



The Vision Thing: Where do we go from here?

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Previous talk

- India has slowed considerably.
- Investment has been slowing for a long time, but consumption has joined in.
- Legacy problems such as financial or power sector stress have not been fully resolved and financial stress is growing again.
- The lack of sustained reforms since 2004, especially in improving the quality of, and access to, factor markets such as land, labor, logistics, and power is
 - Holding back investment
 - Reducing job growth
 - Reducing income growth, increasing borrowing, and reducing consumption growth
- Ill-conceived actions like demonetization and poorly executed ones like the GST rollout have further stressed the economy.
- India cannot sustain spending on its expanding welfare programs without growth. Something will have to give.



This talk: Political economy

- Why did Modi I not do better on the economy?
 - Because the government is extremely centralized and the leadership does not appear to have a consistent articulated vision on how to achieve economic growth.
- Is Modi II's enormous majority a sign that the Indian public does not care about economic performance?
- What kind of political economy model is best for India's stage of growth?
- In reviving growth, how can India help strengthen that political economy model?

Why has Modi I not done better?



- “Minimum government, maximum governance” has been misunderstood
 - It is about enhancing government efficiency rather than liberalizing and reducing role of government.
- Indeed, significant centralization in Modi I and enhancement of PMO and bureaucratic powers contrasts with significant decentralization in UPA I and II: neither works well.
- In Modi I & II
 - PMO all powerful and works through bureaucrats
 - Ministers are disempowered for the most part
 - But bureaucrats typically unwilling to take decisions on their own – especially given vigilance actions against past bureaucrats.
 - Everyone looking up for orders but PMO has limited capacity even if it works 24/7

Why has Modi I not done better?

Paralysis compounded by uncertainty about overall economic vision at the top, mixed follow-through below, and limited coherence in actions.

- Strong political vision, less clear what the consistent economic vision is – markets/state, protectionist/open, liberalizing/populist.
 - Lack of a consistent vision ok if not so centralized.
- Total dependence on top leadership for ideas means periodic “bold” actions, which have not been carefully analyzed or prepared for. These can be problematic.
- Bureaucratic follow-through perforce limited to numerical targets – number of bank accounts opened, number of toilets built, etc. rather than the broader goal of usage and outcomes.
- Actions can work at counter-purpose
 - Bankers told to take commercial decisions, yet given numerical targets for MSME loans per branch, and now asked to conduct melas.
 - Intervention but not interference: Distinction without a difference
 - Bureaucrats need to take decisions without fear or favor, but predecessors who worked for prior governments are subject to roving inquiries. Former finance minister held in jail for “custodial investigation” for over a month.
 - Dangerous precedents being set
 - Desire to attract foreign direct investment, but succumb periodically to unexplained protectionist actions.

Why has Modi I not done better?



- Government capacity is weak
 - Needs a first world administration, with the best in the land brought into governance.
 - Not enough specialists/experts, and insufficient training of existing officers
 - Levels of integrity and motivation vary considerably
- These have always been problems but compounded by Modi I's emphasis on bureaucratic control rather than liberalizing to harness the energies of the private sector.
- Bottom line: India cannot be run solely from the top or the center.



This talk: Political economy

- Why did Modi I not do better?
- Is Modi II's enormous majority a sign that the Indian public does not care about economic performance?
 - No: what the public experienced was good enough but the trajectory is unsustainable
- What kind of political economy model is best for India's stage of growth?
- In reviving growth, how can India help strengthen that political economy model?

Why did Modi II come back with such a large majority?

- Do economic outcomes not matter?

Here are some conjectures as to why the slowdown did not seem to affect voting behavior

- Modi I had a relatively clean public reputation despite allegations of corruption such as the Rafale deal and the administration's alleged closeness to some industrial houses.
- Populist attacks on the rich and elite helped sell unorthodox policies widely
 - Demonetization a political success even if an economic debacle
- Consumption growth, supported by borrowing and transfers, as well as household friendly measures, gave people a sense they were better off, despite few deep reforms (unlike NDA I).
 - But this trajectory is unsustainable – need incomes on household side to support consumption and revenues on government side to support welfare – both need strong growth.
- Superb social media machinery helped sell the government's performance widely, while adverse statistics were buried or denigrated.
 - WhatsApp messages now extoll the virtues of 5 percent growth and many think rumors of a slowdown are fake news
- In a classic populist nationalist move, Prime Minister Modi changed the subject from economics to national security before the election.



