

# Journey towards Holistic Development - From Milton Friedman to Mahatma Gandhi

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The dimensions of development economics, it seems, keep on extending, over time. It may be recalled that in the early 1950s, when India's Planning Commission sought to build equity into the growth Plan, the mainstream development economists scoffed at the idea. Their dictum was: "Enlarge the size of the national cake, the distribution would take care of itself". Those were the hey-days of the percolation or trickledown theory growth – a theory which has been disproved by empirical experience. Equity is intrinsically important as a development goal in its own right. But sharing of economic and political opportunities is also instrumental for economic growth and development. In other words, equity reinforces the growth process itself. This relatively new-found concern for growth with equity shows the development economics has come a long way. Was this belated recognition responsible for breeding predatory capitalism in the meanwhile? We are not sure. What we are sure is that the collapse of the American capitalist model in 2008 now warrants that we move away from predatory capitalism to what can be broadly described as community centered capitalism.<sup>1</sup> Shedding our self-centeredness, we must begin to sensitise ourselves not only to the woes of our less endowed brethren but also larger concerns, at the macro level, of depletion of natural resources, environmental degradation and inter-generational equity. This is what Mahatma Gandhi taught us nearly hundred years ago, by providing the philosophical basis for evolving a society with a value system which resonates to these larger concerns. In a broader context, the recent Commission on Growth and Development asserts that there is no generic formula for growth. "Each country has specific characteristics and historical experiences that must be reflected in

its growth strategy".<sup>2</sup> Is development economics moving away from a narrow mechanistic view of growth which has resulted in dubbing economics as a "dismal science" to holistic development? Examining the more recent development experience of India, I would seek to show that the reform phase beginning from 1991 when the liberalization of the economy was initiated, to 2004 was the most retrogressive phase, battered as the economy was by the market theology obsessed reforms. The second phase subsequent to 2004 marks a gradual return to what one might call holistic development. We begin to wonder whether our contemporary policy makers have slowly begun to rediscover the Mahatma. The journey of the Indian economy from the Milton Friedman phase 1991-2004 to Mahatma Gandhi phase 2004-2009 needs to be authentically documented.

## I. COLLAPSE OF THE AMERICAN MODEL

We are meeting at a defining moment in the history of global economic system. The collapse of the capitalist model of the American economy in 2008 was as traumatic as the collapse of the communist model of Russia in 1991. Perhaps more traumatic because the U.S. "economic crisis of historic proportions", to use the words of President Barack Obama, culminated in world recession. We have thus arrived at a moment in world economic history, when the disillusionment with the centrally planned economies is matched by the loss of faith in the capitalist system led by unbridled market forces. We have discarded the centrally planned economic system and if we now disown the capitalist system, where do we go from here? The present global economic crisis is ferocious and it has changed dramatically the institutional and policy making landscape.

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We may not have our own Reagonomics or Thatcherism to bury: but our contemporary policy makers are soaked in the market theology of IMF/World Bank. It would not be easy to disengage them from the trappings of market theology and induce them to refrain from mimicking the Western models. The period of economic reforms – a period of liberalization of the Indian economy, from 1991 to 2004, I would submit, was the most retrogressive phase in the history of India's economic development.

## II RETROGRESSIVE PHASE : 1991 – 2004

Admittedly, India's growth story is impressive with GDP growth recording an annual average growth of 8.5 per cent during the last five years 2003 to 2008. In the euphoria of sustained high growth, we generally tender to overlook the mistakes committed by our policy makers during this phase. A community centered analysis exposes clearly the darker side of these developments. While there is enough literature on the harm inflicted on the economy by the centrally planned economic phase – the so-called license-permit-raj, little attention has been paid to the negative impact of the pursuit of unbridled market philosophy during the 1991-2004 phase. Economic historians need to pay greater attention to this phase.

I have characterized this period broadly as the Milton Friedman phase: Milton who is the principal protagonist of the so called Chicago School, which expounds free markets, de-regulation, liberalization and globalization. It advocates that the role of the state should be reduced to the minimum. As illustrative of this approach, look at Milton's corporate philosophy: "There is one and only social responsibility of business – to use its resources and engage in activities designed to increase its profits ". Market fundamentalism embodies in the neo-liberalism based on the notion that markets are self – correcting, allocate resources efficiently and serve the public interest well-has collapsed. The "Washington Consensus" in favour of

privatization, liberalization and independent Central Banks focusing exclusively on a single point agenda of controlling inflation, now stands stripped of its sanctimonious robe. It has now become clear that unbridled market forces are not self-correcting, regulation and direction of some sort is needed. The state has a critical role to play in the management of the economy.

