Title

# Essays on India's Economics and Politics in 2019



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# Essays on India's Economics and Politics in 2019

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## Introduction

These essays were written as columns for the *Financial Express* daily newspaper in India. This collection begins in December 2018 and ends in November 2019. The last two columns for 2019 were included with the 2020 collection, marking the challenging "Year of Coronavirus." But in some ways, 2019 was even more significant for India: a general election that cemented the rule of the Bharatiya Janata Party, the dramatic change in the status of the state of Jammu and Kashmir, and political shadows thereafter. Indeed, the last essay in this collection seems to be very relevant for India's current situation of farmer protests over agricultural marketing reforms. The political approach I suggested a year ago is moot now, but the rationale for my recommendations remains. All of these pieces appeared in the *Financial Express*, in print and online, with varying lags from the dates of writing, which are noted after each essay. The newspaper versions had different titles, but the ones below are my original terse title choices. As for the collection of 2020 columns, I hope that reading these pieces in sequence and together will provide a consistent and useful perspective on Indian economic policy in the context of its political evolution.

### An Economic Strategy for India

The title of this column is the title of a concise but comprehensive report by 13 economists, which was released earlier this month. They include luminaries such as former RBI governor Raghuram Rajan and IMF Chief Economist Gita Gopinath, but also other prominent academics and private sector economists. All of them are experts. They have also written individual sector or issue reports, on which the main report builds. All of this is available free on the internet, but this column will offer some highlights and comments.

The report begins by noting that India's economy has performed well in absolute and relative terms, for the last quarter century. But then it opines that India can and must do better. That is the motivation for this outline of a strategy: what should be done? This column, in summarising some of the report's answers, will also offer some thoughts on how components of the strategy might be implemented, and what the difficulties might be, along with a few differences of opinion and emphasis.

A couple of central motivators for the report's approach are the need to create more "good" jobs more rapidly than India has managed so far, and the need to deal with burgeoning environmental problems that could destroy everything that India has achieved in terms of improving the average well-being of its citizens. These are well-known issues, but can never be emphasized enough. Failures of successive governments on both fronts are a rebuke to India's leaders and elites, and a reminder of the gaps in India's economic progress.

Macroeconomic stability is discussed at length as a prerequisite for sustainable, inclusive growth. India's track record here has been quite good, and has been improving. Institutions for managing the national public finances have been improving, as have those for managing the financial sector. But the mess in the banking sector, which has extended to nonbank financial companies, and the government's ham-handed attempt to intimidate the RBI are examples of why one cannot take macroeconomic stability for granted. The report rightly highlights a worsening of public finances at the state level, but I am not sure that its invocation of "cooperative federalism" has substance or clarity, and the idea of using Finance Commission awards to reward good behaviour is an old one that had limited success. My own analysis suggests that giving the states more fiscal autonomy, making their budget constraints certain and clear, and pushing them to do better in the basics of public finance accounting, will achieve better outcomes.

Another theme of the report is the need to fix stressed sectors quickly – these are agriculture, infrastructure (including power), exports and banking. For agriculture, the recommended reforms and goals include innovations in production methods, marketing and access to markets, and better functioning land markets. Of course, what would really help is boosting industrial growth and employment, which would get more people out of rural areas and off of farms. This is something that could have been emphasized more. Also, agriculture and its ancillary activities are becoming major sources of potentially irreversible environmental damage, so that link needs to be recognized more clearly in economic strategizing. The list of infrastructure reforms is also reasonable, including cleaning up the backlog of stalled projects, improving land allocation mechanisms, “revitalizing” public-private partnerships, and creating Special Economic Zones. But the real questions here have to do with expertise and management of large projects, so that outcomes are of good quality at reasonable cost: large sums of money can be siphoned off in such cases, and that has to be controlled. One could have wished for a clearer picture of what the obstacles have been so far, and how to overcome them. Clearly, nothing can really be done without restoring some degree of health to India’s financial sector. There are excellent recommendations for that goal, but also perhaps not enough about the need to improve the functioning of banks, including insulation from political pressure and greater managerial competence. As well, the need to deepen the financial sector and expand household financial savings could have been highlighted.

There are excellent recommendations on making India’s public education system more effective, so that students actually learn what they have the potential for. The recommendations for healthcare include detailed suggestions for training, practice (such as checklists) and awareness through edutainment: these are the kinds of micro-level changes needed in areas such as banking and teaching. The report has innovative suggestions on tweaking labour market regulations and training mechanisms to improve efficiency and skill acquisition, without eroding worker protections, and for ways to increase women’s participation in the labour force. There are important recommendations for revamping environmental regulation institutions, and for reducing distortions that exacerbate environmental degradation. The recommendations for improving social protection schemes are more familiar, though no less desirable.

What is missing most, perhaps, is a clear sense of how to fix India’s moribund industrial dynamics. The discussion of exports notes problems of inefficient scale, low productivity, bureaucratic impediments, and so on. But these are long-standing issues. Arvind Panagariya, not one of the 13 authors, has continued to emphasize the need to expand labour intensive manufacturing in India. Whether or not this translates into “export-led” growth does not matter. The rise of services and the difficulty of global trade conditions also do not nullify this need for creating more dynamic, employment-generating firms in India. What is stopping it? Some answers in my next column.

*December 20, 2018*

**An Economic Strategy for India: Part II**

In my last column, I discussed an important document, "An Economic Strategy for India," produced by 13 economists with wide-ranging expertise on the Indian economy. I described many of the highlights of the report, but concluded, "What is missing most, perhaps, is a clear sense of how to fix India's moribund industrial dynamics." I expand on this idea in this column.

Of course, the report touches on many issues that affect the creation and expansion of greater numbers of "dynamic, employment-generating firms in India" (my phrase). The report mentions firms only in the context of labour market rigidities, land market failures, financing constraints, power sector problems, export constraints, or skill and training needs. All these are vital areas that need to be addressed, and the report has some important recommendations. But there is no part where firms and their performance are the focal point. The alternative terms "company" or "corporation" are absent, as is the word "entrepreneur." These absences just illustrate my contention.

Suppose we make firms the centre of policy attention, and ask, "What will make their performance better?" There are some solid answers available, from several years ago. Here are some samples. In 2011, Ejaz Ghani, William Kerr, and Stephen O'Connell analysed the spatial determinants of entrepreneurship in India. After noting the limits of the "informal" sector, they documented that India's density of new business registration, conditional on per capita GDP, is below average: India lags in the kind of entrepreneurship that could help growth. In most cases, greater new business creation did translate into subsequent higher employment growth. They also found that the rate of entrepreneurship in organised manufacturing was positively affected by the share of population with a graduate education, and by closeness to a city. The strength of local supplier networks was also a positive for setting up new establishments.

Nicholas Bloom, John van Reenen and various co-authors, in work from a decade ago as well as more recently, found that Indian firms with strong management practices were comparable to the best US firms in productivity, but there was a thick tail of badly-run (by their measure of management practices) Indian firms, which often neglected basic tasks such as collecting and analysing data, setting clear performance targets, and linking pay to performance. Shruti Sharma and I, in work published in 2013, found indirect evidence that management quality affected the productivity of Indian manufacturing plants.

Works such as these point to the importance of higher education, including management education (of a very practical nature), and of product market competition. The deficiencies of Indian higher education do not get mentioned in the report – although school education, which is the necessary foundation, is treated thoroughly. The need for greater product market competition is mentioned in a few specific contexts, such as power distribution and agricultural products, but there is no discussion of the general problems of competition in Indian industry.

There are still other factors that matter. These include telecommunications infrastructure, that is, reliable broadband and not just mobile phones; tax policies that support entrepreneurial risk taking (a crucial aspect of Silicon Valley's dynamism); and urban infrastructure for housing, transport and sanitation. The spatial organization of economic activity matters, because there are benefits to clustering, and Indian economic policies do not pay enough attention to this either. There are also implications here for the public finances of cities and towns (especially property tax regimes). Moreover, one can think of Special Economic Zones and Coastal Export Zones as special cases of the kinds of clustering that are needed.

To summarize the argument I am making here, the framing and organisation of the document, "An Economic Strategy for India," covers many important areas of policy action and reform, but it does not bring all the pieces together where it matters, in creating conditions where firms will be established at higher rates, and expand more robustly. Putting this goal at the centre of policy thinking adds several other important areas that need to be part of the overall policy package, as I have illustrated.

A further issue is that of political economy. The report, with some exceptions, is somewhat in a tradition of what one might term "sage advice." There is not much about why many of these fixes have not happened already, when they are large and obvious problems. The power sector, especially the case of the State Electricity Boards, is one example. Of course, we know what the political barriers are, but in that case, a useful economic strategy must also provide some guidance on pathways to political feasibility. One answer here might be greater political competition, not in the sense of more elections, but tying election outcomes to economic performance more closely. Pushing more economic policy freedom (including tax authority) down to the level of states, cities and towns can improve that linkage.

One has to be careful about wasteful political competition, but my judgment is that India is not close to that at the subnational level.

None of the above controverts the lessons of "An Economic Strategy for India." But I am arguing for some refocusing and rounding out of the picture. Whatever happens in the looming national elections, India's economic policymakers will have to think carefully and always strive to do better.

*January 5, 2019*

**Understanding India's Political Economy**

Economists and political scientists have developed reasonably good understandings of how politics and economics interact in abstract, and the case of specific countries. A basic principle of the different explanations is that societal groups and the institutions within which they function create trade-offs between competition for a nation's current output (especially the surplus, or "economic rents") and efforts to expand that output, that is economic growth. That growth creates more economic rents down the road, but economic and political institutions may not allow that to be done in the best way possible. This thinking was behind some of my comments, in my last two columns, on the document, "An Economic Strategy for India."

In particular, I would argue (1) India is too economically centralized for a successful growth acceleration, and (2) institutional capacity, both in terms of public finances and the human capital to manage them, needs to be strengthened at the level of the states, which can be better at serving their constituents in many dimensions than can a distant national government. A subtler argument that also fits in the trade-off framework is the tendency for economic policy thinking to be tilted toward public sector action rather than strengthening the private sector, which will ultimately deliver the growth and jobs that India's citizens need. In my previous columns, I described this tilt in terms of a lack of sufficient attention to "industrial dynamics." This goes well beyond just trying to score better on the World Bank's Ease of Doing Business, though performing better there is certainly an indicator of movement in the right direction. There is also the complication that the private sector can be part of the problem, when capitalists focus on capturing economic rents (or even theft), with the connivance of politicians.

Of course, India is not doing too badly at present, and one should recognize that good performance. Its neighbour, Pakistan, for example, is an example of much more suboptimal economic performance, which can be traced to the economic rent-capture and rent-protection of narrow elites that dominate societal institutions. This needs to be kept in mind as the spectacle of campaigning for India's national elections unfolds. The country's heterogeneity and diversity make the quest for ruling at the centre a complicated one, involving multiple regional political groupings, shifting alliances, and large sums of money, much of it from uncertain sources.

It seems to me that the state of play right now is complicated. Five years, ago, the challengers could point to disappointing economic performance, some evidence of paralysis in policy making, and instances of corruption in a ruling coalition that seemed to have run out of steam in its second term. Promises of better governance and better economic performance won the day, leading to the first single party majority in many years. But the delivery on those promises may not have been enough to persuade voters to give as strong a mandate this time around.