But is majoritarianism good for national security?

- Post election Modi II emphasized majoritarian issues (Triple Talakh, Kashmir) while the budget and economic revival seemed to go on the back-burner.
- Majoritarians want national integration on their terms.
 - In India, this means universal imposition of Hindutva
 - It sells well with Hindus who believe minorities are privileged.
- Yet majoritarianism is intrinsically divisive.
 - By setting impossible terms for minorities to be considered true citizens it alienates them.
 - “A house divided against itself, cannot stand” – Abraham Lincoln
 - Will India be more peaceful and strong if it engages with protected minorities and charts a common consensus for change, or if it imposes a majoritarian wish-list on them?
- India’s freedom fighters, led by Gandhi, believed mutual tolerance and respect leading to internal cohesion was the only option for a diverse nation like India. This reflected considerable thought, and should not be cast aside lightly.



Economic strength, national cohesion, and national security

- India's leaders are welcomed internationally today, not just because of the force of their personality, but because they represent a 1.3 billion strong market democracy that is growing fast.
- Any change in the underlined words will quickly change their reception and India's friends in the world.
- Returning to the Hindu rate of growth will reduce India's capacity to protect itself against external threats of domination.
- In the long run, internal cohesion and economic growth rather than divisive populist majoritarianism will be India's route to national security.
 - May win elections but is taking India down a dark and uncertain road.



This talk: Political economy

- Why did Modi I not do better?
- Is Modi II's enormous majority a sign that the Indian public does not care about economic performance?
- What kind of political economy model is best for India's stage of growth?
 - Is it building on the direction Modi I took?
 - No, we need to strengthen our democratic institutions and reverse creeping centralization.
- In reviving growth, how can India help strengthen that political economy model?



What political model works?

- Many Asian economies were more autocratic when they started growing.
 - Catch up growth compatible with centralized direction
 - Low-capacity governments find it hard to grow while respecting democracy
- These economies democratized as they traversed middle income and approached the productivity frontier. Why?
 - Increasingly educated masses demanded democracy?
 - Innovation requires free speech?
 - Competitive economic markets require competitive politics and vice versa?
- Whatever the reason, there are no rich countries that are not democratic except for the oil kingdoms



Is India better off becoming authoritarian?

- India is still relatively poor.
- It needs infrastructure.
- An authoritarian government can build roads and bridges quickly while stifling political protest at land expropriation.
- It can suppress domestic deposit rates, lower commercial lending rates to favored industries, and intervene in the exchange rate to foster export-led growth.
- India can eventually democratize again, but only after reaching middle income. So why not accept more authoritarianism?
- But will an authoritarian India embrace the East Asian model with its (usually) happy ending?



Authoritarian India – more likely Latin American than East Asian

- Given where India is, and the experience of the recent past, India is arguably more likely to embrace the Latin American model of populist spending to buy legitimacy, and foster cronyism, rather than the East Asian model of consumption-suppression and investment-and export-led growth.
- Authoritarianism could thus slow India's growth further.
 - It is also intrinsically bad from many other perspectives including the instrumental value of democracy, and the need for social justice.
- It is a poor model for further growth when India does make it to middle income.
- India needs to strengthen its democracy and its institutions rather than giving in to the illusory allure of authoritarianism.
 - Democracy not just elections. It is how they are conducted, how they are reported, as well as what happens after – illiberal democracies.

If so, India is going in the wrong direction...