During the first phase of reforms in India, our policy makers were soaked in this market theology. The focus was on liberalization, market-led growth, fiscal correction, promotion of private and foreign investment, development of capital market and generally creation of an environment of consumerism. More basic issues of development were overlooked, which led to neglect of agriculture, deceleration of public investment in agriculture and in the flow of credit to agriculture, disdain for subsidies, whether food subsidy or credit subsidy, focusing on job-less growth, and disregard for the elementary principles of food security. I have documented the pitfalls of the reforms elsewhere.<sup>3</sup>

The "growth culture" itself seems to have gone through a fundamental change during this phase, with reformers fond of repeating parrot like the phrases borrowed from IMF/World Bank vocabulary: "There is no free lunch", perhaps meaning thereby that the poor must fend for themselves. The policy makers quoted with glee the American management guru James Goldsmith's well-known phrase: "If you pay peanuts, you only get monkeys". It required the collapse of the American financial icons – banks, insurance giants and mortgage houses in 2008 to realize that "even if you pay cashew nuts, you get worse monkeys". Chief Executive Officers (CEOs) of private corporate sector would say: "We have money: we have a right to splurge". Cumulatively, we appear to have sponsored sections of Society, to borrow the expressive phrase of Arindam Chaudhari, of "dehumanised materialistic consumer dust bins". The insensitiveness with which

some state Governments went about acquiring arable land, wrenching the small farmers from the land from which they were eking out their livelihood, for accommodating industries in the Special Economic Zones (SEZs) was appalling. "Industrialisation is what matters", the authorities seemed to argue. India, despite graduation to the league of fast growing economics in the world – even during the current world recession – continues to be abode of the largest number of under-fed and undernourished persons in the world. Recent FAO estimates show that the number of under-nourished people in Indian has risen from 206.0 million in 1990-92 to 230.5 million in 2003-05, an increase of some 24 million. But our reformers gloat over the fact that in the liberalized Indian economy today consumers can have the benefit of apples imported from Australia/ New Zeland, grapes / oranges imported from U.S.A and dog-food from France.

I would be content with citing four concrete instances to substantiate how the mindless pursuit of market theology during the phase led to deemphasize development: Food grains Management Policy, Inequitable Rate Regime, Fiscal Inequity and Import of Gold.

### **Food Grains Management Policy**

In respect of food grains management policy, what is disturbing is that India exported a huge quantity of 27 million tones of rice and wheat during the three consecutive years 2001-02 to 2003-04. This was the result of two regressive measures taken earlier: first, the Government introduces in 1997, targeting in the public distribution system (PDS) in the form of Targeted or TPDS. This narrow targeting of the PDS based on absolute income poverty excluded a large part of nutritionally vulnerable population from PDS. Second, due to the continuous raising of the issue price of food grains, the concessionally priced food grains became increasingly inaccessible to the poor. The inevitable consequence was the mounting food grains stocks with

the Food Corporation of India (FCI). At one time, the stocks reached a peak of 60 million tones. No wonder, our policy makers sought a soft option in exports for tackling the issue of the so-called "surplus foodgrains". This was nothing short of development atrocity. The irony was compounded further:

while the policy makers' ostensible objective was to reduce subsidies for domestic consumption of food grains, the same policy makers did not have any qualms about subsidizing exports of food grains! If Mahatma Gandhi were alive perhaps, one could speculate there would have been a satyagraha against such mindless pursuit of flawed food grains management policy.

Bikhu Parekh has admirably encapsulated the poverty profile, as sketched by the Mahatma, in the following paragraph:

"Second, poverty dehumanizes human beings, wastes the potential and deprives their lives of all sense of meaning and purpose. It is one of the worst violence that human beings can commit against other human beings. It is as bad as killing, and even worse for the fact that it is silent, slow and invisible, arouses no anger and is outside the purview of anyone's direct responsibility. As long as even one person is starved, is malnourished or lacks decent housing, the social order stands indicted lacking legitimacy. Basic human needs have the first claim on Society's resources, and it has an obligation to arrange its economic affairs in a manner that the needs of all members are met".<sup>6</sup>

In my Introduction to a book on agriculture, I wrote in 2006: "It was tragic enough for a predominantly agricultural economy not to be able to produce in the 1960s adequate quantities of food grains to meet the domestic consumption requirements of the population: it is perhaps a greater systemic tragedy today that even when we are able to produce adequate quantities of food grains we are able to produce adequate quantities of food grains we are unable to ensure that food grains so produced do reach the needy".<sup>7</sup>

Hunger and poverty are an affront to civilised society and subsidies are a characteristic of the civilized society. One begins to wonder whether we are dismissing poverty or reduction of poverty as mere phrases of a dialectic process, denying thereby its moral urgency of addressing the task.