One way to understand events in India is in terms of an imbalance between political and economic decentralization. The structure of parliament, in which the composition of the Rajya Sabha reflects political control at the level of the states, and the states are large, heterogeneous and sometimes distant from the centre, means that any party or coalition of parties has to work hard to secure a national majority. This was apparent throughout the tenure of the current government, when much attention was paid to multiple, asynchronous state assembly elections, distorting national policies and taking away attention from national governance. This was not the only problem, of course: non-economic factors such as an aggressive ideology of cultural nationalism have also been at odds with the kind of good governance that would promote the best possible economic outcomes. This ideology also conflicts with the reality of a diverse nation, and sometimes with realistic visions of progress (instead of fantasies about the past).

Economic decentralization will not alleviate the political difficulty of stitching together a coherent national coalition for governance, nor change the direct political influence of the states through the Rajya Sabha. But it will improve economic performance, if done correctly, with capacity building and greater autonomy over funds. Ideally, this decentralization needs to extend to India's cities, which also need better governance, and which will be the focal points for future economic growth. This is an arena in which cooperative federalism between centre and states can truly matter, beyond being a nice sounding phrase.

In past five years, we have seen some economic policy decisions at the centre that continued a quarter century of reforms to improve the functioning of government in various spheres, such as taxation, the bankruptcy code, and rules on foreign direct investment. In other areas, there is still much to be done. And in the case of India's central bank and its money, there have been some retrograde steps. In the short term, we will see some attempts to stimulate the economy and make voters feel better about the ruling party. That is to be expected, and is not too harmful. The real questions are whether economic strategy for the long term can survive damaging political compulsions, what institutional changes can be made that reduce the chances of such damage, and which politicians – if any – understand the need to make those changes.

*January 20, 2019*

**Lessons of India's Budget**

Life is never perfect, and Union Budgets are just one example. But in the case of this year's interim budget, it does seem like the glass is at least half-full in the sphere of economic governance at the Centre, even if broader concerns about India's direction remain. The Budget has been described as populist, but one could alternatively characterize it as providing a mild fiscal stimulus, which may not be a bad thing at this juncture, when India's economy is still struggling to get out from under the overhang of bad debt accumulated in prior years.

The slight slippage in the FRBM target is not too much of a concern, and the transfers – implicit and explicit – that will lead to this slippage have been designed relatively well. The key idea here is that transfers are being achieved through cash payments into bank accounts, and through income tax rebates (an example of what economists call "tax expenditures"). A greater concern is what is happening fiscally at the level of the states, and in the realm of state owned enterprises. Problems there are contingent liabilities of the central government, and need policy attention, in the form of improved budgeting practices by the states, continued privatisation, and strengthening of the tax administration and tax capacity for states and for cities. But those issues could not be part of an interim budget.

The Budget also included measures to update and streamline archaic transaction taxes that come under the head of "stamp duty." Further measures provided some tax relief in the real estate sector. Prior to the Budget, there had been steps to rationalise and simplify the GST structure. The introduction of GST had involved complex political calculations and negotiations, and it is interesting to see how, once an imperfect tax structure was in place, it could be evaluated and improved relatively rapidly. The lesson here may be that this government, in particular, seems to have an eye for tweaks to the economic system that are "pro-commerce" (perhaps drawing on aspects of being "pro-market" as well as "pro-business," as some academics have described two possible alternative policy stances.

One has to keep in mind, however, that the slow progress we keep seeing on many fronts in India is the result of a broadly shared vision of "economic reform." The Budget speech touted liberalisation of FDI as one of its achievements, but this has been an ongoing process begun decades ago. Coming to grips with the immediate and the longer term problems of the banking sector, and creating a modern framework for the conduct of monetary policy also have roots in the efforts of previous governments, even if there was a problem of a credit boom and associated corruption in the final years of the last government.

It is important to realize that credit and blame have to be adjusted for external factors, and that should lead one to upgrade the performance of the previous government, as well as not go overboard in praising the current one's economic policies. It is fair to say, however, that the past few years seem to have seen an attempt to stem the rot that was creeping in from excesses of crony capitalism. What remains to be seen is if the approach to governance going into the future can strengthen state institutions so that they do not involve the exercise of arbitrary power, and are more even handed in how the rich and the poor are treated.

The Union Budget continued the practice of bailing out farmers, which seems to be a perennial issue for India. Of course, the real problems are structural – inefficient and distortionary policies with respect to agriculture, whether in input markets, production, or output markets. Pricing, insurance, procurement, credit, marketing and technology choices all need serious policy attention. And underlying it all is the failure to create jobs off the farm and away from rural areas.

The Budget also touted India's digital strategy. Digitisation can reduce harassment of taxpayers, improve collection efficiency, reduce transaction costs to make small business finance more effective, improve access to health and education services, and so on. It is not difficult to see that what is happening as a "Fourth Industrial Revolution." The central government has realised the importance of these trends, but its vision and its detailed strategy seem to be inadequate, as I have argued in previous columns. Unlike health, sanitation and education, where it may make sense to push down implementation to cities and states, the creation of a national digital infrastructure may properly be a central goal. It is important, in this respect to avoid too much reliance on large private actors for this infrastructure (implied pun intended), while pushing aggressively and intelligently for a robust 21st century digital infrastructure to support myriad new applications.

The Union Budget displayed a maturity and rationality of thought and action in terms of basic public finance policies. Within the economic sphere, what India still needs is careful rethinking of the balances and boundaries between public and private; centralised and decentralised; economics and politics; and rich, poor and middle. It will be interesting to see if the rhetoric of the election campaign debates sheds any light on how politicians think of these fundamental underlying issues.

*February 8, 2019*

**Industrial Policy for India**

The notion of industrial policy is one that has been around for decades. Some economists think it is an idea that never worked, whereas others still see merit in the concept. India certainly had an industrial policy, conceptualized in terms of developing heavy industry through state-led efforts. It was the nature and quality of this implementation, rather than the idea of industrial policy itself, that let India down. Economists now often shy away from the idea that governments can "pick winners," in crafting industrial policy. But again, the reality is not one-sided.

It still seems reasonable to argue that Japan got things right in developing its automobile industry almost seven decades ago. Apparently, this was considered unrealistic and foolhardy by some observers at the time, and it took Japan's automobile firms over two decades and some luck (two oil price spikes in the

1970s) to make their presence felt in global markets. Whatever the challenges of implementation, the economic logic was clear: automobiles were a product with a high income elasticity of demand, and significant knowledge spillovers in production. As the consumer good with the most complexity in terms of production, if Japan could make them successfully, it was more than likely that it could also make a range of other manufactured products that required engineering expertise.

By contrast, India treated automobiles as a luxury good for its own population, did not consider exports as an option, and churned out a few obsolete models for decades. Perhaps automobiles were not the place for India to start its industrialization path just after independence, but there was little else where India's policymakers charted a strategic vision and mapped out a supportive policy framework for industrial growth and dynamism. Even more labour intensive products, with lower engineering complexity, did not become categories where India established world class quality and globally efficient scale.

There have been some successes after the economic reform process began, but almost three decades later, India is still struggling with upgrading and expanding its manufacturing sector, and that seems to be an obvious reason why it has not achieved double digit growth rates to match those of the Japanese miracle or China's later economic ascent. What is missing? One argument is a new version of the export pessimism that constrained economic policy thinking at the time of independence, in India and many other developing countries. Now, the suggestion is that India missed that boat, and neither the global trading environment nor the pace of economic growth in advanced economies is as favourable as when Japan and China raced ahead.

But this seems to be a self-fulfilling form of pessimism, just as it was seven decades ago. Global growth is strong, just not necessarily distributed as it was in the past. Tariffs are not that high, despite short run hiccups due to Brexit and the Trump administration's nationalist approach to international trade. Indian policy makers just do not seem able to make a clear enough assessment of where growth will occur, where India's opportunities are, and how to create a playing field in which the most dynamic and well run Indian firms can grow and prosper.

In terms of physical needs, India is going too slowly in creating the logistical infrastructure to allow India to connect to global – and especially regional – production networks. There are financing constraints as well as constraints in terms of expertise, but there seems to be little sense of urgency or strategic intent in this respect. Relaxing the constraints by tapping global capital and multinational expertise seems to be proceeding only fitfully. Nor does Indian policymaking seem to think carefully enough about complementarities in various kinds of infrastructure for supporting industrial innovation and growth.

In terms of the technologies and the products and services that will matter over the next few decades, the candidates are obvious. Digital technologies matter everywhere, for making products and for delivering services. India's software industry has proved its resilience and dynamism many times over, completely belying the pessimists who derided its start at the lower end of the digital value chain, and even called its employees "techno-coolies." But India desperately needs to upgrade and extend its digital infrastructure, and increase the numbers and skill levels of those who will maintain this infrastructure, and those who will use it to deliver a continuing stream of new digital products and services.

There are other obvious areas of global growth. Technologies and products that combat global warming, and those that serve the needs of rapidly aging populations in many countries, will be opportunities for growth. Effective industrial policy will mean listening to innovators, and providing them with the conditions they need to serve new markets. India's policymakers still seems to lack a full understanding of private enterprise and how to encourage it. Continuing examples of corruption and incompetence among India's corporate giants make matters more difficult, but illegality has to be distinguished from honest mistakes and failures.

None of the above means a neglect of basic education and health, including sanitation infrastructure. India remains very unequal in these respects, and denying basic needs to all citizens is as big a scandal as corruption among politicians and capitalists. But even after decades of economic planning, India's policymakers still struggle to put all the pieces together, including industrial policy, for sustained growth at levels shown possible by Japan and China.

*February 17, 2019*

**Courting Economic Failure: India's Judiciary**

India's judicial system has many positive features. It is reasonably fair and impartial, and it has often acted to protect citizens against politicians or the powerful overstepping their bounds. Of course, there is considerable room for improvement in equal treatment under the law, especially in a country riven with social and economic inequalities as India is. And there have been instances of judicial corruption, which is always disturbing, even if rare.

A separate issue is the quality of India's laws:  do they adequately support ideals of fairness and protection of human rights, and, separately, do they promote economic efficiency? The deeper philosophical challenges of assessing India's legal system are much greater than analysing their economic efficiency, and much progress has been made since pioneering efforts such as Project LARGE, headed by Bibek Debroy a quarter century ago, to improve laws with a view to enhancing economic efficiency. The approach to reforming the legal code associated with the relatively recent Financial Sector Legislative Reforms Commission displayed economic sophistication and attention to detail, and one has seen improvements in areas such as bankruptcy law, which have been slowly taking root.

Yet another problematic aspect of the India's legal system, however, is its slowness. The best laws in the world will not help if legal judgments are subject to lengthy delays. Again, as far back as the early 1990s, Dilip Mookherjee, building on the Malimath Committee Report from that period, had detailed the shortage of judges, the lack of effective management of caseloads, and poor work practices among lawyers as among the factors contributing to delays. These problems have persisted, despite the possibility of tackling some of them without significant new resources: the obstacles have reflected political economy factors, where politicians, lawyers, and perhaps judges too, all benefit from the current badly run system. Another possible barrier to change may have been the difficulty of quantifying the costs of current system

This gap has started to be addressed by new economic research. In 2016, Amrit Amirapu provided one of the first quantitative analyses of the economic costs of judicial delays in India. In particular, slow courts increase the costs of enforcing contracts, and may delay investments, or even lead to such investments not taking place at all. Amirapu utilized geographic variation in contract enforcement delays across India's states for industries where such contract enforcement would likely matter, versus less "contract-intensive" industries. He found that court efficiency in civil cases (often involving property or other contracts) did matter quite significantly for industrial growth. The fact that court efficiency in criminal cases did not have such a growth effect made these results more credible.

