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Modi's Economic Reforms: On-Track?

By Pradumna B. Rana

Synopsis

While government officials contend that significant progress has been made in economic reforms under PM Modi, analysts and commentators opine otherwise. Whose views are correct? The answer depends on which aspect of reforms one focuses on.

Commentary

THREE YEARS into his election in which he campaigned on a platform of economic reforms, Prime Minister Narendra Modi is attracting considerable debate on how successful he has been in his reform agenda.

Recently, the *Economist* ran a cover story arguing that Modi is not much of a reformer and lamented the missed opportunity (namely, low prices of oil, an important component of India's import basket). Similarly, the *Financial Times* argued that the economic boom of the past two years is wobbling and one major reason is the serious structural problems from which the country is unlikely to recover rapidly.

Arguments For and Against

Understandably, government officials disagree. Amit Shah, the president of the ruling party recently said: "The BJP government that took power three years ago has completely transformed the thought process of the people and has been successful in creating brand India". Arun Jaitley, the finance minister claimed that "no government in India has reformed as much as this one".

Whose views are correct? The answer depends on which aspect of reforms one focuses on.

If one's focus is on macroeconomic reforms then PM Modi deserves credit. The

adoption of inflation targeting by the central bank has successfully kept inflation under control, below the double-digit rate of the past. His “Make in India” campaign together with Skills India, Digital India, and Smart Cities campaigns have helped attract a record amount of foreign direct investment, albeit from a low base.

This is despite the fact there are many hindrances to doing business in India and the country ranks a low 116 among the 189 countries in the World Bank’s Ease of Doing Business Indicator. PM Modi was also instrumental in pushing a national biometric system (known as Aadhar) which has made it easier to dole out subsidies directly to the needy, bypassing the intermediaries who in the past pilfered up to three-quarters of the amount.

Modi’s most “eye-catching” and “boldest” reform has been the surprise “demonetisation” of large-value bank notes in November 2016. But here, recent evidence suggests that the costs (lower economic growth) have outweighed the benefits (digitalisation and control of “black money” and corruption).

The introduction of the Goods and Services tax (GST) had been under discussion for several years in India. But it was PM Modi who could strike a deal and get the GST implemented on 1 July 2017. In principle, the GST is an excellent idea. The plethora of state level taxes have erected barriers to the free movement of goods and services, fragmented the markets, and raised the cost of doing business.

The tangle of compromises and the complexity of the system has, however, led some analysts to reduce the projected growth stimulus to only 0.4 per cent. The growth stimulus will surely increase in the future if the six rates are eventually unified and the administration of the tax is simplified.

Lack of Progress in Microeconomic Reforms

Microeconomic reforms – sectoral and the second generation reforms comprising mainly governance and institutional reforms – had underpinned PM Modi’s campaign pledge of “minimum government, maximum governance”. During his June 2017 visit to the United States, Modi boasted that 7000 such reforms had been initiated, but this was a great exaggeration. If one focuses on the microeconomic reforms, therefore, Modi has not been successful in driving his reform agenda.

The much-discussed privatisation of state-owned enterprises has been slow. “Bad” debts in the financial sector have not been worked out. The government has also lagged in the provision of basic services to the private sector such as efficient and clean public administration system, education, healthcare, and a functioning market for land and labor.

A new bankruptcy law introduced in May 2016 is an area where some action has occurred. But even this law cannot be fully effective until the judicial system which has a huge backlog of pending cases – 24 million cases, nearly 10 per cent of them for over a decade - is reformed.

Aside from strengthening the Prime Minister’s Office, Modi has done little to reform the public administration and the civil service system. Governance indicators

published by the World Bank - which assess, among others, government effectiveness, control of corruption, rule of law, and regulatory quality - show that India ranks far behind many East Asian countries.

Educational standards are poor and the country lacks a capable and healthy workforce. Much of the education and healthcare is provided by the private sector because of the poor quality of public services.

In many Indian states, firms with more than 100 workers must seek government approval to hire and fire workers. As a result, many resort to contract workers or simply chose to forego economies of scale by remaining small. During PM Modi's first year in office, several states such as Rajasthan, Gujarat, and Andhra Pradesh had sought to partially liberalise their labour markets. But now it looks like these efforts have stopped.

Land is a state matter in India. If businesses need land they must approach the state governments which allocate land in much the same way as the old system which granted business licences.

Implications of Slow Microeconomic Reforms

Slow progress in microeconomic reforms means that the government has not been successful in creating an enabling environment for the private sector. Private sector investment could dip further and the present economic slowdown which began in early 2016 could continue unless it is offset by other favourable domestic and external factors.

The economy grew by only 5.7 per cent in the quarter ending 30 June 2017, the slowest since 2014. Progress in microeconomic reforms cannot be expected, at least, until after the 2019 election. As in the past, an inefficient public sector will continue to be all-pervasive in the Indian economy.

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