### **Inequitable Interest Rate Regime**

These who pontificate on why the concessional lending rates do not help the poor, further expose their innocence of the realities of the present interest rate structure. Financial sector and banking sector reforms implemented in the 1990s have resulted in the emergence of an inequitable interest rate structure, a structure designed to pamper the private corporate sector, and which is biased against agricultural sector and the small borrowers generally. For instance, a small farmer was made to pay an interest rate of 12 percent at a time when highly rated corporate entity could raise money from banks at 6 per cent. This paradoxical situation was the result of mindless implementation of Basel norms and adoption without adaption of concepts like "risks" as understood in the developed world. RBI Report on Currency and Finance 2005-06 provides valuable insights into the structure of interest rates. The bulk of bank lending has been taking place, at Sub-BPLR (Benchmark Prime Lending Rate). For instance, the share of Sub-BPLR lending increased to 82 per cent by March 2007. While higher credit rated corporates are setting credit as Sub-BPLR rates, agriculture and small industry and other small borrowers are generally charged BPLR, or in some cases, above BPLR rates. To quote the RBI report "to compensate for Sub-BPLR lending, other segments are charged higher rates of interest, thus leading to cross subsidization of the economically well-off borrowers by the economically poor borrowers". This is indeed disturbing especially when the objective of both the inclusive growth in the real sector as envisaged in the

Eleventh Plan and financial inclusion is to promote growth with equity. Although this inequitable situation was mollified to some extent by the Government providing interest rate subvention since 2008-09 to ensure that farmers get short-term crop loan up to Rs.3 lakhs at 7 per cent, the basic issue remains. Interestingly enough, none of the reformers of financial sector has identified the problem. It is to the credit of Reserve Bank of India (RBI) that they brought out the problem in the open and appointed a Working Group, in April 2008 to look into the issue.

### **Fiscal Inequity**

The Indian fiscal system is distinguished by the fact that dividends received by individuals are totally exempt from income tax without any limit. Similarly, there are exemptions without limit, from long-term capital gains from the stock market. Thus persons receiving thousands of crores of rupees of dividend income are totally free from income tax, while those earning modest incomes from professions are taxed at high rates. These exemptions are sought to be justified on the ground that they foster the development of equity market. The ostensible rationale is that since corporates have already paid the tax, taxing dividend income of individuals would be tantamount to double taxation. This is a specious argument. In the idiom of public finance, corporates and individuals are distinct entities and hence they ought to be taxed separately. Dr. S. S. Tarapore, former Deputy Governor of RBI, has correctly argued that unlimited exemptions of dividend income are incongruous with distributive justice and are nothing short of fiscal atrocity.

### **Import of Gold**

One of the most retrogressive reforms introduced during the period is the liberalisation of the import of gold. The annual average level of imports of gold works out to a staggering figure of \$5 billion. Import of gold

is in a way definancialisation of savings: because financial savings which could have been channeled to productive purposes, would be diverted to unproductive investment in gold.. Today, in metropolitan and bigger towns there are more jewelry shops than grocery shops. Surely, the WTO did not prescribe the liberalization of gold imports. Even public sector banks are encouraged to sell gold coins. Are we exporting food grains to finance the import of gold? This is a clear case of perversion of priorities in economic reforms, or the ugly face of reforms – a face that has nothing to do even remotely with development. Nobody, of course, would advocate a total ban on import of gold but what is required is restraint on the magnitude of imports. Government does not have to go out of the way to encourage the import of gold.

Overall, these reforms like low interest rate regime for the corporate elite, artificial props to develop the capital market and exemption without limit for the dividend income from tax, reflect private corporate sector centered punditry. Milton Friedman syndrome?

Let me now briefly deal with the India – specific issues both in the financial sector and the real sector.

### III REVISITING FINANCIAL SECTOR REFORMS

What are the implications of the collapse of the American capitalist model, particularly the financial model, for India's reforms? Looking ahead, there is a need for introspection and for a vision on how to move forward: introspection because we have been trying to mimic the American financial model in reforming India's financial sector, particularly in the post-1990s phase. Vision, because in our unabashed attempt to Americanise the Indian financial system our high profile reformers have sadly ignored the nature of the structure of the Indian economy as it has evolved, and India – specific implications for growth. The imperatives of financial inclusion have yet to reassert themselves. Unfortunately, there has been far too much of mimicking American models and copying

"international best practices". It is high time that we must speak our minds freely about what is right and wrong with the reform path our policy makers have chalked out for us. Otherwise there is the danger that reforms might crumble under the weight of the egos of the establishment.

When the icons of American and European financial system-commercial banks, investment banks, mortgage houses, and insurance giants-collapsed like a pack of cards, what happened to the mythology built around the private financial institution like capital adequacy norms, Basel norms, provisioning requirements, asset-liability management, risk weighted lending rates, credit rating-all of which we have been trying to superimpose on our banking system? Why did not this paraphernalia of devices emit warning signals that the whole edifice is about to crumble? Professor Joseph Stiglitz, the Noble Laureate, in a recent interview to an Indian T.V. Channel said : "The U.S. financial system collapsed because we did not have a Dr. Reddy at the helm. "The reference here is to Dr. Y.V.Reddy, former Governor of Reserve Bank of India, and there cannot be a better tribute to the management of the Indian financial system. Even those Indian financial wizards who scoffed at Dr.Reddy's go slow policy towards structured financial products have remained to pray.

It is therefore important that we revisit the financial sector reforms and subject the blueprint for reforms to critical scrutiny in the light of these recent developments in the global financial scenario.