In 2018, Johannes Boehm and Ezra Oberfield carried out a similar study. Working with different industry data, but again using cross-state variation, they found that court delays distorted production decisions, and even the organization of firms, resulting in significant productivity losses. These results complement and reinforce Amirapu's results – the bottom line is that multiple ways of examining the data confirm that the inefficiency of India's courts in the realm of contract enforcement has large negative consequences for economic performance.
Will studies such as the two highlighted here help in influencing policymakers? One place to start may be the World Bank's Ease of Doing Business Index. The Indian government became very excited when the country's ranking according to this index soared recently. The change was associated with improvements in the bankruptcy code (dealing with insolvency is one of the index components), although the index may have given more weight to the promise of those improvements than the reality. But India's ranking on contract enforcement is a dismal 163rd. One weakness of the index is that it cannot ensure that components receive weights that properly their importance for economic performance. If one could make the argument that improving India's ranking in contract enforcement will cause it to rise further in the rankings (with the associated reputational benefits), as well as having large direct benefits for economic performance, this might be a starting point for improvements in court functioning.

Of course, changing massive bureaucracies such as the court system is much harder than rewriting legal codes. Here, another aspect of the quantitative studies may help. Since they exploit variations across states, there is scope for benchmarking and competition between states for improvements in judicial contract enforcement, just as states have competed to be recognized overall as attractive destinations for corporate investment. Quantifiable benefits of location choices may affect such decisions for companies, although infrastructure and access to supply chains and markets may be more decisive.

Interestingly, the 2018 academic study relied on data compiled in a report by Daksh, a non-profit based in Bengaluru, which aims "to promote accountability and better governance in India." This may be a crucial part of the process for effecting change. Non-profits can enable and complement academic research, and both together can make the case for policy reform. The academic studies show that inefficient courts have high economic costs, but do not have specific policy recommendations. Organizations such as Daksh can use these studies to bolster arguments for institutional reform at the micro level, perhaps engaging with organizations representing lawyers and judges to fine tune reform recommendations for India's judicial system. We know for sure that delay in doing this will be costly.

*March 10, 2019*

**Who Will Rule India?**

India's general election will begin in less than a month, but last for close to six weeks, and the results will be determined on May 23rd. That is a long process, conducted on a scale that is unparalleled in the world, and there can be many twists and turns along the way. There will be many more scientific predictions than I can offer, but it is hard to resist the temptation to extrapolate from studying various facets of the Indian economy and polity over several decades, to offer an immediate answer to the question, "Who will rule India for the next five years?"

The answer seems to me to be an easy one: the NDA will certainly capture a majority again, even if it somewhat reduced from its current strength of 336. Recent opinion polls are less certain, projecting a loss of the NDA's majority in some cases, but all of the polls in the beginning of March project an outcome very close to a majority. What other information can one consider in making a forecast?

Despite some evidence of voter dissatisfaction with the NDA's performance, especially evidenced in recent state assembly elections, opinion polls suggest that people are much more likely to think that this government's economic performance is better than that of its predecessor. Academic debates about the quality of economic data and the optimality of different economic policies may be important for improving the steering of the economy, but it seems that voters think the ruling party can still deliver better on this front. It is also important to recognize that voters can and do make very different choices at the state level versus national elections: this is likely to indicate stronger support for the NDA than recent state elections might suggest.

Despite this observation, it is also true that the national election is also a collection of state-level contests, often multi-cornered. In particular, the 31 percent national vote share of the BJP, or the 38 percent vote share of the NDA, are not particularly useful by themselves in judging performance. As a rule of thumb, the further one moves away from the Hindi heartland, the greater is the importance of regional parties. Looking at the vote shares and seat outcomes of the 2014 election in states such as Tamil Nadu, West Bengal and Orissa, it seems unlikely that there will be much change in regional power balances: in any case, the NDA does not have much to lose in such states, and may make small gains. In western India, though not quite the Hindi heartland, Gujarat and Maharashtra seem to be relatively secure bastions of the ruling alliance.

Madhya Pradesh and Rajasthan, where the swing in the state assembly elections compared to the 2014 national election was enough to displace the BJP, may not display the same behaviour in the general election, as argued earlier. Aside from voters generally viewing national elections from a different lens, recent events involving Kashmir and Pakistan are easy for the BJP to make into a salient issue. Uttar Pradesh, which was critical in giving the BJP its majority on its own, by delivering 71 of its 80 seats, may be a tougher proposition this time, simply because of the alliance between the SP and the BSP, which was absent in 2014. In this state, however, the BJP still controls the state government machinery, and that, along with nationalist sentiment, is likely to help it retain a good number of seats.

A final factor is the technology of campaigning. In 2014, the BJP showed that it could conduct an election campaign that was more sophisticated than anything India had ever seen before. Narendra Modi, despite a blemished record in Gujarat, was marketed as a national leader in an impressively orchestrated effort. Now, incumbency, money, a friendly media, lessons from previous success, and boots on the ground all favour the ruling alliance. My view is that these considerations mean that one cannot translate opinion polls into seats won in a straightforward manner – unequal resources and technologies will tilt the outcome towards the incumbent prime minister.

I have provided these observations while being well aware that there are many who have much greater expertise on India's elections. But it is hard not to offer some opinion on an exercise that is vital for India's future. I would argue that the difference will not lie in economic policy. Any ruling party or coalition will pursue some version of what is generically referred to as "economic reform," namely, trying to change India's economic policies to promote sustained high growth, while also providing increasingly sophisticated and better designed safety nets, to ensure political feasibility.

The real difference will be outside pure economics, in human rights, protection of diversity, and various kinds of freedoms. In that sense, a prediction that the ruling alliance is guaranteed another five years in power is also an indictment of those in opposition, who have failed to offer a compelling alternative that includes material and non-material aspects of welfare, and includes all of India's citizens without discrimination. India's citizens deserve better.

*March 11, 2019*

**India's Leadership Deficit**

With the general election just around the corner, opinion polls suggest that some of the suspense about the outcome has dissipated. Of course, as the US presidential election illustrates, nothing is certain until the votes are cast and counted. But India's ruling coalition seems very well placed to retain its position. Its main constituent, the BJP, has a relatively robust organization and national presence, and the government it has led has done enough to compare favourably to its predecessor in perceived economic performance. It also has a leader with experience and credibility, nationally and internationally. There are subnational political leaders among the opposition, of course, but they lead political parties that are firmly regional, and their national profiles tend to be limited. The main opposition party, the Congress, is, of course, led by someone whose main qualification is based on genealogy, and it is not very clear what the party he leads stands for.

Leadership matters. One does not have to use basket cases such as Zimbabwe and Venezuela to see the damage that poor leadership can cause. Just look at the United Kingdom, where poor leadership from David Cameron resulted in a Brexit referendum that was manipulated by the racist UK Independence Party, with scare mongering and falsehoods that were almost certainly the determining factor in the shocking outcome. Cameron's poor leadership has caused, and will continue to cause, his country significant economic harm.

The UK is an interesting case, because it is an advanced economy with a well-established parliamentary system. It is an example of what Douglas North, John Wallis and Barry Weingast have called an "open access order," in which there is competition for political and economic leadership positions that is relatively free of the biases of circumstances of birth. It is true that the current political leadership in the UK is not a good advertisement for this theory, but on average, well-functioning competition is more likely to lead to better leaders, even if there are counterexamples. Indeed, this seems to be true for economics as well as politics: family firms in India may be less well-managed on average than other companies.

As far as I know, Ashok Kotwal and Arka Roy Choudhuri (What Will Improve Governance?, published in *India Review*) were the first to explore political leadership competition in the context of India. They offer a lucid summary of how the Congress party fell victim to dynastic politics. It seems uncontroversial to suggest that this is a major reason for that party's inability to serve as a true opposition party, with an identity based on policies and not personality. Kotwal and Roy Choudhuri do note the dangers of the BJP falling victim to a personality cult and concentration of power in the Prime Minister's Office: these are also steps that can damage competition, in different ways than dynastic succession. Yet, on the whole, the BJP seems to operate in a manner that merges ideology and internal organization, unlike the individual- or family-dependent parties that dominate India's political landscape.

Kotwal and Roy Choudhuri do not analyse the various regional parties, and doing so adds considerable complexity to the story of Indian politics. Regional leaders will always matter because of India's scale and diversity, in ways that they will not in a country like the UK. These leaders can operate within the boundaries of national parties, or outside them. Sometimes they go back and forth between those two modes of operation, but the broad tendency has been for them to go out on their own, simply because there are few opportunities for rising to national leadership through party hierarchies. The current prime minister is a good example of an exception to this constraint, and one can speculate that overcoming India's leadership deficit requires more such examples, until they are no longer exceptions.

I am not aware of a systematic study of regional political leaders in India, and how they came to power. There are those who led farmers' organisations, those who represent caste groupings, many who succeeded a parent, and some who have simply made their way up the political ladder, going back and forth between national and regional roles. Perhaps it is fair to say that competition for political leadership is more robust at the regional level. In that case, one might get better leaders on average, and one systemic way to deal with India's national leadership deficit is to give subnational governments more policy space, both in terms of revenue raising and spending authority.

If that is the case, the centralizing tendencies of the current ruling coalition could hold India back economically, if it is returned to power in the national election. It would be ironic if a national leadership deficit, depriving India's voters of a robust choice in the general election, leads to stifling of leadership and political competition at the subnational level. There are separate worries about suppression of cultural diversity and weakening of national government institutions that provide checks and balances. All of this makes it sad that dynastic ambitions have attenuated democratic options in India's upcoming election.

*April 1, 2019*

**Unhappy India**

Last month saw the release of the latest World Happiness Report, produced by prominent economists and sponsored by the United Nations. India's ranking, already low, slid further in the latest report, and stands at $140^{th}$ out of 156 countries. To rub salt in this reputational wound, Pakistan ranks much higher, at $67^{th}$. This news has been widely covered, but discussions have included some basic misunderstandings. Here I want to clarify what the report really tells us, offer some conjectures on what may be behind the seemingly puzzling data, and draw out some possible implications for the coming national elections.

The main measure of "happiness" is based on responses to surveys of how individuals subjectively evaluate their life circumstances on a 0-10 scale. National scores are averages across individual responses. Finland tops the rankings with a score of 7.769, while South Sudan is at the bottom with a score of 2.853. India's score is 4.015, and Pakistan's is 5.653. India's score has decreased by over one point since 2005-06, with most of this decline coming since 2011, short circuiting a slight recovery from a post-financial-crisis fall. The report also looks at more fleeting "emotional" states based on reporting recent behaviour indicating positive "affect" (such as occasions of laughter) and negative "affect" (such as feeling anxious). India ranks somewhat higher on these measures, and equal or better than Pakistan. This is important, because it gives a clue to what the main indicator of "happiness" actually tells us.

The report uses data on other variables, some from national statistics, such as GDP per capita and healthy life expectancy, and others also from surveys, such as perceptions of social support, freedom of choice, and societal corruption. A statistical exercise uses these variables to try to explain subjective evaluations by country and year. These variables turn out to have significant explanatory power, and have estimated effects that fit with our intuition: on average, a richer country has higher subjective evaluations of life circumstances, as does a nation with more social support, lower perceived corruption, and so on.

Some commentators have focused on these variables to explain India's low happiness score. But none of them are components of the score, which is based on direct reporting, so these analyses are off base. Certainly, the fact that India has a low rank in social support (142nd) helps to understand its low happiness score, but the real issues are different. These are, why has the happiness score been going down when the explanatory variables (especially GDP per capita) have been improving, and why is the score lower than what the explanatory variables might predict? Indeed, Pakistan's rankings on the explanatory variables are mostly not significantly better than India's, and sometimes much worse. If India and Pakistan had happiness scores that equalled the predictions of the model, India's score would be about one point higher, and Pakistan's about one point lower. The real mystery is why the model has these predictive anomalies.

