

## **Economic governance in India: Quality of political leadership important**

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There is much noise about governance, or rather the lack of it. There is also much lamentation about poor economic governance amongst the business community. It is important to step back and reflect on what we mean by the concept of governance itself and then try to evaluate where we as Indians stand.

We cannot really talk about economic governance in isolation. Good economic governance depends on political governance. The concept of economic governance and political governance cannot be disassociated from one another. I was struck when I re-read a very influential essay that was written in 1989 by Francis Fukuyama who, following the fall of the Berlin wall, argued that while there might be many competing forms of social and political organization, none could claim to be superior or more effective or more durable than the idea of a liberal democracy. And he went further to make the case that for the idea of liberal democracy to remain sustainable and alive, ideally it works better and is bolstered by free markets. In essence he made the case that the combination of liberal democracy and free markets had proved to be the most successful and durable form of social, political and economic organization. But a lot has happened since then. Most notably the world has seen two major financial crises: the 1997 Asian financial crisis and then the so called global financial crisis of 2008. Both of these crises have reignited the debate about how well liberal democracy and free markets work together, about the role of markets, about their efficacy, and about their contribution to growing inequality. In parallel, we have seen the spectacular economic success of an alternative model: that of state capitalism represented by the Chinese experience. Many are wondering if Francis Fukuyama was premature in announcing the “End of History”.

Turning to India, let us start with the question: are we a successful democracy? If you look at how India has delivered versus the Millennium Development Goals (MDGs) compared to China, we are way behind. Whether it is life expectancy, whether it is poverty reduction, health, nutrition etc. the empirical fact is that despite being a representative democracy we seem to have failed to deliver on the basics for our citizens. Viewed through this lens, some would argue that India cannot be regarded as a successful democracy. If a country like China, without a free political system, can deliver substantially greater economic prosperity than India to its citizens, has democracy served India well? This line of reasoning may be logical but it is troublesome. Our notion of what is good for our society surely must be firmly anchored in a certain moral and philosophical value system, one in which we as Indians attach value to freedom of choice. In fact, the importance of being able to choose who governs us cannot be measured. The success or failure of governance in India cannot, should not, must not be gauged only in terms of our economic performance. Such an evaluation must also take into account what else we have achieved since Independence. It is to such an evaluation that I now turn.

What is the record of political governance in post-Independence India? While it is absolutely true that in terms of the millennium development goals our performance has been disappointing to say the least, the evidence is strong that we have succeeded in building a robust democracy. Consider the following. At the time that we became a republic, the probability that most ascribed to India surviving as a democracy was close to zero. Recent empirical research by political scientists who have reviewed data on emerging democracies shows that income per capita is by far the most important predictor of a successful democracy. The wealthier the country at the time of “democratization”, the likelier it is to survive as a democracy. India is quite the exception. We had the lowest per capita income of any country as we embarked on our democratic journey. And we continue to be a vibrant democracy despite the fact that our per capita income is lower than almost any other functioning democracy in the world today.

I think it is incontestable that Indian democracy has, over the past 60 odd years, become more representative. Take the very simple indicator of the cast composition of our country. Schedule Castes, Schedule Tribes and Other Backward castes comprise some 65-70% of the population. And if you look at their participation in levels of decisions making, and their participation in politics generally, their influence today, compared the time before we got universal suffrage has grown dramatically. The experience of South India in particular is very interesting in this regard. This is a part of the country that saw a social revolution going back to the 1920's and 30's and where the 1950's and 60's saw very effective Dalit participation in politics. That this led to the end of the hitherto disproportionate influence and dominance of the Brahman elite is well established. Arguably, the Mandal movement represents the unleashing of the same dynamic some 40-50 years later in North India. What we saw happen in South India going back to 1950's we are seeing unfold in Northern India starting with the Mandal movement of the 1980's. It is incontestable that lower caste communities have greater voice in the governance of our country today than ever before. For a society that has been burdened by the insufferable rigidities of an intensely hierarchical caste system, this is no mean achievement.