The blue-print for reforms has been provided by the Raghuram Rajan (RR) Committee which submitted its Report in 2008/09. These high profile reformers, whether it is the Narasimham Committee which submitted its Report in 1998 or the Raghuram Rajan Committee referred to above, share the following four characteristics. First, they are soaked in the marked theology of the IMF/World Bank: *Directed credit and credit subsidies should be shunned*. Second, they

demonstrate a congenital dislike of the public sector in the financial system. Third, their whole focus seems to be on mimicking the financial models of the West, particularly, the American model. Fourth, they lack a sense of India's financial history. Elsewhere, I have examined the RR Report at length and shown that its recommended reforms are unrelated to the India-specific socio-economic milieu and are inconsistent with the strategy of inclusive growth embodied in the Eleventh Five Year Plan (2007-2012).<sup>10</sup> The Committee's basic approach to financial sector reforms is flawed. The RR Report reflects faithfully the market theology of IMF/World Bank, ignoring the India specific strength of public sector dominated financial system. For instance, "The majority of this Committee does not see a compelling reason for continuing government ownership" of financial institutions including banks. The Committee has therefore recommended to begin with, selling small public sector banks to the private sector. In the global financial conflagration, when major private sector icons of banks and financial institutions perished both in the U.S. and Europe; the Indian institutions stood, rock-like, unharmed. Indian public sector banks have made us proud. How incongruous such illogical advocacy of privatization sounds in the light of global financial crisis.

As Governor of Reserve Bank of India (RBI) emphasizes: "India's banking system remains healthy, well-capitalised, resilient and profitable. Credit markets have been functioning well and banks have been expanding credit notwithstanding the perceptions in some quarters of lack of adequate credit from banks to the commercial sector".<sup>11</sup>

It is to the credit of the Indian public sector banks, that, they have been able to successfully blend the objectives of social banking with the market philosophy of optimizing profitability. It is time that our high profile reformers realize that banking efficiency is ownership neutral. Where is then the case for privatization?. There is very little intellectual support for such proposals

for privatization. In fact, the view is gaining ground that banks should be treated as public utilities.

In a similar vein, echoing faithfully the Washington consensus, The RR Report recommends the Reserve Bank of India (RBI) should abdicate its development responsibilities and concentrate exclusively on control of inflation. This recommendation also has, I have demonstrated elsewhere, no intellectual support.

Clearly, the RR Report should be set aside. Perhaps it would be useful to set up a new committee headed by "Dr.Reddy like experts" to provide an alternative blue-print for future financial reforms which would be in consonance with the inclusive growth strategy in the real sector. While on this subject a reference may be made to Professor Robert J.Shiller's work which advocates the democratization of finance or making financial markets "work for the benefits of the common person".<sup>12</sup>

### Three Core Issues

In the contemporary financial scenario in India, there are three core issues: inclusive growth or broad-based, decentralized growth in the real sector, the new architecture of the financial system to facilitate such growth, and the inequitable interest rate structure. Logically, the reinvention of the next generation financial sector reforms should have emerged from a holistic analysis of these three core issues. Judged by these criteria, high profile reformers have frittered away their energies on a random assortment of recommendations: some relevant, some not so relevant, mainly aimed at mimicking the "best practices" of banking in the developed world.

In terms of priorities, developing a market for complex structured credit products like credit derivatives, important as it is, can wait; but addressing these core issues cannot brook any delay in terms of food and employment security, and in terms of reducing poverty. As I have spelt out elsewhere, inclusive growth in real sector has now become a growth and

development imperative: Growth, because a high GDP growth like the 8 or 9 percent targeted in the Eleventh Plan (2007-2012) can be sustained only if other sectors or segments of the economy, which have been sluggish because of a number of reasons, including policy neglect, can be activated *and* Development, because this is perhaps the best route by which bulk of the poor can be provided with livelihood and food security. In other words, we can no longer depend on "autonomous" forces for growth of the real sector; this growth has to be policy-induced with a view to enabling sections of the population, whom the growth process has by-passed, to fully engage themselves with the development process. The trickle-down theory or percolation theory of growth is dead. While wealth may accumulate, men may decay. An interventionist and pro-active policy is therefore warranted. This should be the starting point for designing what are now called the next generation financial sector reforms. In this context, the contemporary experience of China is illuminating. China's Township and Village Enterprises (TVEs) provided increasing job opportunities outside agriculture and this phenomenal expansion of non-farm sector played a critical role in reducing poverty.

The unorganized sector holds the key to broad-based decentralized growth. The recent report on the sector spells out that micro enterprises-with an investment of below Rs.05 million constitute 94 per cent of small enterprises in the country and provide employment to 70 million people and contribute 30 per cent of industrial production. Some 40 per cent of exports are contributed by this sector. Despite occupying this central position, these enterprises receive only 2 percent of net bank credit.<sup>13</sup> If additional credit is injected into this sector, it may lead not only to higher production, but it may also promote up-gradation of technology, improvement in marketing efficiency, and so on.

The micro, small and medium enterprise (MSME)

sector has been affected adversely by the recent global financial crisis. MSMEs particularly related to exports like textiles and garments, gems and jewelry, have been facing problems like slackness in demand for their products and delayed payments of dues by large undertakings.