A reasonable explanation for the puzzle is that India's people expect better, and they are feeling disappointed. The idea of rising expectations is a familiar one in the Indian context, and it is difficult to think of any other explanation, though increasing inequality and feelings of injustice or unfairness are also a plausible contributing factors. This also fits with the data on "affect." The low ranking of South Sudan (and countries such as Afghanistan, Yemen and Rwanda) may reflect extreme misery, while Pakistan's population may simply be more resigned to their situation. In all of these discussions, one should also mention that the report's authors have acknowledged cultural differences in response modes across disparate region such as East Asia and Latin America, but these are less likely to be significant within a single region such as South Asia.

What are the implications of the happiness data for India's upcoming election? Unsurprisingly, analyses suggest that higher levels of life satisfaction favour political incumbents. For example, there is evidence from the US that areas with low measured life satisfaction (current and future) were more likely to swing to the insurgent, Donald Trump, in the 2016 presidential election. Given the trends in India, that kind of effect would be bad news for the ruling coalition. One saw some evidence of this possibility in opinion polls from a few months ago, which suggested a loss of their parliamentary majority. But there is a wrinkle in this correlation, because unhappy voters also tend to prefer those they view as strong leaders. Of course, perceived strength may not reflect competence or decency, as the case of Trump amply demonstrates.

In India's case, the recent conflict with its neighbour reminded many voters that the country's current leader is strong, precisely in that international dimension. It is possible that some voters would have reached this conclusion anyway, comparing the incumbent to the alternatives. As I have argued previously, India's voters do not have good choices on the political leadership front. Truly strong leadership includes depth of understanding and the ability and willingness to build a competent team. Until India gets better political leadership, its citizens may continue to be less happy than the data might predict. Hopefully, they will not become resigned to the current state of affairs.

*April 2, 2019*

**India's Unhappy Election**

My last column, over a month ago, was about the reasons for India's low ranking in national lists of "happiness," a shorthand for survey measures of self-reported life satisfaction. In that column, I suggested that Indians have been expecting better than what they have been getting, especially in material wellbeing, and that makes them unhappier than numerical measures such as GDP per capita and healthy life expectancy might predict.

This column is being written after the conclusion of India's general election, but before the results have been declared. But pre-election polls predicted a victory for the ruling coalition, and exit polls after the final phase have only strengthened that conclusion. The stock market has reacted positively, so perhaps one can conclude that investors are happy with the outcome, but they are a small proportion of the population. Perhaps relief is a better characterization of the emotion behind the response, since a stable government is preferable, other things equal, for the progress of the economy. The premise here, based on the last three decades of Indian experience, is that any likely government will pursue more or less similar economic policies, differing at the margins in terms of how and to what extent certain kinds of redistribution are carried out, or which business people are favored, but not in the fundamentals of tax policy, expenditure policy or monetary policy. A slow but perceptible economic reform process is a given.

What was most noticeable about this election campaign was the absence of much, if any, serious discussion of economic policies, beyond attempts from the current opposition to create a version of a universal basic income program. This seemed to be a contrast to recent elections, where there was debate on whether government policies were promoting adequate levels and sharing of economic growth. Instead, this was a campaign of fear and division, especially from the ruling party. Even in the last US presidential election, Donald Trump combined his xenophobia, racism and reactionary social policies with an economic message, appealing to those who have been left behind by globalization and technological change.

But in India, the majority of the population has not even had their first chance, so there is nothing for them to miss, except by comparing themselves to those in India who are racing ahead. And the incumbent could hardly blame the failure to deliver economic benefits more robustly on the preceding government, a full five years after its ouster. In mid-May, Simon Mundy in the Financial Times offered a pessimistic view of India's prospects, based on strong evidence of weakness in consumer demand, both rural and urban. Soutik Biswas, for the BBC, offered a similar conclusion, bolstered by the concerns of economists such as Kaushik Basu, who noted the anemic performance of Indian exports, and Rathin Roy, who observed the failure of India's consumption story to broaden, so that consumption patterns are looking more like Latin America than East Asia.

Some of this goes back to the continued failures of job creation in India, the lack of sufficient industrial dynamism, including the lack of positive feedback loops from growth in industry to skill acquisition to accumulation of experience to new firm creation. Because the last five years have seen a focus on consolidating political power, and on pursuing a particular vision of nationalism, while many reforms that have been ongoing for years across several governments have been carried out, a government headed – for the first time in India – by someone with an urban working class entrepreneurial background ultimately did not bring much innovation to the formulation and implementation of economic policy.

As a result, the election campaign was an unhappy one, highlighting external threats, and creating internal ones where they do or need not exist. This is not a profound observation: everyone has seen how the campaign was conducted. What is surprising is that the opposition did not really seem to provide an answer, or be able to rise above the level and tone set by the ruling party. Perhaps there is no way to accomplish that elevation, when a strong communicator is pressing those buttons for voters that will trigger emotions of fear and concerns for safety. That was certainly the case of Donald Trump, who continues on that path more than halfway into his term.

Milan Vaishnav, in an article in *Foreign Affairs* magazine, has used the characterization of what is happening as “The Battle for India’s Soul.” This is not just about the election, but what has been happening before it, and what might happen after it, where certain groups in Indian society are marginalized or even demonized, where a broader concept of national identity is made impossible, and where dissent and difference are suppressed. It is an unhappy state of affairs when reasoned debates about economic policy and inclusive growth are replaced by historical grievances and fear of the future as the basis for political choices. An unhappy election campaign, even if it results in a stable national government, may not lead to a happier population. I hope the pessimists are proved wrong, but discussing how that might happen will need another column.

*May 20, 2019*

**What Did We Learn from the Election?**

What did we learn from the expected victory of the ruling coalition? We already knew that Narendra Modi is a charismatic and effective campaigner, and that the BJP is well-organized and influential communicators. What we learned from the stronger than (mostly) predicted triumph was that voters were susceptible to the kind of appeal that the ruling party and its leader, in particular, offered. This was an assertive nationalism, firmly grounded in religious identity. Certainly, elements in Pakistan played into this narrative – without the attack in February, the margin of victory might have been smaller. But the result also suggests that, even without the specific national security angle, a campaign of emphasizing threats from outsiders, whether hostile neighboring governments or hapless illegal immigrants, would have paid dividends. The core message of the BJP has been sinking into Indian minds, becoming normalized and familiar. A party that had never captured much more than a third of national parliamentary seats before 2014 is now by far the single most dominant force in Indian politics, with a robust new presence in the nation's East and (partly) its South.

The substance and style of the campaign also taught us something about what many Indian voters value in a leader. Modi has effectively created himself as a "man of the people," though with clear signals that he is also special (the many doubles, the ubiquitous images, the various symbolic actions and markers of holiness). In a sense, he is – someone from an urban working class background, not a descendant of a wealthy dynasty. Jawaharlal Nehru acquired the common touch by his participation in the freedom struggle, though he remained an aristocrat at heart, but each succeeding generation has move further away from that legitimacy. Rahul Gandhi was figuratively left in the dust in the comparison with Modi, even losing his parliamentary seat in a former family stronghold. As many have noted, Modi is a new kind of leader for India.

We also learned that many Indian voters are willing, at least temporarily, to put aside concerns about their material wellbeing, in order to follow more elemental desires for security and feelings of belonging. To the extent that these feelings are fulfilled by denigrating others, this is a dangerous situation, not just for the victims of this exclusion, but ultimately also for the victimizers. Division and conflict of this kind do not lead to good outcomes. This is partly why I described India's election as "unhappy" in my last column. Of course, there are many examples of identity-based conflict throughout independent India's existence, but the vote in this election suggests an unwelcome resurgence of acceptance of that state of affairs.

What we did not learn from the election is how these factors will play out over the next five years. It is certainly possible for an autocratic ruler to erode institutions that support democracy, through various checks and balances, especially if enough citizens acquiesce or are apathetic. Some observers have noted the tendency of the last government to act in ways that diminish institutional autonomy and integrity. If that impulse continues, then this election may mark a permanent shift in India's polity.

We also did not learn how serious the ruling party is about economic progress. At times, there have been positive signs, including a continuation of reforms started under previous governments, as well as striking new initiatives such as a focus on toilets and sanitation. However, in many ways, the last government continued the worst habits of all its predecessors: overcentralizing, emphasizing symbolism rather than effective implementation, and not drawing on a broad enough range of expertise. Centralization and personalization of power and decision making are unlikely to lead to economic policies that support economic progress at the rate India needs, and is probably capable of.

We also do not know how opposition parties will respond to the new state of affairs. It is plausible that the national government's relative failure on the economic front contributed to the wins for the opposition in recent state assembly elections in the Hindi heartland. In the campaign not one opposition party seemed to offer a message of a pathway to economic betterment that could be an alternative to the nationalist war cry. Nor did they articulate a compelling alternative ideal of what India is as a nation. Perhaps nothing would have worked in this campaign, but the lack of vision is worrisome. "*Bijli, sadak, pani*" is not passé, but needs to extended to "*hawa*" and "*zameen*," as environmental degradation starts to erode the quality of life and even livelihoods. The Congress Party has a complementary problem as well – its lack of any compelling vision of how to drive improved material wellbeing for the masses is connected to its being run as a family business, with weak organizational structure and no room for new ideas. We do not know if it can learn any lessons from two successive drubbings, and implement the changes it needs to stay politically relevant.

There are many lessons of the momentous election that has taken place in India, and many causes for concern. But there are also many uncertainties and India's future is not completely determined by the results of this one election. The next few months may provide clarity: whether that is positive or negative has to be seen.

*May 23, 2019*

**Economic Challenges for the New Government**

Narendra Modi and the NDA won a famous victory last month, consolidating political power in a manner that many had not imagined was possible in contemporary India. The country of a "million mutinies" seems to be increasing aligned with a particular vision of national identity. But political power is no guarantee of success in economic policy. Improving the material well-being of India's long-suffering masses will require focused attention to the nation's economic challenges. What are they?

The foremost challenge, I would argue, is fixing India's financial sector, especially its banks. Finance is both the fuel and the lubricant of the economy's engine: fueling growth by channeling funds to productive investment, and lubricating transactions and day-to-day economic activities. The overhang of debts that are on the balance sheets of banks and other financial institutions but will almost certainly never be repaid prevents new investment taking place to the degree it needs to. The new bankruptcy law, and the RBI's attempt to make it operational and effective, have run into obstacles, which, if not removed, will allow the situation to linger and even worsen, rather than the hoped for improvement. In that case, the skyrocketing ranking in the World Bank's Ease of Doing Business measure will be meaningless. Whether additional new laws or new regulations are needed is up to the experts, but clearly there has to be political will to move quickly through a process that will inevitably be painful.

The next challenge lies in India's tax system. India is closing in on three decades of reform of what used to be a devastatingly inefficient tax system. But it remains an underperformer in terms of its tax-to-GDP ratio, adjusted for its per capita GDP. The GST still needs to be simplified and implemented fully. Simplification, and possibly even lowering of rates, can improve compliance and enforcement. Continuing to broaden the income tax base, and working out an effective and non-capricious way of collecting corporate taxes, especially from multinationals, both have to be done. Recent governments have resorted to retroactive tax judgments that undermine certainty and trust, and will only discourage investment. While local and other subnational taxes can often be inefficient, the Center should consider allowing local and even state governments to increase their tax authority, even by piggybacking income tax surcharges on central collections. This last measure would need a constitutional amendment, but improving the assessment and collection of property taxes requires no legislative change, just political will and administrative competence. Property taxes are relatively progressive and should be difficult to avoid. In any case, increasing public resources in ways that are non-distortionary and non-extortionate is an imperative. The need for these resources to clean up the financial sector mess adds to the urgency.