- Because institutional checks and balances are weak in India, and the private sector, including the press, largely kowtows ... because government has so much ability to favor or hurt them...every government in India with a massive majority runs the risk of becoming authoritarian
 - Especially if it is built around a single personality such as Indira Gandhi in 1971 or Narendra Modi in 2019
- Key is whether the government erodes checking institutions or strengthens them? Recent actions do not inspire confidence.
 - Behavior of investigative agencies and tax authorities
 - Surprising number of opposition politicians have tax cases or corruption cases filed against them before relevant elections.
 - Behavior of Election Commission – a tax investigation seems to have been opened against the wife of one commissioner who dissented
 - Behavior of high judiciary that was so active in the past
 - E.g. High judiciary has not pronounced on the constitutionality of changes in Kashmir, or on the continuing restrictions on a sizeable number of citizens there.
 - Contrast with UK Supreme Court pronouncement on suspension of Parliament



Equally concerning, further constitutional centralization.

(adding to the centralization in the way the current government is structured)

- India's constitution gave the center substantial powers, believing unity was critical in an emerging nation.
- India has achieved substantial unity. Increasingly, the issue will be managing diversity among its various states and sub-regions.
- Arguably, decentralization offers a way forward, including checking the power of the center.
 - Neither weak center nor an overly strong center
- Recent actions unfortunately reduce powers and funding of states.
 - Converting Kashmir into an union territory
 - Terms of reference of 15th Finance Commission
 - Growing use of cess in Union budget (not shared with state) while taxes (and cuts) are.
- Center not only culprit: The local leg of government was strengthened with the 73rd and 74th amendment to the constitution, but local bodies still have relatively modest powers and funds.
 - States have not devolved power further down.



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- What kind of political economy model is best for India's stage of growth?
- In reviving growth, how can India help strengthen that political economy model?
 - If the current model is unsustainable, it will have to stop. What is my wish list for a replacement?



If it were politically feasible...

- Till recently, the trend in India has been towards greater democratization and decentralization.
 - Need to resume traveling on this path
- Strengthen the institutions that are critical to democracy by further de-politicizing the appointment of their leadership and reducing interference/intervention in their functioning.
 - Supreme Court, investigative agencies, bodies like CAG, CVC, CIC, VCs of universities, etc.
- Devolve more funding from center to state to local bodies, much as every Finance Commission has advocated in the past.
 - Devolve powers based on the principle of subsidiarity



If it were politically feasible...

- Enhance public's ability to hold government at every level accountable for services it is entitled to as well as the way it spends public money.
 - Local police paid by local funds will be much more sensitive to local needs
- Reduce the government's ability to arbitrarily interrupt, facilitate, investigate, or fund economic activity.
- I will focus on the last, embedded in an economic plan for revival.



Turning to the economy...

- Deal immediately with stressed sectors.
- Improve functioning of factor markets.
- Prune some regulations while improving others.
- Reduce public sector presence.
- Re-embark on steadily reducing trade barriers and tariffs.
- Put central and state budgets back on FRBM Review Committee path.



Deal immediately with stressed sectors.

- Talked about the twin balance sheet problem in last lecture.
- Financial sector stress spreads: Formulate targeted plans to revive distressed firms in construction/real estate/infrastructure and amongst NBFCs
 - Scrutinize stressed developers and NBFCs carefully.
 - Private sector shareholders will have to bear substantial losses and may be wiped out.
 - Government may need to find buyers/get owners to recapitalize stressed firms.
 - Auction distressed firms for minimum capital subsidy demanded by reputed players
 - Some assets (e.g., apartments) will have to be held off the market in special purpose vehicles that will unload them slowly.
 - Some arbitrary decisions are unavoidable, so transparency and oversight, without impeding speed of action, are essential.



Deal immediately with stressed sectors.

- Implement specific reforms to revive
 - agriculture
 - power
 - banking & NBFC
- Many committees have opined on each of these, Abhijit and I have a book with suggestions from 13 economists & I am happy to offer details in the Q&A



Improve functioning of factor markets

- Labor market
 - Allow for multi-year fixed term labor contracts, renewable at end, with severance pay increasing linearly. This will facilitate mutual investment and longer term relationships with contract labor, without enforcing permanence.
 - Remove labor law penalties to increasing the scale of firms
 - Encourage various corporate worker training initiatives, including apprenticeships and partnerships with technical colleges.
 - Ensure accumulation and portability of benefits, including through self employment.