To ensure that the special problems faced by this sector are addressed, there is merit in the proposal to set up a dedicated Development Finance Institution (DFI) with a mandate to provide refinance to banks for on-lending to micro enterprises. Such an umbrella institution should be also able, in addition to facilitating adequate flow of credit, to provide consultancy services.

This sector needs specialized treatment because of another reason: it is an amorphous sector with at least three different segments each of which has its own problems. First, there is a wide range of informal enterprises like tailoring shops, tea shops, auto repair centers and flour mills. Second, enterprises in the growth sectors like housing, auto, white goods, pharmaceuticals etc. The third segment relates to exporting MSME units that have thrived on the global consumption boom. Many of these have been adversely affected by the present global crisis, as mentioned earlier. To cater to these segments the establishment of a dedicated development finance institution seems appropriate. This may facilitate extending the reach of lending institutions to this sector and also technological up gradation.

The *second core issue* is the institutional infrastructure. *Micro finance* is expected to play an important role in promoting financial inclusion and inclusive growth. It is a sort of supplementary credit delivery system that is cost effective and user friendly for both banks and the poor borrowers, RBI's initiatives in promoting this channel of credit delivery have centered around two models, namely SHG-Bank Linkage programme and Micro Finance Institutions (MFI) model. At the same time, the corporative credit

delivery have centered around two models, namely SHG-Bank Linkage programme and Micro Finance Institutions (MFI) model. At the same time, the corporative credit structure is being reorganized, on the lines recommended by the Vaidyanathan Committee. Similarly, the more recent developments reveal that regional rural banks (RRBs) could become the main institutional mechanism for providing credit to the poor. As Dr.Thingalaya, a professional banker who has made in depth study of RRBs, puts it: "The process of their merger at the state level, reducing the number from 196 to 96 has expanded their operational base considerably. The best among them like the Karnataka Vikas Grameen Bank or Pragathi Grameen Bank are comparable to the best grameen bank, anywhere in the world, including the much publicized bank of Bangladesh.....out of the 1.29 crore of borrowing accounts handled by them, 1.07 crore or 83 per cent are in the advances group of *Less than Rs.25,000'* .<sup>14</sup>

The blue print for the future institutional structure should clearly indicate how the pyramid comprising banks, RRBs, Co-operatives, micro finance institutions and self help groups (SHGs) needs to be built. Here again, there are regional variations. SHGs are more prominent in southern states like Andhra, while co-operatives are strong in states like Maharashtra. NGOs working in the relevant area may also be linked to the pyramid.

The final point is related to interest rates. At present, there is intense lobbying by the private corporate sector for further reduction in lending rates by banks. It is necessary to caution that this may prove counter-productive. If India's growth story continues to be intact, despite to global financial mess, it is because India has emerged as a high saving economy with gross domestic savings of 34 per cent of GDP. As the recent Growth Commission puts it: "Capital inflows over the past several decades have a mixed record. Our view is that foreign saving is an imperfect substitute

for domestic saving, including public saving to finance the investment a booming economy requires". In India, investment as a percentage of GDP increased from 25 per cent in 2002-03 to 38 per cent in 2007-08. Of this 13 percentage points increase, as much as 10 percentage points was financed domestically through higher household, public sector and corporate savings. As a result of reducing lending rates, recently, banks have already reduced deposits rates. If banks are compelled to reduce lending rates further, banks may reduce deposit rates even further. Such very low deposit rates and rates on savings accounts may eventually result in shrinking overall savings. This is particularly so because household sector is a major contributor to overall savings and household savings are sensitive to interest rates. We must guard ourselves against this danger.

To sum up, any blue print for future financial sector reforms cannot be meaningful, if it does not address these three core issues.

### **Pyramid of Rural Lending Institutions**

How should the financial system, particularly, commercial banks, respond to the challenge of facilitating inclusive, or, broad based and decentralized growth in the real sector? The answer to this question can be given in two parts: first, the coverage of households and second, the loan-portfolios of banks.

Is universal coverage or 100 per cent of coverage of households by banks, as the RBI seems to interpret it, the answer? I, for one, would demur. Banking sector resources are, and would continue to be, limited. Optimum utilization of banking sector resources demands a selective approach to credit extension. Ideally, credit should chase productive activities and universal coverage would be tantamount to de-hyphenating credit and productive activities: this would not augur well for facilitating inclusive growth. Of course, it is conceded that at present almost 40 per



cent of the adult population of the country comprising mainly those with low incomes and those without collateral are unable to access mainstream financial products. Hence capturing this section should be our long-term objective. In the meanwhile, if credit is made to chase productive activities, we would promote optimal use of banking sector resources. Spreading available resources too thinly, which universal coverage necessarily implies, may defeat this objective. Furthermore, opening “no frills” accounts with low charges may be reduced to mere tokenism. In fact this may add to transaction costs which may provoke banks to raise their general lending rates. The whole approach to universal coverage of households appears flawed. As we have emphasized, we must think in terms of a pyramid of rural lending institutions and financial institutions as a cooperative enterprise by all the institutions involved. Bank’s resources may be enabled to reach the rural borrowers, either directly or indirectly, through the use of multiple channels such as SHGs, MFIs, NGOs, farmers’ clubs, panchayats, etc., as Business Facilitators or as Correspondents.