On the other side of the government's accounts, reducing outflows of funds due to loss-making or inefficient government enterprises is a third urgent challenge. Air India is the most obvious case, since it burns taxpayer money in a market that serves the relatively well off. But there are problems across many sectors, including electric power, hospitality, and, of course, banking. There is a vicious circle at work here, since there are many existing jobs at stake, while new jobs are not being created rapidly enough. But it is better to sell off such enterprises with restrictions on immediate job cuts, than to perpetuate value destruction: creative contracts are needed. This avenue of reducing government ownership will be important for a sustainable financial sector, beyond the short-run clean-up of balance sheets.

A fourth challenge lies in the agricultural sector. Rural India, where the majority still reside, remains relatively poor and is falling further behind. Restrictions on marketing and trade often constrain the ability of farmers to get the most value for their crops. Intermediaries continue to exert disproportionate power in markets for inputs and products. Crop procurement schemes are inefficient and also subject to intermediary capture. Insurance that reduces risk and uncertainty barely exists, exposing farmers to unsustainable debts that then lead to fiscally costly loan waivers. Agricultural extension has not kept up with the needs of modern agriculture. Thus, the government intervenes inefficiently and in the wrong places, often not doing things where it could really add value. This has been a common theme in Indian economic policy, but agriculture has reformed the least, under cover of protecting the poor, but actually keeping them in relative poverty.

There are other challenges as well, of course, but even tackling just the above four effectively would make an enormous difference. The vice chairman of NITI Aayog, Rajiv Kumar, spoke of a priority list of "big bang" reforms right after the election results. It included much of the above list, along with other reforms such as ones aimed at labor and land laws. So nothing in the above is particularly original. Furthermore, he spoke of making progress in the first 100 days, which would be remarkable if it happened. Of course, proper formulation and implementation can take time, but even strong public commitments to tackle specific challenges can be useful.

Having a strengthened government with significant continuity of expertise and decision-making can certainly help in moving forward more expeditiously than is typical for India. Perhaps we will see some truly positive developments in economic policy over the course of the monsoon season.

*June 14, 2019*

## Governance Challenges for India

Four of the most important economic challenges for India, as I argued in my last column, are fixing the financial sector, solidifying the tax system, shedding inefficient public enterprises, and reforming the agricultural sector. The list of economic challenges does not stop with these four, but it is more important to understand the governance structures that make these and other reform areas challenging, before lengthening to-do lists. Indeed, governance challenges invariably underlie economic challenges.

The slogan of the NDA in the 2014 election campaign, "minimum government, maximum governance," hinted at an overarching idea of reducing unnecessary government interference (presumably including, but not restricted to the economy), while improving the efficiency of what government is actually supposed to do. But that slogan does not provide enough conceptual depth or richness to be a useful guide to action. So how should one think of the underlying governance challenges that India faces?

Governance includes lawmaking, institution building, regulation and administration. All of these are potentially intertwined in designing good policies and in implementing them. For example, inadequate bankruptcy laws, government ownership of banks and nonbank financial companies, and poor regulation all contributed to the bad debt problem in India's financial sector. The laws were recently improved, and the quality of regulation was improving in a parallel and complementary development, but the political compulsions of the ruling party and the overreach of the Supreme Court have both tended to move the situation further away from a speedy and efficient resolution of the problem.

This is India's core governance challenge: a tendency to concentrate power and control at the top, among a small number of loyal politicians and bureaucrats. The economic reform process of the last three decades has been marked by innovations in laws, regulatory institutions, and sources of administrative and policy expertise, all of which have the potential to support a higher growth path for India. But the general trend in the current ruling coalition has been in the direction of reversing these innovations, at least *de facto* if not by explicit rollbacks. Even robust governance institutions are subject to damage and erosion if a leader is determined, incompetent or malevolent enough: one is seeing this process occurring in the United States, where cronyism and corruption are rampant in the Trump administration, expertise is discarded or ignored, and there is pressure on supposedly independent institutions such as the Federal Reserve. One might argue that Trump is a strong leader who knows what he wants and is getting it by imposing his will, but many observers are concerned about the resulting long run damage to various governance institutions.

India's potential challenges are somewhat different. In particular, its legal and regulatory institutions are not yet robust and efficient enough to support a thriving modern economy. For example, the agriculture sector is one of the areas of the economy that has seen the least progress in changing how productive activities are governed, instead continuing with archaic and severe market restrictions and distortions. Government control of the sector is politically valuable, and it remains to be seen if the new government's stated interest in reform translates into changes that are politically viable. The internal organization of the judicial system, namely the manner in which legal proceedings are conducted and lawyers and judges are educated, also remains largely unreformed, as does the bureaucracy.

In this situation of limited institutional strength and efficiency, there is a real danger that those areas which have seen progress, such as the functioning of the RBI, or where there is a strong tradition of competence and trustworthiness, such as the Election Commission (EC), will have their quality eroded by a dominant political force at the top of the governance pyramid. The EC is an interesting case, since it has been considered one of India's strongest regulatory institutions, but it came in for criticism in the recent election for evidence of weakening impartiality. Of course, the EC does not regulate economic activity, but if elections are no longer reliably conducted, their role as an accountability mechanism for politicians will erode.

In sum, governance is not well measured by terms such as "maximum," but by indicators of outcomes and efficiency, and by measures of accountability. Cities such as Bengaluru have experimented with citizens' scorecards, and there is much more that can be done in that respect, especially at the level of cities and towns, where the quality of governance affects residents' daily lives most directly. At the national level, the link between efforts and outcomes is more tenuous, and the decisions to be made are more abstract: the benefit of giving the RBI the freedom to conduct monetary policy without political interference is not something the average voter will appreciate. Privatized banks that are more efficient, but still incentivized to serve less-well-off rural customers, will be appreciated more directly, but again, the link between the government policy and the benefits to citizens is not transparent. It may be that good governance and its recognition will be something that are best built from the bottom up, in which case the national government's role is to allow and enable subnational governments to flourish. In

India's current situation, both vertical and horizontal deconcentration of governance are desirable, but achieving either will be a challenge.

*June 25, 2019*

**The Big Picture of the Budget**

This year's Union Budget was different from most, since it followed a general election and an interim budget. Every Budget includes a list of expenditure plans and proposals, along with estimates of the tax and other revenues that will make those possible. Those revenues, as well, are partly determined by plans with respect to tax rates and coverage. What is the big picture that emerges from the conglomerate of specific revenue and expenditure proposals?

The overarching theme is, of course, the task of reviving economic growth. Unfortunately, this challenge has to be tackled in a situation where there is significant uncertainty with respect to the national income statistics which are the basis for headline growth numbers. It is a pity that, when attention should be on the quality of all the economic activities that are components of aggregate growth, mindshare is being dominated by the quality of measurement of those activities. It should not be difficult to clarify the construction of the national income data, and to correct any deficiencies, and doing so seems like it should be an obvious priority.

There is another, less salient, data issue, which has to do with the Budget assumptions about nominal (not inflation-adjusted) income growth. The discrepancy between the Economic Survey assumption and the Budget assumption has been pointed out, and addressed by the Finance Minister. However, either number, together with real growth assumptions, seems to imply an inflation rate that is above the RBI inflation target. Nominal growth below assumptions will have serious implications for tax revenue, and fiscal stability, and this is a potentially worrying aspect of the Budget, although one must admit this is not the first time this issue of overoptimistic projections has arisen.

Reviving growth requires a recovery of investment, and this is a major theme of the Budget, with various proposals for liberalising both direct and portfolio investment by foreigners. The proposed measures chiefly involve relaxing rules, which is a necessary condition for increasing investment from global sources, but probably not sufficient. What is needed is the creation of attractive combinations of infrastructure (hard and soft) to incentivize FDI, in particular. More focused and urgent efforts to develop Special Economic Zones are needed. The Budget also included measures for domestic investment, particularly reductions in the corporate tax rate except for the very largest firms, and more favourable tax treatment for start-ups. These are steps in the right direction, but one could argue that more is needed. Even the largest Indian firms are not giants by global standards, so it would make sense, and be simpler, to lower their rate as well. With respect to start-ups, one would like to see more flexibility, including abandoning attempts to have bureaucratic determinations of which start-ups are 'eligible' for favourable treatment. These bureaucratic approaches perhaps are hangovers of the licence-permit Raj.

Sometimes, eligibility restrictions or tax disincentives are driven by concerns about misuse of funds within the system. The new share buyback tax seems to be driven by this kind of thinking. Certainly, many corporate actors have been guilty of theft or misuse of funds, but the way to deal with this is through tracking, enforcement, competition and capability-building for managers, auditors and regulators. A command-and-control approach will not achieve the kind of investment boost that India needs. Indeed, the focus should be on making it attractive for households to increase financial, as opposed to nonfinancial, savings, and building up the quality of financial intermediation should be a priority. There are glimmers of this goal in the Budget, such as the continued tax incentives for creating a global financial hub in Gujarat, and one can be hopeful that modernisers will prevail over those who are overly cautious about risks. However, one has to side with those urging caution in the case of the plan for the government to borrow in foreign currency: the potential risks here seem to be substantial, with no real benefits.

The Budget also contains ongoing themes of digitisation, more effective policies for inclusion and welfare support, and agricultural reform. These themes had varying degrees of explicitness and salience in the latest Budget, and the details of policy formulation and implementation will continue to challenging, especially in the context of India's political economy of rent-seeking by politicians and others with power. While the GST was being finalised and introduced, 'cooperative federalism' was a popular term, but there is much more that needs to be done in terms of making subnational governments more effective.

Separate from the Budget, the Terms of Reference of the 15th Finance Commission do not inspire confidence that the Union government is willing to trust and to strengthen sub-national governments to make significant economic decisions. In education, health, industrial growth, urbanisation, environmental management and even exports, state and local governments have critical roles to play, and it remains to be seen if the national government's centralising impulses can take a step back when economic growth requires sub-national governments to step up in ways that they have not been empowered to in independent India's history.

The big picture of the Union Budget is a continuing increase in trust with respect to the private sector and foreign economic actors, but still not enough trust in India's own people and the governance choices they make at the sub-national level.

*July 13, 2019*

**Surveying India's Economic Strategy**

My last column, on India's Union Budget, attempted to bring out some general themes underlying the detailed revenue and expenditure proposals of that exercise. Those themes are straightforward: higher growth through higher private and public sector investment, along with concern for equity through continued social protections. The budget proposals do lack coherence in places, especially when rich individuals, large corporations or foreigners are singled out for higher taxes in ways that undermine the larger growth objective.

Not surprisingly, the Economic Survey of India (ESI) has a similar focus on investment, along with some frills about "virtuous cycles" of investment, demand, exports, growth and jobs. If we compare the two documents, it seems that the ESI emphasizes exports in a way that the Budget does not. Indeed, the protectionist aspects of the Budget, with higher tariffs on many goods, seem to be at odds with the kind of economic openness to the world that would support higher growth.

The ESI also differs in emphasis from the Budget by providing a significant chapter on growth dynamics of firms. When a group of prominent economists produced a report on an economic strategy for India, covering all the usual issues of infrastructure, exports, education, agriculture, labour markets, and jobs, I suggested (Financial Express, 24 Dec, 2018) that what was missing in this otherwise excellent analysis was a focus on the role of firms and their growth in promoting overall economic growth. The ESI provides evidence that older small firms are less productive than younger small firms, and that policies which distort labour markets and which favour small size lead to firms that are less productive and less likely to grow. The ESI also offers indicators of which sectors are more likely to generate higher numbers of jobs as they grow, in manufacturing as well as in services.

