

Is India Ready for the Market Economy?

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Abstract

With changes in the international economic order, India too had to commit itself to the market economy in the early 1990s. However, in this context, actual legislation and administration have often failed to emulate the vigour demonstrated by the government in issuing promises. This poor implementation has been the result of the political necessity of keeping various groups with divergent interests happy, and concerns relating to the likely impact of the transition on equity, poverty and welfare. But the market economy is in fact a most flexible system – more a system of practices, than a single ideology – and provides opportunity for developing a suitable mixed economy for India, by combining the efficiency, macroeconomic stability and incentive for individual effort and initiative of the market economy, to the ability to directly address socio-economic issues inherent in the planning economy. Thus, the market economy offers us the scope for both economic growth, and the impetus to sustainable development.

The glass is falling hour by hour, the glass will fall for ever,

But if you break the bloody glass you won't hold up the weather.

- Louis MacNeice, 'Bagpipe Music'

The international economic order has witnessed rapid changes in the past couple of decades. With the collapse of other alternative systems, the market economy has found place, either explicitly or in more muted forms, in most countries of the world. Since the early 1990s, India too has committed itself to the market system, and retracting may be both impossible - in view of pledges made to international organizations - and undesirable - giving a bye to the international trade and technological linkages is hardly good strategy. The practical course would be to accept the changes, if possible to mould them to better suit Indian realities, and use them to our benefit. The market economy is indeed like the weather – all pervasive and undeniable.

Throughout history every society has had to face the fundamental question of the uses to which its limited resources are to be put. However, the options were streamlined in the 20th century between two competing economic systems - command economies and market economies; the planning system and the market system as J.K. Galbraith terms them.

The first to systematically describe and study a market economy was perhaps Adam Smith in *An Inquiry Into the Nature and Causes of the Wealth of Nations*, in 1776. Anyone wishing to enjoy more of the material goods and services produced in a market economy faces strong economic incentives to work hard, spend carefully, and save and

invest. Successful businesses have to sell good products at market prices, pay employees market wages, and treat customers courteously. In the words of Smith, rational individuals are led "as if by an invisible hand" to work and behave in ways that use resources efficiently, in terms of producing things that other people want and are willing to pay for, even though that may have been "no part of their original intentions."

This allocation of resources, contingent on the interaction between buyers and sellers, remains the crux of a market economy. Though market economies are often identified with capitalism, such connections need not be very strong. In fact, it is possible for them to have considerable government intervention. The basic difference with a command economy rests in how, not how far, this intervention is exercised – if the government wants something in a market economy, it collects taxes and buys the good; in a command economy it simply orders it to be produced, with government committees setting down the production levels for these goods, the factories which will produce them, often even the prices to be charged in the market. While such economies have at times achieved significant success in initial stages, with economic growth, and the accompanying increasing numbers and complexities, the task of avoiding shortages and wastages becomes unmanageable for any *one* planning committee. It is here that the decentralized nature of the market economy becomes its prime source of efficiency. If individual producers decide what and how to produce to satisfy their customers, competition and self-interest ensure efficient resource allocation and usage. This combination of efficiency and democracy - allowing individuals to decide – inherent in market economy, retains its appeal.

However, a "pure market economy" may never have existed even in the heydays of the laissez faire movement, and today, as the so-called capitalist nations speak of the

welfare state, and China of private industry, the concept becomes still more blurred. Yet, in their pursuit of the 'mixed economy', different countries have assimilated different aspects of the 'market', and we shall try to identify where and how far India should adopt the market economy.

Here we face the other stumbling block. India has traditionally been a classic case of economic dualism – a modern industrial economy alongside a traditional agrarian one. The last decade of liberalization has increased this chasm, rather than remove it. As such, it is hardly likely that all sub-parts will be “ready for the market economy”, and the economic measures demanded by them will also be divergent, at least in the short run – some sectors seek removal of agricultural subsidies doled out of the money paid as tax by them, while the persistence of the same subsidy may be critical to growth in certain other parts of the economy. Resolving such conflicts require exclusivist normative judgments. Rather, we will examine a broader economic framework, with emphasis on the impacts of such shift on India's growth prospects, and on the overall human development situation, on both of which counts India continues to fare much below potential.