Secondly, we need to prioritise sectors or segments of the rural economy which need credit support. Let me illustrate. Foremost among sluggish sectors is agriculture which is central to India’s economic development future agricultural growth will have to be necessarily water-centric. Five inter-connected programmes assume significance in this context: watershed development both macro and micro, rain water harvesting and conservation, renovation of traditional water bodies, improving water efficiency in public irrigation works, notably in canals, and promotion of micro irrigation technology like drip and sprinkler irrigation systems.

There is another heterogeneous bunch of projects related to rural development: animal husbandry, horticulture, fisheries, development of waste lands and forests, soil conservation, drainage and flood control, organic farming with organic seed and compost

preparation, food processing, storage, ware housing and marketing.

The moot point in providing a list of illustrative segments is that the loan portfolios of banks and other rural lending institutions must begin to reflect the more diversified credit support to these emerging segments and not merely support crop production, important though the latter will continue to be. This involves the inculcation of a new banking culture, with evolving of appropriate procedures and practices, for project identification, appraisal and monitoring.

The building up of the pyramid of rural lending institutions, including banks with all their multi-channels of credit delivery – should be the central theme of the new discourse on next generation financial sector reforms.

#### IV. THE REAL SECTOR

##### Rediscovering the Mahatma

The ambitious Bharat Nirman programme launched in 2005 – marks a radical departure from the Milton Friedman phase. Involving a massive investment of Rs. 1.74 lakh crore this is a time bound programme of rural infrastructure development focusing on six subjects: roads, drinking water, irrigation, housing, electricity and telephones. In a way, this symbolizes the beginning of the rediscovery of Mahatma Gandhi’s philosophy of rural development. This was subsequently supplemented by other flagship schemes for education and health. *Sarva Shiksha Abhiyan* for education, *Mid-day Meal* scheme providing cooked meals to school children, *Integrated Child Development Services* (ICDs) to promote nutritional supplement to children up to the age of 6 years. The Mid-day Meal programme covers some 15 crore children. Furthermore, the National Rural Employment Guarantee Act (NREGA) 2005, is the best thing that could have happened to the poor. This guarantees 100 days of employment in a year to every rural household. In 2008-09 it is estimated that about 4.5 crore rural

households benefited from the scheme. The culmination of these efforts is reflected in the National Food Security Act Programme proposed by the President of India in her Address to the Parliament on June 4, 2009. This Act seeks to provide a statutory basis for a framework which assures food security for all. Every family below the poverty line in rural as well as urban areas will be entitled, by law to 25 kilograms of rice or wheat per month at Rs.3 per kilogram. In the Budget Speech of June 6, 2009, the Finance Minister assured that the government will come up with the necessary Act and necessary provision or outlay for the programme will be made. Taken together, these measures go a long way towards meeting the basic needs of the poor- a goal set by the Mahatma.

The Budget Speech sums up the new approach to development: ".....the UPA Government has gone for a paradigm shift for making the development process more inclusive. It involves creating entitlements backed by legal guarantee to provide basic amenities and opportunities for livelihood to vulnerable sections. "Aam Admi" is now the focus of all our programmes and schemes". Are we recapturing the rhythm of our old growth song?

## **V. FROM PREDATORY TO COMMUNITY – CENTERED CAPITALISM**

The issue of predatory capitalism has assumed a contemporary relevance with the recent fall from grace of the American capitalist image. The word "predatory" is defined in simple terms "as addicted to, or characterized by a tendency to exploit or destroy others for one's own gain". Revelation of corporate crookedness and accounting scandals have shaken the very foundations of the American capitalist model. The depth of degradation to which unbridled corporate greed can lead to has become all too obvious. The Enron, World Com and Xerox and Global Crossing exposures have unveiled the ugly side of western style capitalism under which, in the quest for short-term

gain, wrong doings are overlooked. These developments cannot be dismissed, as some apologists of American capitalism seem to be doing, as isolated incidents. Professor Lester C. Thurow puts it as: "The Enron and WorldCom are not abnormalities in a basically sound system – scandals are endemic to capitalism". "The London Economist summed up the situation: "Chief executives and accountants have become a despised breed less trusted than politicians and Journalists". Again, take the current financial crisis in U.S. which started as a sub-prime mortgage crisis. in the U.S. which started as a sub-prime mortgage crisis. The litany of actors involved and the sharp practices followed is long. A fast growing new breed of lenders was luring many people into risky mortgages they could not afford. With incentives for aggressive loan disbursement, banks poured billions of dollars of loans into poor households often with incomplete documents. The unquestioned faith in the status of triple-A credit rating led to buying of billions of structured bonds which later turned out to be worth nothing, since the market for a number of structured products became non-existent during the period of financial meltdown. Thus not only mortgage houses, but investment banks, accountants and credit raters were also involved in the melo-drama. Have the financial professionals also joined the breed of CEOs mentioned above by the Economist?

