Efficient policy of India

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Accepted 19 September, 2013

Public policy and governance, which defines country’s growth strategy, plays a significant role in any country’s development story. In case of India, if its development and growth is compared with other nations, who were once just as developed as India was, we found that India has not been able to transform itself into a developed nation that it could have done by now. The reason behind this is not just slow but inconsistent growth of India’s GDP and its public finance policy, which together played an important role in its inefficient growth. India's tax to GDP ratio and Expenditure to GDP ratio is just 1/3rd of most of developed nations like European Union countries which together have tax to GDP ratio as high as 40.1% in the year 2011. India has never shown a consistent growth rate in its 65 years unlike its other peers for example Indonesia, Brazil, China. On the other hand, Indian government has been following divestiture led privatization policy, which raised the Non debt Capital Receipts for the country in place of contributing to the Non-Tax Revenue. These points of inconsistent growth, public finance policy leading to low tax to GDP ratio, divestiture led privatization prove that macroeconomic policy of India is not very efficient and it has not able to utilize its capital efficiently.

Key words: GDP ratio, divestiture led privatization, efficiency, growth rate.

INTRODUCTION

India got independence on 15th August 1947 and successfully transformed itself from well-governed to a well administered country. It turned out to be world’s largest and successful democracy with free and fair elections in every nook and cranny of the country as one of its strengths, which proves that secularism, justice, and freedom are its core values. However, the world has come a long way since 1947, and various nations like Brazil, China, Denmark, Japan, Malaysia, and Sweden have not just administered their country but also managed their resources in order to have best in potential output. They proved their efficiency through their consistent growth rate, high tax to GDP ratios, and high HDI ranks. China, for example has shown a consistent growth rate of more than 7% for the last 25 years, which has made it now to have the world’s second largest economy next only to US. Therefore, the study done to probe the factors behind it has the following objectives:

1. To analyze investment efficiency of India in macroeconomic terms.
2. To evaluate the efficiency of privatization being done in India.
3. To analyze the efficiency of the policy being followed in budget over the recent years.
4. To analyze the GDP growth rate of India in comparison to other nations who have shown sustainable growth rate of more than 7% for at least 25 years.

RESEARCH METHODOLOGY

The research purpose is diagnostic, with objective to diagnose the public policy of India. It tried to utilize the academic knowledge of the author in the right direction. Data from various sources were used. Applied research is being conducted through collection of Data from the
sources like published reports and journal articles. The research is done by the use of academic sources and with various examples.

Indian incremental capital output ratio

Incremental Capital Output Ratio is an important indicator of development that was introduced by Sir Roy Harrod and Evsey Domar. It refers to the rate of change in output with every unit change in capital, which implies that economic growth requires savings and technological advances through Government policies.

In case of India, its Incremental Capital Output Ratio for the financial year 2007 was 4.25 and in the year 2008 it was increased to 6.508. 1If it is compared with China—China had shown a gross capital formation of 43.1%2 in the year 2007 and its GDP had grown at the rate of 13%1, which resulted into its ICOR as 3.31. But India’s Gross Capital Formation was 38.7%3 and had shown a growth rate of 9.1%, which resulted into the ICOR of 4.25. India’s ICOR was even more than that of a country like Brazil that had shown an ICOR of 3.105.

Though India’s Capital formation is fairly high, the Government is unable to utilize that capital as efficiently as it is being done by countries like Brazil and China. In order to generate high growth rate, the Government needs to utilize its capital efficiently, and needs not increase the rate of capital formation, which otherwise increases the rate of inflation.

For example, Brazil had shown a growth rate of 5.1%1 in 2008 through the capital formation of 18.9% and resulted into 3.7 ICOR, which is far better than that of India in terms of efficient utilization of capital.

What it means is that though high rate of investment and high rate of Capital Formation is important to achieve high rates of growth, equally important is utilizing that capital through technical progress, education, and productivity.