From the sociological perspective, social equality and social dignity are equally if not more important than economic equality. Whereas we may not have been as successful in delivering economic equality to all those who have been disadvantaged historically, we have made significant progress -- even though we have further still to go -- in terms of delivering greater respect and recognition for the socially oppressed.

Thus, our political system may appear dysfunctional and corroded by corruption, but it has actually delivered quite robustly on political governance in the sense that it has greatly enhanced the representation of, participation by, and dignity for, disadvantaged segments of our society.<sup>ii1</sup>

Now let me come to the question of economic governance. Even as we started our post-Independence political journey whole heartedly embracing liberal democracy, we did not start with the same enthusiasm for markets. Even though our political governance, for all its flaws, has proved to be robust, we have fared less well with economic governance. On the economic front we started with the Nehruvian state-led so called "mixed economy" model. This model has over the past couple of decades been lurching somewhat reluctantly towards a more market based economy. The watershed for this transition was the macro-economic crisis of 1991 which became the trigger for deregulation and economic reforms under the Narasimha Rao led government. From Independence to that time we were, in the economic sphere, used to managing and administering a system that relied very much on state intervention of various kinds. And the entire bureaucratic machinery of the state was trained and conditioned to that way of functioning. The same goes for our judicial and dispute resolution machinery. Since we started the economic reform process in 1991, I think that we have not been very successful in changing the paradigm of state engagement with the private sector from how it was in the era of "command and control" to an era of deregulated markets. And this I believe is the challenge of economic governance that we face today. Ironically, this challenge of economic governance has been made tougher by the very success of our democracy in political terms. Managing the interplay between democratic politics and entrepreneur-centric private enterprise in a context where institutions such as the judiciary and bureaucracy have not kept pace with the needs of the transition to a market economy is the central challenge of economic governance that we face.

Now let us come to the question of economic governance. Broadly speaking there are three classes of issues that we face with economic governance. First, is a set of problems that relate to our somewhat reluctant transition to a market economy. Although we started our post-Independence political journey whole

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<sup>1</sup> See Ashutosh Varshney's "Battles Half Won", 2013 for more on this line of reasoning.

heartedly embracing liberal democracy, we did not start our economic journey with the same enthusiasm for markets. On the economic front we started with the so called “mixed economy” model. During the first 45 years after Independence we created a most elaborate system for managing and administering the economy, one that relied very much on state intervention. Over the years, our bureaucracy and judiciary became conditioned to that way of functioning. As a result, since we started the economic reform process in 1991, we have not been very successful in changing the paradigm of state engagement with the private sector from how it was in the era of “command and control” to what it should be in era of deregulated markets.

Twenty years after “liberalization” the extent of state participation in the economy remains stubbornly large. For example, the share of PSUs in the combined sales revenues of all listed companies actually rose from 41% in 2003 to 43% in 2013. In infrastructure, the entire electricity supply chain, with the exception of generation, remains dominated by government companies. Fuel supply is the largely the monopoly of Coal India. Transmission is the monopoly of the Power Grid Corporation. And last mile distribution, except in a few cities, is controlled by State Electricity Boards, which remain notoriously dysfunctional. In agriculture, the pricing of sugar, the procurement and exports of food grains, the marketing of agricultural commodities, are all still subject to pervasive state controls. The state continues to play an invasive role in land markets and PSU institutions still account for more than three-quarters of the financial sector’s assets. This widespread government participation in economic activity has been used to pursue the state’s political agenda in a manner that has distorted markets and undermined economic governance. Directed lending to agriculture from PSU banks, free electricity through SEBs, subsidized petroleum products through the oil distribution companies are but some examples.

Being in a half-way house where the state is reluctant to give up economic space and the private sector is eager and anxious for more space has made effective business regulation difficult. An effective regulator must be independent and autonomous. But in an economy where the state itself competes with the private sector how does one ensure that the regulator is independent? Our country is replete with examples of sectors where we have an inherent conflict with the government competing with the private sector while also playing regulator. With a few notable exceptions, regulators such as those of the State Electricity Regulatory Commissions are typically retired civil servants that act largely to protect the political interests of the governments that appoint them.