The CEO of one of the bigger banks which was sinking helped himself to hefty bonus. There was public outrage that some executives of an insurance giant were helping themselves with handsome bonuses from out of the bail-out package extended by the U.S. government. The automobile giants Ford, Chrysler and General Motors went in their private jets to seek aid from the Congress! The peanuts – monkey philosophers could do well to ponder over the statement of the Financial Services Authority in the U.K. that overgenerous remuneration practices in the financial industry contributed to the market crisis, since

they motivated staff to pursue “unduly risky practices”. The multimillion dollar bonus culture of investment banks has been blamed for contributing to the risky behavior which brought about the near-collapse of the world financial system.

Contrast this with the important revolutions that India witnessed since Independence: the Green Revolution of Dr.M.S.Swaminathan, the White Revolution of Dr. Verghese Kurian, Telecom Revolution of Mr. Sam Pitroda, the Satellite Revolution of Professor Yesh Pal and the IT Revolution of Mr.Narayan Murthy. None of these were paid princely salaries nor were they motivated by the million rupee bonuses.

Fortunately, such predatory capitalism is now dead and today’s prophets of private sector philosophy disagree with Friedman. Take the case of Coca-Cola Chief who represents the not so pretty face of American capitalism, scarred as it is by the recent Enron and Enron like episodes, redefines corporate responsibility. As guest editor of Economics Times, Mr.E. Neville Isdell wrote:

“The future of a 21<sup>st</sup> century company is tied to the health of the community and our planet. Some leaders may consider sustainability work to be in a company’s enlightened self-interest. I disagree. In ways that will determine our ability to achieve consistent, global growth and profitability it is quite literal self-interest”. (Editorial, March 17,2008). Water is the main ingredient of Coca-Cola and lack of public access to clean water is a serious problem in many communities where Coca-Cola factories are functioning. Hence the objective of the Coca-Cola company has been to return water used in its manufacturing process safely to the environment. In India the company is installing more than 100 rain harvesting structures in 17 states. Contrast this with the rapacious mining in the colonial era by foreign companies; for example, copper mining in Zambia or gold mining in South Africa. One hopes that such community-centeredness becomes in future, the focus

of the functioning of private corporate sector, both Indian and foreign.

Mahatma Gandhi had distilled the core of Indian philosophy from our ancient scriptures and evolved his own philosophy. In addition to basic needs of the common man being the first charge on the Society’s resources, he had another important ingredient: the concept of trusteeship. We should hold our wealth as trustees and not as exclusive owners, so that this wealth is available for sharing by others who need it most. Dr. Swaminathan would like to add intellectual property rights as well to the concept of wealth.

From times immemorial, Indian philosophy has maintained that the all-round development of society is best achieved through betterment of the individuals which no doubt includes economic well- being but extends well beyond it. Social conscience must be inculcated among individuals through education at all stages and also professional training. All individuals must be sensitized, at their young age itself, to abject poverty, the squalor, disease, ignorance and illiteracy that surround us. They must begin to think in terms of what is our *dharma* or duty towards alleviating some of the infirmities that affect our less fortunate fellow human beings. Some Asian countries, recently, have introduced in school textbooks lessons on corruption. But that is a narrow and negative concept. We must aim at building a holistic concept of the right conduct.

One of the ancient scriptures of India the *Brihadarnyak Upanishad* enjoins us that our life must be guided by the following three “*Das – Damyata*, that is control yourself, “*Datta*”, that is give to others, and “*Dayadhvam*”, that is be compassionate. Thus we must practice self-control, charity and compassion. Collectively, these three characteristics constitute development conscience.<sup>16</sup> Building up such conscience among all section of the population would go a long way towards evolving a compassionate Society – an ideal which the Mahatma sought to achieve.

Incidentally, it is interesting to add here one point that modern social analysts have been confirming, year after year, Denmark's status as a "happiness superpower".<sup>17</sup> The secret of this achievement is low expectations of Danes who are not trapped in the hedonic treadmill. This modern research merely endorses what traditional Indian philosophy has been advocating centuries ago. It was left to Mahatma Gandhi to distil this wisdom and evolve a practical programme of a code of conduct.

## VI. RE-ORDERING OF PRIORITIES

The current chorus of the powerful lobby seems to be that freed from the Marxist's shackles; the new UPA government should rush in to implement liberalization reforms. What does this articulate lobby mean by reforms? Disinvestment, privatization of public sector banks (PSBs); a bigger role for foreign direct investment (FDI) in retail, insurance, aviation and banking; dilution of government equity in profitably run state entities; making Mumbai an international financial centre where multinationals could freely enter; merger of the associate banks of State Bank of India (SBI) with the parent bank so that this bank could compete internationally, based on the principle "too big to fail", and so on. Are the ghosts of Milton Friedman still haunting our reformers and articulate lobbies?