Efficiency in public finance

Tax-to-GDP ratio is a simple measure of dividing total taxes by national income and at the heart of India’s fraught public finance situation lays the dismal Tax to GDP ratio. In the budget of 2006, presented by Mr. P. Chidambaram on 28th February 2005, India’s Tax to GDP ratio was just 10.6%3 and for the same year, budget presented in Germany showed up to 43% Tax to GDP ratio and France’s Tax to GDP ratio was 50.7%. (Financial Times, 2006).

The lower the Tax to GDP ratio, the lower will be Expenditure to GDP ratio. Therefore, Expenditure to GDP ratio of India in the budget of 2006 was 14.8% and in 2010 budget this figure increased to 15.98% due to the fiscal deficit of 5.5%4.

Also, India’s plan Expenditure in the Budget of 20095 was just 5.5%, which is further reduced to 5.3% in the budget of 2010; and earlier in 2006 it was just 4.10%.

On the other hand, India’s non-plan expenditure is as high as 10.6% in the budget of 2010 though decreased from 11.88% of 2006. It should be considered that country like Denmark, which has its Tax to GDP ratio as high as 49.1% utilizes its collection in Public Service and Human Development. But India 3.5% of GDP in the Budget of 2010 is attributed to interest on debt, which is almost half of tax collection. Countries like Brazil, Sweden, and Denmark have High Tax to GDP ratio and they are pulling people out of poverty, which is clear from their ranks in Human Development index published by UNDP (Human Development Report, 2009).

Apart from that, as of 2008-09, Central Government’s internal debt is 35.6% of GDP (Basu, India Scorecard, 2010); though it has reduced from 41.6% in 2002-03, it is still fairly high.

Also India’s FDI inflow in 2008 was just $41billion6, which is even less than Brazil’s $45billion, and nowhere around China’s $147billion. And its gold and US$ reserves ($257billion) are little more than 10% of China’s $1966billion. These indicators proves India’s inefficiency in public finance policy, which means there is managerial challenge and urgency to raise the tax to GDP ratio and improve the public finance situation.

India’s privatization

India’s out of 214 operating public sector enterprises 159 are making profits and 54 incurred losses in the year 2007-08 (Public Enterprise Survey, 2007-2008).

Though the number of loss making enterprises reduced from 60 in the year 2006-07 to 54 in the year 2007-08, the overall loss of these enterprises increased from Rs.8457 crores in 2006-07 to Rs.1332 crores in 2007-08 (Public Enterprise Survey, 2007-2008). It shows that loss of enterprises has been increasing. And in order to reduce the overall loss from loss making Enterprises, Government has been using the Divestiture led Privatization.

What is being done in India is divestiture led privatization and the money is being added as non debt capital receipts, which is actually loss of potential revenue from an enterprise in case it would have been turned into the profitable organization.

The policy should have followed Non-Divestiture led

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1 India Scorecard by Prof P K Basu and the Data published by world bank
http://data.worldbank.org/indicator/NE.GDI.TOTL.ZS
2 Data published by world bank
http://data.worldbank.org/indicator/NE.GDI.TOTL.ZS
3 Union Budget 2005-2006http://indiabudget.nic.in/
4 Union Budget 2010-2011 http://indiabudget.nic.in
5 Union Budget 2009-2010 http://indiabudget.nic.in
6 Data published by world bank
http://data.worldbank.org/indicator/NE.GDI.TOTL.ZS
Privatization so that the Government could increase its revenue.
What could have been done in India is:

a) Building up of management cadre outside civil service: The Government could have built Management Cadre through Industrial Management Service just as it was done in 1957 by Pt. Jawaharal Nehru.
b) Arms length relationship with public sector enterprises: The government–public enterprise relationship should have been of “partners” and not as of “fiefdoms”; there should have been “involvement” and “Accountability” for results with Efficiency and welfare.
c) Increasing autonomy of board vis-à-vis government with accountability: The public enterprises should have been given corporate form, where enterprise is managed by board of directors and they are accountable to public as well as government.
d) Replacing a priori with a posteriori controls.
e) Management contracting or leasing prior to divestiture of ownership.

