The reform conundrum

The government must reach out to Opposition parties to get the reform process moving

In my last column, I wrote of the need to clarify what we mean by Make-in-India. If indeed it is taken to make India the investment destination by reducing the transaction costs and improving the ease of doing businesses, a number of measures have to be taken to both alter the structure of incentives and creating an enabling environment. In particular, improving competitiveness of Indian manufacturing requires institutional reforms, provision of state of the art infrastructure and getting the prices right. Institutional reforms are to ensure proper structure of incentives and accountability, effective regulatory system which does not hinder development and avoiding price distortions by moving away from the regime of determining prices through administrative fiat. The question that can legitimately be posed is: Despite the rigidities and constraints, how has the Indian economy recorded an average of over 7.1% growth since 2001-02 and over 8% during the last decade? Does this mean the economy will continue to register high growth without reforms?

A careful analysis shows that growth acceleration since the dawn of new millennium was mainly due to acceleration in infrastructure investment, particularly through public-private partnerships and investor-friendly policies followed by the Vajpayee government. The focus on the development of highways and large investments undertaken though PPP had major spinoffs in terms of improving the infrastructure and opening up the economy to markets. Not surprisingly, there was steady acceleration in the growth rate and as the momentum was maintained even during the UPA I regime. There was a steady increase in savings and commensurate increase in investments. The ratio of gross domestic savings-to-GDP increased steadily from 24.8% in 2001-02 to 36.8% in 2007-08, and the increase in gross capital formation relative to GDP during the period was up from 25.7% to 38%. This was mainly on the strength of increases in public savings from minus 1.6% to 5% and in corporate sector savings, from 3.3% to 9.4%. The aggregate fiscal deficit reached the lowest level of 4.5% in 2007-08, and this helped to have a low-interest rate regime. Exports were buoyant due to benign international environment, the country recorded more than 9% growth in three consecutive years from 2005-08.

The constraints on growth started with the electoral budget cycle. The budget of 2008-09 which projected a fiscal deficit of 2.5% at the Union level, actually ended up with a deficit of 6.5% due to large outlays on public sector pay revision, farm loan waiver and expansion of rural employment scheme from 200 districts to the whole country. With oil prices shooting up in July 2008 and unwillingness of the government to pass on the burden to the consumers, there was a proliferation of subsidies and transfers resulting in ballooning fiscal deficit. Rising commodity prices, high fiscal deficit putting upward pressure on the interest rates and global financial crisis striking in September 2008, the constraints on growth became binding. However, the consumption-type stimulus created by pay revision, loan waiver and expansion of employment schemes along with election expenditures created a huge aggregate demand to increase the growth rate in the next two years, but that could not be sustained as both saving and investment started declining.

M GOVINDA RAO

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The policy and institutional constraints on growth became binding during UPA II. The ballooning fiscal deficits and raging inflationary environment forced RBI to maintain high interest rates. The environmental activism and poor environmental governance posed bottlenecks in implementing infrastructure projects. The chorus against land acquisition which started with Nandigram gained political currency and every political party wanted to be seen in the "right" side, resulting in the passing of the obstructive land acquisition Act of 2013, making it difficult not only to the new but even ongoing projects. The widespread illegality in mining and the Supreme Court's decision brought about the entire sector to a standstill. With land acquisition becoming increasingly difficult and costly, and fuel supply to power generating companies constrained, many of the projects got stalled. The external environment continued to be difficult and the CAG reports on the allocation of spectrum and coal blocks virtually brought about a policy paralysis.

The situation today is much different from the one existed when UPA I was in power. Inability to shift the labour to manufacturing sector will continue to put pressure on the farm sector and rural areas and restrictive labour laws was continue to dampen labour intensive manufacturing and exports. This is a tragedy for, at a time when the labour costs are increasing in China, a more flexible labour market in India could have helped to expand manufacturing output and employment. With rising awareness and costly process of land acquisition in place, it would become increasingly difficult to acquire even the unproductive land for industry. The infrastructure woes continue to plague the country due to the stalled projects, increasing non- performing assets of the commercial banks and poor fortunes of the electricity distribution companies. The government continues to be in the election mode, even after winning the election and both the government and opposition seem to be engaged in a perennial war. Rather than getting the opposition to work with it to get the Bills passed through negotiation and dialogue, it continues to be in a mood to spike it. It seems to have forgotten that the mandate for it was development, and not flogging the dead horse and losing credibility fast. Ultimately, it is the people, not the political parties that suffer.

To come to the questions raised in the beginning, we desperately need the reforms if we have to sustain high growth of the economy. This is because transition to labour-intensive industrialisation is not possible unless flexibility is brought into the labour market which will enable moving the labour away from land in rural areas to engage in productive employment in manufacturing. It is important to enable acquisition of land unsuitable for agriculture with ease by paying suitable compensation. Binding constraints on infrastructure will have to be removed and this requires, besides policy and institutional changes, substantial infrastructure spending and this has to come from both by augmenting capital expenditure by the Union and state governments and reviving implementable model concession agreements for PPP.

The important point is that reforms in both policies and institutions are inevitable for achieving sustained high growth and in the prevailing situation this cannot be achieved by continuing the confrontational approach. What is important is that the government should have a strategic vision, move away from the election mode, reach out to the opposition parties through negotiation and dialogue and get the reform implementation process moving. It is not winning the war with opposition or comparing whose misdemeanours are of greater magnitude that is important. What matters to the people of India is improvement in their living conditions.

The author is member, 14th Finance Commission, emeritus professor, NIPFP and advisor, Takshashila Institute