Impacts on growth are easier to analyze, though here sentiments tend to be volatile. A year back – with poor monsoon for the third successive year (five in some parts), increasing inflation, threat of Chinese goods flooding the economy, little breakthrough with Pakistan, prospects of oil price hikes – the economy seemed set for a tough time. Today, with most of the threats not materializing, and the country actually enjoying a good monsoon, the mood is upbeat. The National Council for Applied Economic Research reports the highest level of business confidence in years. The Confederation of Indian Industry has revised growth projections to over 6 per cent.

In fact, it could be good time to commit further to market economy. The 1990s may indeed have seen India break free of the 'Hindu Growth Rate', as called by Prof. Raj Krishna, with few countries other than China making as rapid progress in growth and developing the basic infrastructure for future growth. But there remains a lot that can and should be done, and providing industry and individuals with more freedom, better infrastructure and a superior arena to harness their potentials might be a spur to growth.

However, the transition is 'pregnant with conflict', in the words of Kuznets, much of the difficulties being laced with issues of will. The New Economic policy was adopted by India in the early 1990s more as a consequence of external realities – the foreign exchange crisis – than internal developments. The government, which in the early period was generous in policy commitments, seemed hesitant when it came to actually drafting or administering the policies. Political necessities and the need to keep various organized groups – large businesses, agricultural lobbies, labour unions, public sector and government employees – satisfied seems to have deprived the 'new economic regime' of its 'newness' even before it actually came into being.

In fact, two of the most often cited arguments against the transition are inflation and unemployment. We shall now examine how far these are true in the Indian context.

Price liberalization -- the relaxation of government control of prices -- is an essential step towards a market economy. Since the earlier prices were often held artificially low through legislation, in spite of demand outstripping supply, price liberalization leads to price increases for goods that were in chronic short supply. Yet, supporters of free market insist that such inflation is only temporary. As market mechanisms of supply and demand begin to function, the demand-supply imbalances are removed, prices stabilize

and the economy settles down to a far more manageable rate of inflation. Further, the inflationary obstacles are largely the result of governmental restrictions on prices and capacity, and the longer these restrictions are allowed to operate, the tougher a transition to market economy will be. Thus, even at the risk of inflation, the best time to tackle the transition is always *now*, rather than tomorrow, when the potential inflationary pressures will be still greater.

India's experience with inflation has however been different. When the rate reached the high of 16.7 per cent in August 1991, the Union Finance Minister's prescription in fact included a shift away from the command economy we had been practicing. Tackling the fiscal deficit and reduction and rationalization of import tariffs were felt to be major thrust areas in tackling inflation. For India, the route out of inflation lay in the stabilization policies and the structural adjustment policies (SAP) – a move *towards* a market economy.

As regards unemployment, competition and the need for efficiency force inefficient businesses to close down or to reduce the work force. Cut off from government subsidies, many businesses, including large state-owned enterprises providing employment to large numbers, face obsolescence. But, as in the case of inflation, the market itself intervenes to relax the strains of unemployment. Entrepreneurs, seeing opportunities for new business ventures, hire new workers; foreign and domestic investment stream in. Not only do job opportunities increase in numbers, but also in diversity, job flexibility and choice.

However, a market economy does not guarantee full employment. Any free economy necessarily finds workers searching for new jobs. They constitute what is known as

'frictional unemployment'. However, since such voluntary unemployment, to a large extent, reflects the workers' freedom to change jobs or to undertake training, and generally does not persist for long for any particular individual, it is not, by and large, seen as a serious problem. Yet, not all forms of unemployment are as benign. Market economies are prone to cyclical and structural unemployment. The former is closely related to the economic cycles affecting the overall economy, while the latter relates to workers lacking in education, training, or job experience for employment. The effects of the former can be tackled through effective fiscal and monetary policies, as the Great Depression of the 1930s had shown. Though structural unemployment usually affects only a small percentage of workers in an economy at any given time, dealing with it can be slow and expensive, and emphasizes the relevance of the nation's educational and technical training programmes, and may be grounds for governmental supervision and even control of the systems, though such control in no way justifies persistence of a command regime.