Improve functioning of factor markets

- Land market
 - Improve access to land for development
 - computerized land mapping
 - government-guaranteed titling
 - the creation of land banks including waste land, land occupied by defunct enterprises, excess psu and government undertaking land.
 - Reform Land Acquisition Act (2013) based on best practices in states
 - use of auctions for land acquisition
 - schemes for sharing future improvement in land value between buyer and seller, etc.
 - Create Special Economic Zones, not necessarily with a sole focus on exports, but also for domestic production.
 - Easier access to land, improved infrastructure and environmental clearances in such zones can accelerate investment.
 - Can be venue for experimentation for regulation and laws before rolling out all-India.



Prune some regulations while improving others.

- Reform is not just de-regulation but better, enforceable regulation.
- Prune entry- and competition-inhibiting regulations.
 - Competition authority should ensure level playing field between private, public sector, and foreign entities.
- Improve regulations focused on workers' and public's safety and environmental sustainability.
- Some competition between empowered states on regulation will be healthy.
- Detail regulatory mandates, strengthen independence of regulatory institutions, while holding them accountable to their mandates via oversight committees staffed by non-political public citizens.
 - Have transparent checks on regulatory performance and measures of behavior of specific officers.



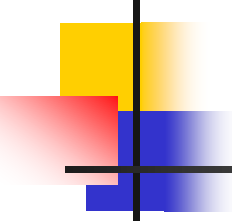
Reduce public sector presence steadily

- Confine public sector presence steadily to sectors where essential.
 - Restructure with a view to privatizing, or shut down.
 - Delink remaining entities from the state while strengthening their public governance.
 - Can have different mandates but pay for them.
 - Don't restrict/alter their operation based on ownership – range of functioning should be ownership neutral.



Steadily reduce trade barriers and tariffs

- Re-embark on steadily reducing trade barriers and tariffs while negotiating for open markets for Indian exports.
 - Focus on non-traditional exports like education, healthcare, and tourism
 - Have a transparent institutionalized process for changing regulations/tariffs



Put central and state budgets back on FRBM Review Committee path.

- ...in line to achieve deficit (5%) and debt (60%) targets, with some allowance for slippage over the cycle
 - Coming clean on window-dressing while committing to bring budget back on track, may give a little more scope for spending today.
- Simplify and rationalize tax code.
- Raise compliance without unduly empowering tax officers, using IT and data.
- Free up public resources for investment through privatization and asset sales.
- Target welfare spending better, move to consolidated cash transfers where possible, and reduce government provision where ineffective.
- Account for contingent liabilities, including on financial guarantee schemes, pensions, and healthcare.
- Create more transparency on government spending on private sector.
 - E.g. Press advertisements, grants to NGOs and private universities
- Create a Fiscal Council to opine on budgetary assumptions and challenges.



Why would all this increase democratization?

- It places checks and balances on the government, including its ability to influence the private sector.
- The private sector becomes more efficient and independent, and has more certainty about outcomes, promoting investment and jobs.
- An efficient independent private sector can serve to check government instead of simply aiding and applauding the policies of the day.
- Foreign investors will also flock in, bringing new technologies and capital, and the need to keep them interested will prevent arbitrary government policies.



Conclusion

- Economic adversity is a terrible thing to waste.
 - It offers scope for substantial reforms.
- The government has a tremendous majority.
 - It can always decentralize more, while strengthening institutions. Unfortunately, there is no pressure on it to do so.
 - It can revitalize growth, and if it does so relying on market forces, these will help further democratize India.
- Or it can stay on the current course. Apparent political success may divert its attention from the growing economic stress.
 - Without stronger growth, distributive policies, which have been quite effective, will overwhelm revenues, driving the economy into a hard corner.
- Time will tell...