Special interest groups wield enormous power in most democracies. In India, given the pervasive involvement of government in all manner of economic activity and business decision making, corporate lobbying has become a particularly important part of Indian business culture. The construction and infrastructure investment booms triggered huge competition for raw materials, land and government contracts and concessions. With stakes for private business having risen to unprecedented levels, lobbying has degenerated into “crony capitalism” over recent years.

A third set issues, hardly unique to Indian democracy, are to do with protecting the interests of future generations who do not vote vis a vis those of present day voters. It is not easy for democracies to balance inter-generational conflict. It is politically more convenient to indulge present day voters at the cost of future generations. It is expedient to borrow now and pay later. This is what drives our runaway subsidy bill and stubbornly high fiscal deficit. It also explains our eagerness to please farmers with free electricity, free water and cheap fertilizer even though the environmental consequences of these policies for our water table and soil quality are potentially devastating for future generations.

What is to be done? That economic decision making in our country is heavily politicized may not be good from an economist’s perspective of delivering optimum economic outcomes. But this is in a sense the price

we pay for democracy, the value of which cannot be measured in economic terms. The bottom line is that we cannot improve our economic governance by wishing away its underlying political drivers. Our electoral system has in fact been very successful in delivering greater representation and voice to historically disadvantaged members of society. We must build the rest of the essential institutional bulwark of our democracy and our economy. Here are few thoughts on what else we could do.

First, because we are truly exceptional case of a democracy that is hugely representative at a very low GDP per capita, we must experiment with new institutional structures and platforms that facilitate and support policy making from outside the traditional and very partisan parliamentary legislative process. We should try to build more “national institutions” like Election Commission, the Office of the Comptroller and Auditor General, the Finance Commission and the Reserve Bank -- institutions that can be trusted by all parties with issues of national interest. For example, the Planning Commission could be turned into a widely respected and non-partisan platform on economic policy, rather than serving mostly as an allocator of central government funds. The goal would be to turn the Commission into a platform that engages all stakeholders in dialogue on vital policy issues outside of Parliament. This could be perhaps be achieved by having members of the Commission appointed through an apolitical process and have its recommendations deliberated through a collegium of chief ministers. Another possibility is to build autonomous regulatory authorities that have the legal powers to make policy decisions on such issues as railway tariffs, user charges for essential services such as water, and the pricing of petroleum products. Indeed there is already a proposal to create a new Railway Regulatory Authority. I do not know if these ideas will work. I am merely suggesting that we must be creative about building and strengthening institutional platforms that permit adjudication of difficult policy questions of national importance in a non-partisan manner.

Second, we must build on initiatives to make governments in general, and the bureaucracy in particular, at all levels (centre, state and below) accountable for service delivery. Here is where greater transparency and community participation could be most effective. Policy cannot be formulated through mass participation – there are limits to direct democracy. But service delivery can certainly be improved through these means. This is where Nandan’s work on the UID Project could bring transformative change to the country. It is critical in my view that we ensure we build on this work. It could hold the key not only to the more efficient delivery of government benefits, but also the delivery of financial inclusion to the masses of households that are currently not served by the formal banking system.

Third, a huge effort is required to change the nature of engagement between the state and the private sector. To improve the quality of our economic management, our bureaucracy particularly, but also our judiciary and other institutions must evolve to higher levels of sophistication, competence and autonomy such that they facilitate, regulate and adjudicate economic activity, rather than supervise it or participate in it. This will need a lot of capacity building and training at various levels of the bureaucracy. It will also need improved coordination horizontally and vertically across different layers of government. Dispute resolution is an area that needs focussed and urgent attention. Specialist courts with suitably trained officials and an appeals process that does not have to go through the normal winding path of the mainstream judiciary are initiatives to think about.

Finally, the quality of political leadership is important. At a time in our evolution when the supporting institutional structures have still some way to go before they attain the requisite levels of competence and sophistication, there is a huge premium on leadership. Our country is too complex to rely on just an individual now. We must attract a new generation of leaders into politics -- leaders who are able to navigate the rough and tumble of electoral politics, but have also the perspective to be able to rise above its parochial and partisan compulsions.

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