The ESI makes a good start on this issue, though there is much more analysis that needs to be done, and existing analysis that needs to be incorporated into policy making. Issues of economies of agglomeration (clustering), management efficiency, and integration into domestic and global supply chains, among others, all need to be tackled in the context of enabling the growth of efficient firms.

There are more basic issues as well, because it is not clear that the MSME category makes sense from a policy perspective. Lumping together micro, small and medium enterprises under a single policy umbrella does not have sound economic logic behind it. A second issue is that some small firms have characteristics such that their size is going to be limited – the "mom-and-pop store," for example. Their growth cannot be forced, although they can still become more productive and efficient with improvements in economic structure (such as logistics), or in technology. Finally, firm dynamics is not just about small firms growing, but also efficient large firms becoming larger. And often these large firms will support an ecosystem of small suppliers. The ESI makes only a beginning in understanding what will make Indian firms more productive.

The ESI also offers some innovations in Indian economic policy thinking that cannot be incorporated in a budget speech. These include designing policies to take advantage of insights from behavioural economics, fixing the problem of judicial delay, and expanding access to certain types of data that has public good characteristics. Each issue is different in nature, but each can have significant positive impacts. Given the current government's shyness over some of its economic data, the ESI view on data as a public good is especially welcome.

In addition to the above three takes on economic strategy (Budget, expert group and ESI), a fourth essay deserves mention. Rakesh Mohan, one of India's most seasoned, has produced an analysis for Brookings India that returns to the decades-old metaphor of a "big push" for India to get to a new growth trajectory. Some analysts thought the Budget lacked this kind of big vision and urgency, and Dr.

Mohan provides a corrective. Of course, investment is central to the projected growth story, and Dr. Mohan rightly emphasizes labour-intensive manufacturing and exports, much as Arvind Panagariya did while at NITI Aayog. Some of the special insights provided that may not receive enough attention elsewhere are policies for higher household financial savings, renewed attention to agricultural research and development and extension activities, and infrastructure investment in transport and logistics. On the last of these areas, of course, Dr. Mohan headed a committee that produced a major report outlining needed policies in great detail.

Dr. Mohan's report also covers the most challenging area of all, that of governance. Perhaps the most important aspect of his recommendations is to remind everyone of the need to emphasise and incorporate technical competence in policy making. This is something that has been a staple of Indian economic policy making, but may be in danger of being eroded in the current political climate. A more specific recommendation is in the call for NITI Aayog to step up its capabilities and to become a technically competent coordinator for a "big push" economic strategy. That would certainly help if done well: it is still unclear if the government's economic strategy has the coherence and consistency that is ultimately needed.

*July 14, 2019*

**Household Savings in India**

India has two fundamental problems in its pursuit of higher economic growth. First, it needs to increase investment. Second, it needs to increase savings. Both investment and savings have fallen as percentages of GDP, and are below the levels needed to support GDP growth of 8 to 10 percent a year. There is a counter argument that higher growth itself will rekindle animal spirits of investors, but I think the starting point has to be with creating prospects for better investment returns. The investment slowdown is related to the collapse of the preceding investment boom, which included too much corruption and, more generally, misallocation of capital. Until the overhang of bad assets is cleaned up, so that credit flows more freely again, investment will stagnate. The government has been trying, but perhaps not hard enough. The battles with the RBI on this front have also not helped. Efforts to attract foreign investors will also not achieve too much until the financial sector and corporate balance sheets are cleaned up. Even then, the policy framework for investment has to improve, in terms of taxation, infrastructure, and stability.

The savings side is trickier, but also has the potential for plucking some low hanging fruit, with the right degree of policy attention. This is because the policy environment for savings in India is suboptimal. This is particularly true of the household sector (including smaller firms in the Indian case), which has been the largest contributor to overall national savings. The other sources of savings – corporations, government and foreigners, are potentially important, but their determinants are more complicated, including whatever factors determine the investment climate, and the politics of government expenditure. Households, however, can be potentially reliable sources of savings.

There are three interrelated aspects of household saving where policies can be changed to make a difference. First, the level of household savings has fallen in recent years, despite high real (though not nominal) interest rates. Second, Indian households tend to put a relatively smaller proportion of their savings in financial assets, versus physical assets such as gold and real estate. Third, Indian households put relatively little of their financial savings into long term savings such as pensions and insurance products, versus bank accounts. All three factors result in a paucity of funds that can be intermediated into productive investment.

Tarun Ramadorai, who headed the RBI committee on household savings that reported in 2017, has pointed out that the tax incentives for long term savings through pensions are muddled and weak. He has made detailed proposals for clarity and simplicity in the design of pension schemes and the tax incentives that accompany them. This is about more than just "nudges," but requires significant, but straightforward, policy changes. The government may be worried about possible losses of revenue through tax breaks, but this seems to be an area where the returns will justify any short term revenue hit.

Last year, Radhika Pandey, Ila Patnaik and Renuka Sane, in the India Policy Forum, provided a detailed empirical analysis of the impact of tax breaks on household financial savings, and found that such incentives must be carefully designed to avoid distortions between different types of financial saving. They also emphasized the need for more sensible regulations, giving insurance companies and pension funds more room to invest in assets other than government bonds. In brief, household savings have to be channelled efficiently to more productive investments.

The need for better channelling of household savings is driven home by a more recent analysis by Patnaik and Pandey, in an NIPFP working paper. Government policy on this front does not seem to be coherent or sufficiently evidence-based. Budget proposals often seem to be piecemeal and fragmented. Nevertheless, one can characterize this area as low-hanging fruit, because there is so much room for improvement. Despite the nuances of having different types of financial saving, with different types of institutions and regulations for collecting and channelling them, the underlying economic behaviours are not difficult to model and analyse.

A comprehensive, evidence-based policy approach to household financial savings will also help draw attention to institutional weaknesses in financial services and financial intermediation. It can be politically difficult to deal with such weaknesses without an overarching goal. Improving the level, composition and channelling of India's household saving can provide the requisite framing for political feasibility of more fundamental institutional reforms, as well as reforms in tax policy and regulation for the financial sector. Institutional reforms here could include a greater role for private sector firms, more competition, and more effective use of digital technology. Patnaik and Pandey make all these points, and they just need more detailed modelling and simulation for evaluating policy options.

None of the above makes redundant the need for continued improvements in the climate for nonfinancial firms to do business, or to innovate, or to export. All the real aspects of producing and selling things in India are subject to hurdles that the government has the power to reduce or remove, if it decides it wants to be growth-promoting rather than rent-seeking or populist in its policy stance. But higher growth requires higher investment, and that will need more household financial saving, channelled to productive uses. This is an area that needs better policy attention than it has received.

*August 1, 2019*

## Kashmir and Development

"Audacious" seems to be an appropriate word to describe the step that the Indian government took in early August, not only dispensing with Kashmir's special constitutional status under Article 370, but also splitting it into two, and downgrading both parts to Union Territories. The ruling party had long and openly declared its intentions for Article 370, but the manner of its implementation of those intentions was more than surprising.

There are many dimensions of the implications of what the ruling party has done. Internationally, the government's actions may increase regional tensions, and escalate the existing level of conflict, at least in the short run. Domestically, the implications for Indian federalism, which has tried to balance the complex heterogeneity of India, especially its peripheries, seem to be negative as well. That the national government has flexed its muscles so obviously, both as a regional power and as a centre that dominates subnational units, is unsurprising, and fits with its larger project of creating a homogenized, "Hinduized" nation. Much has been, and will continue to be written on these two aspects of the Kashmir action. What deserves a little more analysis are the implications for Kashmir's and India's development. India's current rulers have gone to some lengths to stress that "integrating" Kashmir into India will be good for Kashmir's economic development. Is there a basis for this claim?

First, one has to unpack the idea of development. This goes back to recent debates in India about aggregate GDP growth versus broader goals of development, such as the enhancement of freedoms and capabilities, and amelioration of economic inequalities. Whereas those debates were sometimes posed in terms of opposing goals, it is arguable that they are complementary in the medium and long run. From this perspective, the actions in Kashmir do not seem conducive to sustained development. A population that was already feeling discriminated against and oppressed is only going to feel more so. If growth comes from investment by non-locals, it is likely to exacerbate existing inequalities.

In the case of gender inequality, the claim that Kashmiri women will especially benefit from this move (with the underlying but unspoken idea that Islam is unequal in its treatment of women) seems to be belied by Internet postings that now non-Kashmiri men can marry Kashmiri women (along with buying property and take jobs there). There is a certain ugliness to the discourse that the national government's political action has unleashed with respect to Kashmiri identity and autonomy. Furthermore, there is ample evidence that gender inequality is a regional problem in South Asia, especially its northern plains, much more so than any religion-based explanation.

More directly, if we think about the conditions for successful development, they involve investments in physical infrastructure and human capital. These will still be needed in Kashmir, but the truth is that all of those investments could have been made without any change in Kashmir's political status. That change is a complete red herring with respect to any deficiencies in Kashmiri economic progress. The case of Punjab is illuminating here. Punjab has, at least since the 1950s reorganization, been a state without any special status. Investments in specific infrastructure by the state and national governments allowed the Green Revolution to take hold and to flourish. But when neither level of government did enough to upgrade the state's infrastructure to go beyond producing wheat and rice for the national public food distribution system, matters deteriorated rapidly. Inequality increased, water shortages arose, and the state was locked into an economic structure that is headed for disaster. There was no rush of private investment, despite the positive reputation of the state and its people, and Punjab has struggled with violent conflict and societal ills like drug and alcohol abuse.

Indeed, Punjab illustrates another lesson: the national policy of making Punjab subservient to the national goal of foodgrain self-sufficiency without adequate long run resources, because it arrested Punjab's development, contributed to political conflict. This conflict was exacerbated by Punjab being a minority-majority state, situated on a volatile international border. And none of this had anything to do with any kind of special constitutional status. All of this suggests that the promises of economic development for Kashmir are based on false premises. A centrally controlled effort, dominated by non-locals, in a situation where the local majority already feels oppressed, and there is international military tension, is unlikely to lead to any significantly positive outcomes.

To summarize, India may indeed demonstrate its regional might by absorbing Kashmir more firmly into a centralized national polity, and perhaps the government's radical moves will lead to a recognition of the de facto "lines of control" as proper international boundaries, and less conflict in the long run, after some short-run instability. India may also move further along on the current government's project of creating a homogenized, centralized nation, culturally as well as politically (much as China has done and is doing in Tibet and Xinjiang), though that would be a depressing outcome, over any time horizon. But the claim that the government's recent political actions have anything positive to do with economic development, either as aggregate growth or more broadly interpreted, seems to lack any basis in experience or in theoretical understandings of what leads to sustained progress.

*August 20, 2019*

**India's Bank Mergers**

The planned mergers of several of India's public sector banks represent another bold move by the current government. It is hard to imagine previous governments acting so dramatically, although there have been previous bank mergers, as the problem of non-performing bank loans has emerged over the past few years. The gravity of the situation certainly calls for decisive steps, although recognising bad loans and cleaning up balance sheets directly is what is truly needed.

Why merge banks? For financial institutions, combining portfolios can provide additional risk diversification, and that is part of the motivation. India's banks are relatively small by international standards, so mergers could also provide economies of scale and make the merged banks more competitive. More importantly, combining weak banks with stronger ones (in terms of balance sheets) can reduce the risk that the weaker ones go under, although one has to be careful that the weak ones do not drag down the strong. Presumably the mergers that were chosen have this rationale, and the underlying analysis has been performed to support the decisions made.

