# Economic Policy Reforms: A Stock Taking

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(Views are personal)

Soon after the UPA Government took office, the stock market crashed because investors expected a sharp slow-down in reform, given the UPA's dependence on left parties. At that time, I had written that in areas in which markets were expecting a halt in reform namely labor laws and PSU privatization, there had been little actual policy action in the previous 2-3 years. So, even if there were no labor policy reform this would not amount to a slow down. Further, though privatization was ruled out, disinvestment of shares was still possible. These unjustified apprehensions were dispelled after the first budget and the market recovered and exceeded expectations in the subsequent six months.

Taking stock of the entire one-year period, the pace of reform has been in line with the average pace seen since 1992-93. Once the crisis driven spurt in 1991-92 was over, the pace of reform has been modest under every government. This slow and steady pace has continued under the UPA government. For instance, the SSI reservation list has been gradually reduced with the removal of remaining labor intensive textiles and other exportables. Similarly peak non-agricultural tariff reductions have continued with a reduction to 15% in the last budget.

There have also been sporadic policy reform initiatives from other ministries. Thus the FDI limit in domestic airlines was raised to 49% and in Telecom to 74%. In Telecom indirect channels of foreign investment were simultaneously closed thus increasing transparency. The permission given to private Indian airlines to fly on foreign routes and the open skies agreement with the USA could transform foreign air travel over the next few years. One hopes that private investment in upgrading major airports will finally get underway after 5 years of policy circumlocution. The SEZ law could similarly have resulted in a revolution in labor intensive exports, but the dropping of the labor clause has made this a little uncertain.

The performance on tax reform has been mixed. In CENVAT the reduction in rates on polyester etc. has been offset by a move away from genuine CENVAT in textiles. Income tax reform has been a mixture of simplification (saving exemptions) and new complexity (securities transaction tax, fringe benefit tax). The latter will have to be reformed 5 years later. The harmonization of States' sales tax rates that passes under the name of VAT has finally got under way, a great political achievement. From the economic perspective however, a genuine equitable State VAT that simplifies the system by replacing all indirect taxes requires a uniform 10% rate on all goods and local services except food, drugs and medical equipment/ services. This has to be complemented with a handful of sales taxes on final consumer goods (e.g. entertainment, petrol, cars) as argued in Planning Commission Working Paper No 4/2002-pc.

One of the predictions that I made at the start of PM Manmohan Singh's Government is that given his depth of understanding and commitment he would be a Prime Minister who would pay greater attention to long term and difficult issues like governance reform. This process has indeed been initiated and a few things like the 'Right to information Act' already passed. But there is still a long way to go and I expect that in the remaining four years further action will in fact be taken.

Most new governments take at least a year to find their feet and get going on policy reforms. As this was the first year of the Government and given the novel political arrangements in which the leader of the major government party is not the Prime Minister, it was perhaps inevitable that the Government would take a little time to settle down. It is hoped and expected that the pace of reforms will gradually accelerate over the next couple of years.

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