A nation's labour policy is expected to deal with the following specific areas: -

- i. Generation of new employment
- ii. Equitable spread of labour opportunities
- iii. Protecting labour from employers
- iv. Dealing with inevitable retrenchment

In India, the focus has always been on the third area. In fact, over time the labour laws have so rendered retrenchment impossible, even in the face of economic justifiability, that the last area has been virtually redundant. Yet, in the move towards a market economy, retrenchment will indeed become necessary at times, and the government will have to look into ways of looking after unemployed labour. In such a scenario, the

first two areas will also become critical – the State must address labour issues beyond passing the burden onto industry via legislation.

Over the 1990s India has seen a move towards a market economy, with ‘privatization’ acting as a prelude to the eventual regime change. Attempts towards privatization may be seen as something of a paradigm shift, a switch to setting in motion more important changes. However, the Human Development Report 1993 lists down seven dangers of privatization: -

- i. “Maximizing revenues without creating a competitive environment
- ii. Replacing public monopolies with private ones
- iii. Using non-transparent and arbitrary procedures
- iv. Using the proceeds on Finance Budget deficits
- v. Simultaneously crowding the financial markets with public borrowing
- vi. Making false promises to labor
- vii. Privatising without building a political conscience”

(Singh 1995: 303)

These could be the real dangers inherent in a transition to a market economy, and the government must devise ways of tackling them. But it is important that the liberalization initiatives do not slow down – if these problems seems grave today, the dangers will be yet more poignant as we allow the command economy to continue.

In fact, this transition does not in any way reduce the relevance of the government - it is increasingly believed that a good democratic system and a market economy complement each other. But there will have to be shift in the government’s activities from active direct action and policy changes, to a supporting role of creating a climate

conducive to private investment. The emphasis must shift from excessive regulation and protection to promotion. However, for a developing country like India there are at least two areas where further progress is contingent on active government intervention. A significant portion of India is, and will remain, outside the purview of the market. Unless the government itself takes up the task of empowering them through education and infrastructure, they will fail to contribute to the economy or to reap future benefits. Education – particularly primary education – and infrastructure often entail significant investment without immediate returns, making private participation unlikely. These are areas where the government must play an active role.

Many economists, including Amartya Sen, argue that a market economy is not suitable for India because of the lack a level playing field – socially and financially – and sudden liberalization will only increase disparities. The argument is not without merit. Growth itself is unlikely to have any trickle down effect of the benefits automatically extending to every stratum. Rather, the government must develop ways to directly address the issues of poverty and inequity. But, growth alone – which surely will be a result of liberalization – can provide the nation with more resources to deploy to the tasks of sociopolitical change and sustainable development.

The transition into a market economy is an eventual certainty. And while it carries its own hazards, they are likely to be lesser today – in an upbeat financial and economic atmosphere - than in an uncertain tomorrow, when the malignant stagnancy inherent in a command economy will be even more difficult to shake off. The question however is how far the new measures are to be incorporated. The classical economists' "invisible hand" is a powerful argument in favour of the efficient market economy, but the externalities and 'market failures' exposed by the neo-classical economists also warn against an ad hoc and total abandonment of government control.

We may do well to devise our own form of mixed economy – a ‘Dual Economy’ in Hansen’s words, or a ‘Controlled Economy’ to quote Lerner. One of the difficulties in appreciating a market economy is its flexibility - it is a collection of practices rather than any single ideology. India must decide on its own balance of social democracy and popular participation, to provide a macroeconomic environment with stable prices and currency, a fair tax regime, correct price signals and an effective system of encouragement and reward for initiative. The state must actively step in to tackle market failures, to provide legislative protection to industry and consumers, and to protect and empower vulnerable groups.

In this quest, West Germany’s Social Market Economy may serve as an example. In coupling economic rebuilding with social necessities it comprised the most unique political and economic strategy of the 20th century – the "Globalsteuerung", overall steering – which Andreas Müller-Armack described as a shaping principle. The question to ask might not be “Is India ready for the market economy”. The real question is how do we make the market economy more ready for India.

Bibliography

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