An additional potential benefit is that, if the stronger banks in the mergers were better managed than the weaker ones, they can transfer their better management practices to the acquired entities, leading to banks that are better run. Whether this turns out to be true has to be seen, and there are genuine concerns that the "acquiring" banks will find their management expertise and attention stretched beyond what they can handle, especially in a situation where they are already dealing with the problems created by non-performing loans. Potentially, this difficulty can be handled by hiring experts specifically to implement the mergers, which will require combining all kinds of information technology systems, as well as organisational structures. Both software and people are likely to present challenges, and affected bank employees are already expressing unhappiness with the mergers. All of this is manageable, provided that adequate attention and resources are devoted to seeing through all the detailed implementation steps required.

Will the costs of the mergers be worthwhile? It is hard to be sure. There is another aspect of the situation that may reduce the net benefits of this entire exercise. The problem is that public sector enterprises in India are not just inefficiently run, on average (which may not be improved simply by merging several organisations into one – recall the merger of Air India and Indian Airlines), but they also are subject to exploitation by politicians. This is especially true for banks, which can directly dole out money to those who are politically favoured. Nothing in the process and outcomes of merging public sector banks solves or even reduces this problem.

The real solution is to have a system where political distortions are less likely to occur, and that means relying more on private sector enterprises – though they, too, may be subject to political pressures, and even extortion. Currently, private sector banks in India are less affected by non-preforming loan problems. Some of this difference may be because they can cherry-pick customers and choose lending strategies that are driven more by profit maximisation, without social goals being factored in. But in India, even private sector banks are required to make some loans based on social goals. And private sector banks can also be looted by those with connections, political, familial or other. But on the whole it does seem that private banks in India have been better run and performed better than their public sector counterparts.

The implication is that allowing existing private sector banks to expand, or new ones to enter, and reducing the government's stakes in public sector banks may be necessary steps, irrespective of the current pursuit of mergers. In that case, one might question the wisdom of expending resources on the mergers, rather than moving towards greater privatisation. Again, it is difficult to make blanket judgments, and one will have to see how the implementation or mergers proceeds. But one should constantly stress the need to fix the underlying problem of non-performing loans, as well as the organisational weaknesses that contributed to the loan problem in the first place.

Another, deeper structural issue that also needs attention is the limits of traditional banking, especially in the age of digitisation. Other types of financial intermediaries may be more suitable for many kinds of financing of investment. The problems of non-bank financial companies in India illustrate the urgency of structural reforms that are needed there as well. There is also the potential to use digital platforms for intermediating savings and investment for various needs, and the government and RBI should both be working to accelerate innovations in financial intermediation, while making sure that regulation is well-designed and properly implemented to reduce moral hazard problems.

While the bank mergers have attracted considerable attention and will continue to be analysed, the issues they are addressing are only the tip of the iceberg of financial sector reform that India desperately needs. This aspect of economic reform deserves to receive more attention from the media and from academic economists, as well as from policy makers. If the bank mergers trigger this increased attention, that will be a welcome spillover.

*September 8, 2019*

## Federalism and the 15th Finance Commission

The current ruling coalition has shown a propensity for bold moves, in its attempt to reshape India's polity and society to match its vision of the nation. The economy has sometimes received similar treatment, with the GST finally being implemented, and with demonetisation and public sector bank mergers as two other examples. The last Union Budget was somewhat timid, perhaps, given the growth slowdown, but recent economic policy changes have shown more willingness to respond more vigorously to the problem.

Of course, boldness does not guarantee that a decision is the best possible, or even that it is a move in the right direction. The Terms of Reference (ToR) for the 15th Finance Commission (FC XV) reflect that cautionary observation. Finance Commissions have been one of the success stories of India's constitutionally created institutions. Despite shortcomings, they have established precedents, mostly dealt well with challenges and changes in the country's federal finances, and retained some degree of independence and integrity. The central government has not always adopted their recommendations whole heartedly, but overall, it has respected the institution. The current challenge, however, is whether the ToR will push FC XV into problematic territory.

The main job of the Finance Commissions has been to recommend tax sharing rules between the centre and the states, and among states, supplemented by other kinds of fiscal transfers. A major goal has been to help poorer states fund adequate levels of public services. The challenge has been to achieve this without unduly damaging state government incentives for raising their own revenue and for spending with profligacy. Given the large transfers required by the constitutional assignments of tax authority, and India's heterogeneity, the outcomes have not been too bad, certainly better than in some other large federal nations, which have seen subnational governments spin out of control.

So what is the problem with the FC XV ToR? I would argue that they are too expansive, and that this expansiveness is in the direction of tilting the fiscal balance further in favour of the centre over the states. In particular, the call to revisit the previous FC's decision to increase the share of the states is worrying – that decision made a great deal of sense in putting the states on a firmer fiscal footing, while also reducing the scope for discretion and political wheeling and dealing that comes with it. As Govinda Rao had pointed out in 2017, the net increase in the states' share was much smaller than what still gets reported, and going back on what the last FC did will be damaging. The ToR also places emphasis on providing performance incentives to states, and controlling "populism," but that raises all kinds of difficulties in defining that term, and could lead to a complex mess, just when the last FC had succeeded in simplifying somewhat the criteria for fiscal transfers. Incentives of this nature had been tried earlier, and did not seem to work particularly well.

Perhaps the most striking example of pushing the envelope of the ToR is the recent, last-minute addition of asking FC XV to suggest ways of allocating non-lapsable funds for defence and internal security. Aside from issues of process, the aspect of concern here is that a technical panel that has already almost completed two years of consultations and analysis is being asked to weigh in on issues of expenditure that have a high level of political sensitivity. It fits in with an approach to the ToR that seems to push FC XV into serving as a political tool of a particular national agenda.

It is certainly possible that the final report, now due at the end of November, will manage to finesse the political difficulties. Certainly, FC XV has extraordinary technical issues to deal with, after the introduction of the GST, the elimination of the Planning Commission, and the proposal to change the base year for population weights (which poses its own set of political challenges). But I would argue that the centre's ToR have been bold in the wrong direction, towards greater central control. What is needed is a fiscal federal system in which states and local governments (particularly cities and larger towns) have greater autonomy to decide on their own revenues, perhaps by piggybacking on the central income tax, or by strengthening local property tax systems, or other avenues that will allow subnational governments to be judged by their constituents on whether they are raising these revenues effectively and translating them into higher quality public services. Centralisation of fiscal authority merely allows subnational governments to go on contending that the centre is the source of their problems.

Increasing the fiscal authority and autonomy of state and local governments will require constitutional changes, but these have been implemented before in the realm of fiscal federalism, and the government has demonstrated its willingness to be bold in other arenas. Given the timing of the FC cycle, perhaps the centre, through the NITI Aayog, should immediately consider structural reforms in India's fiscal federalism that will promote efficient subnational spending on health, education and infrastructure, and lay the groundwork for the kind of broadbased growth that India needs.

*September 15, 2019*

**Rescuing India's Economy**

The Indian economy is in a very difficult position. Instead of engineering a growth acceleration to go with a demographic dividend, policymakers have allowed growth to slow dangerously, with underlying causes that can lead to long-term harm. The most severe problem lies in the financial sector. Financial intermediation is meant to channel funds from savers to investors. The investors are supposed to put the money to productive use. This generates returns for investors and savers, and overall economic growth.

When the global economy was booming, India also grew rapidly, and saving and investment rates went up, supporting that growth. When the financial crisis hit, like most countries (developed or developing), India injected fiscal and monetary stimulus to ward off a depression. But this allowed a situation where a lack of structural reforms meant that savings were going more and more to speculative or unproductive investments (or simply being effectively stolen).

What we are seeing now is wave after wave of problems associated with a speculative boom gone awry. First it showed up in the banking sector, then in non-bank financial companies, and most lately in cooperative banks. There is plenty of blame to go around for this situation: politicians who are corrupt, lack knowledge, or focused on their own power; bureaucrats who share the same traits; regulators who are out of their depth in a complex modern economy; and economists who also know less than they admit.

But rather than spend time pointing fingers, we should focus on remedies. The situation is dire enough that this should be thought of as a rescue operation. The broad contours are easy enough to lay out, but turning those into detailed, coherent, well-implemented policies will be a challenge, as it always has been in India. The biggest priority is a clean-up of the financial sector. An overhang of bad debts can kill growth for many years. Just look at Japan. More focus, attention, expertise and resources need to be devoted to this ongoing task.

Second, the clean-up needs to be accompanied by structural reforms. Too many financial institutions in India are poorly structured, poorly managed, poorly regulated. Fixing this will be a Herculean task. Structural reforms create losers and they resist those changes, but the danger of extreme outcomes can help to concentrate everyone on minimizing the pain. Of course, sometimes an outsider has to make the tough decisions. The additional cost of bringing in expertise is trivial compared to the potential economic damage of a financial standstill. The regulators really need to step up here, since the problems have arisen because of their failures as well.

With respect to demand and growth, consumption and investment are the major components of demand. There is a chicken and egg problem here. If households are not spending, then firms have no incentive to invest, especially if they already have too much capacity. The government has given tax breaks to households and firms, but directly putting money into consumer pockets is needed. Rural work programmes are a relatively inefficient way to do this, but putting money into all the new rural bank accounts that have been created might help.
What happens to inflation and the fiscal deficit? In retrospect, the inflation hawks seem to have missed the signs of a downturn. Monetary policy stayed tight long enough to crush high inflation expectations, but too long given all else that was going on. Aggressive monetary easing, as is going on, will help, but it has its own

problems, since it hurts savers, and doesn't necessarily increase borrowing and investment when balance sheets are bad and uncertainty is high.

The biggest mistake has been a fiscal responsibility framework that neglects the business cycle and the possibility of severe downturns. The government should be less focused on fiscal deficit targets in the short run, and should not try to pretend they are being met by creating over optimistic projections. In all of this, the failure of economists to provide robust and reliable models of the behaviour of India's macroeconomy is striking.

The government has a perennial problem of failure to raise adequate tax revenues. Periodically, it resorts to "tax terrorism," which only creates more uncertainty and damages growth. A programme of improving the tax structure and administration from centre down to states, cities and villages needs to be implemented to address this problem. Meanwhile serious privatization is an obvious and necessary step to reduce one aspect of the government's own wastefulness.

In 1991, India faced a severe crisis that triggered major reforms. Those reforms would have been politically difficult otherwise, but were easy to conceptualize and implement, since they involved removing controls that were strangling economic growth. The problem had been brewing since the late 1980s, and smaller efforts at reform had been made. Now the government has to conceive, prioritise and implement more complex reforms, which involve improving the quality of many public institutions. Its recently won robust parliamentary majority give it political room. It will be interesting to see if it can and will assemble the varied expertise and knowledge needed to rescue India's economy before things get even worse.

*October 9, 2019*

**The Economics Nobel Prize**

This year's Nobel prize in Economics was particularly noteworthy for several reasons. For the world as a whole, the fact that one of the winners, Esther Duflo, was only the second woman and – at 46 – by far the youngest ever, Economics winner stood out. Duflo has been vocal in pointing out the deficiencies of the profession in terms of making women feel welcome and valued. Her prize will help to accelerate a corrective process already underway.