In the post-collapse phase of the American capitalist model at least, we should be convinced that there is no intellectual support for privatization *per se*. Diluting public ownership of undertakings is, of course, quite another matter. In this context, it is appropriate to quote the following paragraphs from President's Address to Parliament on June 4, 2009:

" Our fellow citizens have every right to own part of the shares of public sector companies while the government retains majority share holding and control. My Government will develop a road map or listing and people – ownership of public sector undertakings, while ensuring that government equity does not fall below 51% " *People – ownership* is the *keyword*.

Interpreted in terms of the Mahatma's broad principles, the new Government should shed the inherited ideological baggage and address the more mundane India specific issues both in the financial and real sectors. I have already outlined the financial sector priorities and let me end my lecture by briefly indication the kind of real sector reforms needed on a priority basis. There are three issues in the broader area of food and water security: watershed development, rural employment and food grains management.

First, even today about 60 per cent of the total cultivated area is rain fed and hence future agriculture growth will have to be necessarily water-centric. Watershed development is the mother of all water management modes and today it is seen as the principal strategy for holistic development of rain fed areas. Even though we have been making a lot of noise about the programme, in terms of dimensions involved, the progress is tardy. We should therefore promote a massive programme aimed at covering say 50 per cent of the total eligible area in the next two years. We could designate the two years 2009-10 and 2010-11 as Watershed Development Years.

Second, National Rural Employment Guarantee Act (NREGA) 2005 is the best thing that could have happened to the rural poor. Happily, the Budget for 2009-10 envisages the expansion of the scheme. Rural connectivity, water harvesting structures, drought proofing, minor and micro irrigation works are among the activities undertaken under the scheme. Perhaps, it would be good to mandate this scheme to concentrate on watershed development activities in the next two years in the rain fed areas.

Taken together, these would go a long way towards providing water and food security to the poor.

Third, there should be no exports of food grains, except some small quantities of high value commodities like Basmati rice. Domestic consumption should have the first claim on our production of food grains. Before the threat of bad monsoon during the current year, there was some talk of export of 2 million tones of

wheat. Hence this position needs to be reiterated. Furthermore, the Food Corporation of India (FCI) needs to play a pro-active role in the management of food grains prices. We seem to treat FCI as glorified go down keeper. Instead, it should emerge as a market. For instance, with its present huge stocks of rice and wheat of around 50 million tones, it should ensure that food grains prices in the open market do not rise to high levels. It should be able to identify pockets of high price rises and by unloading appropriate quantities of food grains in those pockets, it should seek to bring down prices. Thus it should be able to contain food grain prices within a reasonable band, Finally, forward trading in food grains should be banned. Farmer's decisions regarding crop planning and investment are guided by minimum support prices (MSP) rather than by forward prices.

## VII. SUMMING UP

It is an irony of economic history that India which was a pioneer in emphasizing "growth with equity" in its approach to development, much before mainstream development economists caught up with it, should have relapsed into a phase of mindless pursuit of market theology. The period of economic reforms from 1991 to 2004 was the most retrogressive phase, a phase which I have called the Milton Friedman phase. Although India graduated to a high growth league during this phase, it had to pay a heavy price. While wealth accumulated, men decayed. The number of under-fed and under nourished people in India rose from 206 million to 230 during this period. The growth culture itself became toxic. A huge quantity of food grains was exported, at a time when the number of under-fed persons increased. Policy makers of the time condemned subsidies for domestic consumption of food grains: but they have no qualms about subsidizing export of food grains. The interest rate regime which emerged as a result of reforms pampered the corporate elite and discriminated against the small borrowers, generally. There was fiscal inequity again

designed to pamper the dividend earning elite.

The launching of Bharat Nirman Programme in 2005 marked a radical departure from the Milton Friedman phase. Our policy – makers, it appears, began to rediscover Mahatma Gandhi. There was the Mid-day meal programme for school children, nutritional supplement to children up to age of 6 years and so on. The National Rural Employment Guarantee Act, 2005 was the best that could have happened to the rural poor. The culmination of this journey towards holistic development is the proposed National Food Security Act. I have called this phase the Mahatma Gandhi phase.

There is no generic formula for growth. "Each country has specific characteristics and historical experiences that must be reflected in its growth strategy". That is where the philosophy of Mahatma Gandhi for evolving a compassionate society with a value system which resonates to these Society's larger concerns acquires contemporary relevance. The collapse of the American capitalist model in 2008 now warrants that we move away from predatory capitalism to what can be broadly described as community centred capitalism. Let us not be trapped into hedonic treadmill. Our contemporary policy-makers, should realize that economic efficiency is ownership neutral. There is no intellectual support for privatization *per se*.

Viewed against this broader background, our agenda for reform would warrant a re-ordering of priorities. And I have sought to indicate what such re-ordering means both in the real and financial sectors.

The Journey towards holistic development takes us well beyond growth models. Evolving a compassionate society, for which the Mahatma struggled, involves betterment of individuals whose life must be guided by the three "Das – Damyata, Datta and Dayadhvam: practice self-control, charity and compassion.

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