[t]he phase of jobless growth is a thing of the past”, his chart on the number of workers in this sector shows large cyclical fluctuation in this number as industrial production fluctuated during the past nearly two decades. The index of Infrastructure Industries shows a very worrisome choppy movement and was adversely affected by the global recession but has seen a marked increase in the closing months of 2009. The major components of the organised service sector, namely, construction, tourism, information technology and financial services, which were adversely affected by the slow down, are expected to be reviving. The paper also shows how the reform process and the policy response have taken account of external shocks. One wishes the review had covered more recent developments.

XXX. Ashima Goyal in her paper points out the contribution which foreign inflows, which are “an inevitable part of globalisation”, make to investment, technology and organisation and the growth rate of the economy, presents data on the different components of the inflows and provides a very useful documentation of the process of deepening of the Forex market in the Indian economy. Average daily turnover in India’s Forex market has increased rapidly from 3 Billion US Dollars in April 2001 to 34 Billion US Dollars in April 2007 or from 0.18 per cent of 0.85 per cent World’s total daily Forex turnover. The Forex market deepening in India has taken place over the period at a faster pace compared to a country such as Australia, but is still very small in comparison with the World’s total daily Forex turnover. Total Forex derivatives in India (comprising currency forwards and swaps) were more than twice the size of total Forex spot in April 2007. RBI’s intervention in Forex markets through spot purchases and sales as percentage of total spot turnover has declined over the period. Currency futures in US Dollars were started in 2008 and later in other currencies.

XXXI. The author justifies the policy bias towards permitting foreign inflows in equity rather than in debt by pointing out that equity investments, in contrast to debt, shares in risk in that liabilities are reduced in crisis. India’s prudential regulations on banks and restrictions on external borrowing and caps on interest rates on NRI deposits protected it during the global financial crisis. She recommends exercising caution in liberalising debt inflows until domestic financial institutions and domestic debt markets are strengthened and other distortions such as large interest gaps and one-way predictable exchange rate movements are removed. She considers various well known alternatives to reducing the high cost of holding foreign exchange reserves, but does not propose a solution. Emerging economies must bear this cost because of their limited absorptive capacity and inadequate international financial architecture. For strengthening the fisc, she muses expenditure caps and recommends direct income transfers to those below the poverty line in preference to the present system of keeping food prices lower than international levels through the food subsidy and procurement mechanism. However, this could unleash the wage-price spiral unless domestic food supplies increase.

XXXII. The author’s suggestion of keeping the account not fully open and allowing greater exchange rate flexibility, as Forex and domestic debt markets deepen, so that monetary policy can be used more effectively by using Forex market intervention for “signalling to affect exchange rate, freeing the interest rate for the domestic policy” may be appropriate over the medium term as a policy package to use exchange rate appreciation as a complement to a rise in interest rates. However, it would not be correct to interpret the tenor of the author’s highly nuanced argument to recommend a low interest regime in the immediate situation to stimulate investment and growth and keeping an appreciated exchange rate to address the inflationary situation. A combination of exchange rate and interest rate can, of course, be used to tackle the growth-inflation tangle. Given that growth in the country under present strategies has not generated much increase in employment and has tended to be highly skewed in favour of the very high income classes, the trade off between growth and inflation in the present context has to be tilted heavily towards moderating inflation and its impact. We must also remember the delirious effects of a policy of keeping low real interest rates on employment growth, as pointed out above, as also on the health of financial institutions, flow of resources to them and consequently on the availability of institutional credit to meet the credit requirements of some major under-served sectors in the economy. This is particularly true since we have neglected the development of domestic debt market so far, and some of under-served sectors cannot access either the formal equity market or debt market. I have just seen a brief report by the chief economist of a public sector bank,[4] which brings out the favourable effect which the recent increases in the interest rates on bank deposits is having on deposit mobilisation by banks and their profitability, and while the gap between credit growth and deposit growth for the Scheduled Commercial Banks (SCBs) has narrowed, SCBs' non-food credit outstanding has itself shown a strong increase in the first quarter of 2011-12, in contrast with the usual seasonal decline in the first quarter.

XXXIII. Indeed, in order to increase the flow of resources to financial institutions and the supply of long term savings, it would be useful to consider seriously a proposal for the issuance of inflation indexed government bonds and small savings instruments, made some time ago in a DRG Study of the Reserve Bank of India. [Chitre et al., 1996].

XXXIV. Ashima Goyal recommends a "middling policy" or one of "principled pragmatism" in approaching the question of capital account convertibility. I interpret it to be a road map with indicated guide posts. Indeed, reform itself has to be seen as the necessary institutional changes and new policy and strategy initiatives to achieve the long term objectives of the society. Reform process and the necessary policy initiatives need to evolve incrementally, in small or large steps, based on an assessment of the outcomes by the polity and consensus regarding the assessment in the polity. The role of the policy maker's judgment or discretion is crucial in deciding the timing and the adoption of necessary changes in the available policy instruments so as to move towards the fulfilment of the societal objectives in the light of the outcomes and the guideposts visualised in terms of the unfolding socio-economic, technological and institutional circumstances. Consensus building is facilitated if reform and policy measures deliver in a large measure outcomes considered to be desirable by a majority of voters, for which the voters may need to be educated by the civil society.

XXXV. The editor sums up the overall assessment of the reforms pithily and eloquently, saying that it is "like the proverbial curate's egg, 'good in parts'". After the careful scrutiny of the Balance Sheet of two decades of structural reforms, come the following stringent observations:

"In conclusion, one may say that the reforms strategy, which seemed to be on a gradual track in the early years of the reforms process (1991-96) was suddenly shifted into high gear around 1996 with a distinct thrust in favour of large-scale industry and foreign investment, while several precautionary regulations on the financial sector were removed in undue haste. The fault lines, so evident in the reforms strategy now, are essentially an outcome of this latter epoch which

[4] See Rege Nitsure (2011).

stretched for a decade or so. Since 2005, however, the government seems to be seriously concerned with the ‘human face’ aspects of the reforms and has initiated a number of laudable initiatives. But clearly far more remains to be done on this front, and it is important to highlight that, as long as the reforms strategy continues in its present form, these measures will essentially be of a supplementary nature.” The Institute and all contributors have to be complimented on a careful and critical evaluation of the outcomes of the reforms and identifying the challenges ahead. I am sure that the Report will be widely read and reflected upon. One would look forward to a follow up volume, bringing out the varied new policy initiatives and institutional changes required to meet the challenges.

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