The prize, of course, was not based on gender, but the work done, and it was noteworthy also for recognizing a methodological approach that has sought to understand the causes of poverty by doing field experiments, or randomized controlled trials. Duflo's co-winners, Michael Kremer and Abhijit Banerjee, while a decade or so older, are still relatively young prize winners, which adds to the statement being made about the value of this kind of research. The benefits, of course, are precision with respect to causes – if one is interested in whether A causes X (and how much is the impact), controlling for other factors, applying the 'treatment' A, and having a benchmark, or 'control' ('not A') to further isolate the impact of A on X, is much more reliable than using data that was collected for other purposes. In the latter case, one might pick up correlations and confuse them with causality, or be unable to control for other factors, and end up with misleading estimates of impacts. I will return to the methodology shortly.

Kremer was cited for pioneering experimental work in East Africa (interesting fact: my colleague, Jonathan Robinson, once co-authored an important paper with Duflo and Kremer, explaining seeming puzzles in the use of fertilizer by Kenyan farmers, and he has gone on to become an important practitioner in this academic area), but Banerjee and Duflo have mainly worked in India. Indeed, Banerjee and Duflo are husband and wife, and the supreme academic power couple. Their story, and the fact that they have also been producing non-technical books that explain the relevance of their work (*Poor Economics*, published in 2011, and *Good Economics for Hard Times*, being published next month), has been dominating the headlines, overshadowing their co-winner to some extent.

Of course, the fact that Banerjee is of Indian origin, and has been commenting and advising on Indian economic policy, has been extremely important for a nation that has been somewhat starved of good news in recent months. There are certain ironies in his academic pedigrees from India, Presidency College and Jawaharlal Nehru University, in terms of the state of higher education in India, as well as national and state politics. For the moment, everyone is celebrating his prize, and he is "fully Indian," something that Raghuram Rajan was once accused of not being. Coincidentally, Banerjee and Rajan wrote and spoke together exactly on the day the prize was announced, and Banerjee's recommendations included prescriptions for fiscal and monetary policy in the short and medium terms, as well as the suggestions that might most appeal to the government, 'pray' in the short run and 'pray more' in the longer run. Banerjee and Rajan were two of over a dozen co-authors of a report on India's economic strategy, which I commented on in these columns at the beginning of 2019.

Banerjee and Duflo, and many others, have made working on the Indian economy more mainstream and respected in the economic profession in the US, and that has been a welcome outcome of their passion for doing relevant economic research. I have previously highlighted the portal, Ideas for India, where non-technical accounts of much of this work can be found. A look at the range of that research also reminds us that there is much to be learned from so-called administrative data (such as household surveys) as well, despite the challenges posed for identifying clear causal relationships between policy 'A' and outcome 'X.' Diane Coffey and Dean Spears used different kinds of data, and not just field experiments, to make the case for paying more attention to sanitation and access to toilets, with visible impacts on policy and politics. In other cases, such as questions of what is happening to household savings in India, the only useful data may be from large-scale surveys, and not smallish field experiments.

One hopes, therefore, that after the immediate glow of the prize has passed, Indian government decision-makers, including both politicians and bureaucrats, and at the state and national levels, will be more and more open to making administrative data readily available to researchers from all nations, and giving freedom to researchers to conduct field experiments. It must be noted that university researchers are already subject to strict standards for how they deal with human 'subjects,' by their home institutions. A corollary of this openness is being willing to allow NGOs or non-profits the flexibility to fund and collaborate in these studies, since they can often bring in local, ground-level expertise that makes the research more reliable and valid, or make it possible to do the 'trials' at scales that are more informative and policy-relevant. One should also remember that bureaucrats can be an important source of information for asking the right questions and designing the right policies to test – strengthening that avenue of interaction could also reap rewards for India's economy.

*October 17, 2019*

**The Reforms that India Needs Now**

The current state of the Indian economy is bad enough to merit the description of being in a crisis. This is not the kind of crisis that triggered the economic reforms of 1991. At that time, India was facing the prospect of being unable to pay its bills to other countries, whereas now its problems are much more domestic, and superficially not as severe, with growth still at around 5 percent. The remedies now are also going to need to be very different. Removing controls and cutting punitive import duties and tax rates is not where major reforms have to come, although trimming some tariff rates could help Indian firms that need to import equipment or intermediate goods that they need for efficient manufacturing.

The biggest problem, as has been said in this column multiple times, is in the financial sector. First banks and then nonbank financial companies (NBFCs) have run into trouble, and credit has dried up in many key areas of the economy, with domino effects on real economic activity in those sectors. Cleaning up this mess will require major, concerted efforts if it is to be accomplished in a way that minimizes the depth and length of the crisis. Bankruptcy and default situations involve renegotiating complex sets of claims by multiple creditors, and a poor resolution process can lead to an ongoing destruction of value, as uncertainties are prolonged, and forward-looking actions such as new investments are put on hold.

India's new bankruptcy code represented a significant step forward, but it has not yet been operationalized in the best way possible. Some of the problem lies with a judicial branch that is relatively inexperienced in such matters, perhaps to the point of lacking sufficient competence and expertise. A large problem may be continued political interference. Political corruption and cronyism have been the bane of India's financial sector. Government bureaucrats and financial regulators also lack sufficient expertise and experience, along with a problem of bandwidth. This is one area where bringing in foreign knowhow could be very valuable. It would be expensive, but with many billions of rupees of lost economic activity at stake, it seems that it would be an appropriate crisis response.

Unfortunately, the government has seemed reluctant to being open to ideas and expertise from outside. A welcome trend of involving academics of Indian origin with stellar reputations has been reversed over the past few years. Even the warm glow of Abhijit Banerjee's Nobel prize only lasted a few days, as he became subject to ugly personal attacks by prominent ruling party members, annoyed by his gloomy, if realistic assessment of the Indian economy. Right now India needs more experts like him, who will speak their minds and provide unbiased analysis, as well as specialists who can manage and accelerate the process of financial restructuring.

Another opportunity for "crisis driven" reform is in privatization. In the long run, the GST will help India's government in raising more revenue, and as growth recovers, personal and corporate income taxes will also be more buoyant. But for now, a well-structured, transparent series of privatizations, in areas such as the financial sector, telecoms, and air transport has the potential to raise revenue that the government needs to avoid a different (more traditional) kind of economic crisis. Privatization will also have large long run benefits, as money losing public sector enterprises are removed from the government's broader fiscal responsibility basket, and are forced to become more efficient and competitive. This kind of privatization has to be whole-hearted, not just the sale of minority stakes that do nothing to force greater efficiency of operations. Again, experts are needed who can design the mechanisms for structuring these privatizations, and the biggest challenge is whether the government is willing to recruit them from a global pool.

A complementary reform to privatization is opening up entry in some areas of finance, in particular, but also possibly in telecoms and other sectors where there is a shortage of supply, dominant players behaving as monopolists, possibilities for growth, or all of the above. Just repeating slogans about a $5 trillion economy will not bring it about, and not having a broad vision of where the growth will come and how it can come about will ensure that the goal remains unattainable for a long time. Having a concrete vision of what a robust economy, driven by competition and innovation, might look like in the next decade will also require expertise from around the world, including from people who do not necessarily agree with the government on everything, or indeed, on anything.

The ruling party has a solid national political mandate for the next five years. It will soon complete its project of extending that mandate to enough states so that political control of the upper house of parliament is also ensured. But political control will be worthless if it is not used for decisive actions with respect to the economy that will restore growth and even accelerate it finally to East Asian miracle levels that have remained a mirage for almost three decades. Making the right decisions will need openness to ideas and drawing on global expertise in ways that have so far escaped the thinking of the current government.

*November 5, 2019*

**Imagining a New Green Revolution**

The Green Revolution of the 1960s saved the people of India from chronic food shortages, and the government from embarrassment at having to receive foreign charity. The label refers, of course, to the introduction of high yielding varieties of grains, especially wheat and rice, combined with irrigation and use of chemical fertilisers, to increase yields and total grain output. In India, the Green Revolution is closely bound up with the then-state of Punjab (now Punjab and Haryana), where the innovations first took hold, and with the working of the Public Distribution System (PDS), which procures wheat and rice at minimum prices, and makes them available at subsidised prices to consumers.

More recently, the label "Green" has come to mean something quite different, namely protection of the environment, including air, water, plants and animals – that is, the ecosystem. It is the height of irony, therefore, that one of the consequences of the original Green Revolution is to work against "greenness" in this newer, world-sustaining sense. Matters have come to a head with the widespread, life-threatening pollution caused by burning of rice stubble in Punjab and Haryana. The Supreme Court has acted decisively, if somewhat emotionally, by demanding that this burning come to a complete stop. The desired outcome is understandable, because of the scale and severity of the problem. But the Court's punitive approach towards farmers, inevitable given the scope of what it can do, will not solve the longer run and deeper underlying problem. The Court has chastised the two state governments, with some justification, but the true causes lie with the policies of the Union government.

Over five decades ago, India's government needed to solve the problem of food shortages, and vigorously promoted the Green Revolution. Punjab, for various reasons, took the lead, and enhanced prosperity followed for the state, as well as a sense of pride in feeding the nation, in being India's breadbasket. But already, by the early 1970s, problems were beginning to emerge. The rivers of the plains of Punjab and Haryana that remained in India were not able to provide enough water to meet the demands of the new growing technologies. This problem grew worse when rice began to be grown in Punjab, following the lead of wheat: the PDS and the logic of crop rotation drove this shift to rice from other crops, creating a wheat-rice cycle that further locked in farmers.

Without enough water from rivers and canals, tubewells powered by electric pumps became a major source of water for irrigation. The political economy of the two states, especially Punjab, dictated free water and power to keep the Green Revolution going. Groundwater levels began to fall precipitously. Attempts at crop diversification failed in the face of the dominance of the PDS and guaranteed minimum prices for wheat and rice: change was too risky for farmers. The response was to force delay in planting paddy, to reduce demands on groundwater. This worked, to some extent, but squeezed the timing of the wheat-rice cycle so much that burning the rice stubble became the only viable solution for farmers already struggling with diminishing returns and lack of power vis-a-vis larger intermediaries providing inputs and credit.

Delhi is choking because the Green Revolution was pushed to the point where it became distortionary and dangerous. Even if stubble burning is stopped by paying or punishing farmers enough, Punjab will turn into a desert in just a few years. The Green Revolution contributed to a particularly disastrous mix of politics, economics and religion in Punjab, and the state has lacked good governance and fiscal resources for a long time. The Supreme Court's approach to the problem, while legally impeccable, is likely to exacerbate conflict: already one is reading about farmers burning rice stubble as a protest against the larger forces that are destroying the last vestiges of the great hopes that were once associated with the introduction of high yielding varieties.

The bottom line is that this is a national problem, not a local or regional one. And it will be solved not by piecemeal and punitive measures, but by imagining and implementing what I will call a New Green Revolution. In this case, the colour will be more appropriate, since apparently the original name came from a US official offering an alternative to the "Red Revolution" in the Cold War era. A New Green Revolution will involve crop diversification, economic diversification (including animal husbandry, food processing and more), a reinvented agricultural extension system, implementation of numerous technologies for saving water, reducing use of chemical fertilisers, and a major overhaul of the PDS system, indeed, of India's policy thinking about food security.

A New Green Revolution will require a deep version of cooperative federalism, not one where the centre and states just bargain over an existing pie such as tax revenues, but cooperation in redesigning economic institutions (both public and private), regulatory schemes, and market interventions. Cooperation will have to be not just between the centre and states, but among the states themselves, particularly Punjab, Haryana and Himachal Pradesh.

Most of all, a New Green Revolution will have to involve a shared vision with the people of the region and of the country, about what future prosperity can look like. Farmers in the 1960s certainly followed economic incentives, but they also felt they were part of a national vision of improving the lot of the entire population. India's politicians have failed to create a concrete new vision, but maybe choking on burned rice stubble can change that.

*November 16, 2019*