If we take Britain for example where its steel was privatized in the year 1988; at that time its profit was £490 million, but before that its profit was £42 million in the year 1986. There were other companies like British Aerospace and British Telecom which were first converted into Profitable institutions and then privatized but the golden share remained with the Government. And, as the enterprises were first converted into profitable institutions, the Government was able to make good money out of selling shares to the public (Basu, 2005).

There are other examples of country like Japan, where privatization often conveys commercialization of departmental state enterprises by converting them into joint stock companies with shares owned by the state.

**Consistent growth**

In the financial year of 2007, India has shown a growth rate of 9.1% and in 2007-08 it has shown a growth rate of 9.0% but suddenly it fell down in 2008-09 to 6.7% (Basu, India Scorecard, 2010)

India has never shown up growth rate of at least 7.0% consistently for even five years. But there are 13 countries in the world which have shown the consistent growth rate of more than 7.0% for at least 25 years. These countries include Botswana, from 1960 to 2005; Brazil (1950–1980); China (1961–2005); Indonesia (1966–1997); Malaysia (1967–1997); Hong Kong (1960–1997); Japan (1956–1983); Malta (1963–1994); Oman (1960–1999); Singapore (1967–2002); Thailand (1960–1997); Taiwan (1965–2002) and South Korea as well. (The Growth Report: Strategies for Sustained Growth and Inclusive Development, 2008).

According to ‘The Growth Report: Strategies for Sustained Growth and Inclusive Development” published by World Bank in 2008, five common things in these 13 economies were:
a) They have fully exploited the world economy.
b) They Maintained the Macroeconomic Stability
c) They mustered high rate of Savings and investment.
d) They allowed market to allocate resources.
e) They have committed and capable Government.

These common things show that, firstly, countries like Botswana, Brazil, China had used their strengths in exploiting the world economy by maintaining trade relationships with almost every country in the world. But India had found its strength in IT only in the 21st century, and still unable to generate growth of at least 7% growth consistently.

And, if we consider macroeconomic stability of India, its inflation rate was as high as 8.2% in the year 2008-09 and fiscal deficit for the year 2008-09 was 6.2% (Basu, India Scorecard, 2010) and in 2010 it was 5.5%.

India has practicing socialist economy since independence, so market has never had much role to play in allocating resources. It was only in 1991 that new economic policy was introduced by then Government with the objective of liberalization, privatization, and globalization.

But, in terms of rate of saving and investment, there has been consistent increase in the savings rate since 2000-01 (23.7%), which was 37.7% in the year 2007-08 (Basu, India Scorecard, 2010); though it has not been able to utilize that saving rate as efficiently as it is being done by countries like Brazil and China.

Therefore, India has not been able to prove its mettle on these parameters, which turn out to be its main deterrent in its successful growth story.

**FINDINGS AND CONCLUSION**

1. India’s Incremental Capital Output Ratio was increased from 4.25 in year 2007 to 6.508 in 2008. Our ICOR is fairly than China (4.93), which shows that we are not investing as efficiently as China is doing.

According to CSO’s India’s Scorecard, India has been able to show the growth rate of 9% in the year 2007-08, but as per calculations from WDR’s data its investment efficiency has been reduced.

2. India’s tax to GDP ratio for the budget of Feb. 2005 was 10.6% (7.7% in 2010) and the countries like US, Japan, UK had more than 30% of GDP as tax collection. Similarly India’s expenditure to GDP ratio in the budget of Feb 2005 was 14.8%. Higher tax to GDP and income to GDP ratio would have contributed to the welfare state as Government can use that money in reducing income inequalities.

3. In India, divestiture led privatization is being done and
receipts get added to the Non-debt Capital Receipts. In reality, government loses its capital as the money is used in reducing fiscal deficit.

4. India has never been able to grow at the rate of more than 7% consistently for more than 5 years. But countries like Botswana, Malaysia, Indonesia have done it successfully for a minimum of 25 years.

In a nutshell, it can be said that it is true that India is the largest and has successful democracy in the world, but it needs to be much more efficient in terms of investment, privatization policy, which will lead us to have consistent growth rate in GDP and higher rank in Human Development Index.

REFERENCES


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