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Ajay Chhibber: India's missed reforms

Unlike China, India did not reform its bureaucracy and administration, and is now paying the price for this in terms of reduced growth

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India's growth has faltered in the last two years as inflation has remained at the highest level in the emerging economies. After a decade of heady GDP growth of 8-9 per cent per annum India now struggles to maintain even 4-5 per cent growth. The period of rapid growth saw poverty fall sharply when for the first time the number of extremely poor declined by 125 million in the period 2000-01 to 2010-11. Another decade of such growth would have seen huge progress in India's goal of eliminating extreme poverty and moved India out of the low middle income status. But with the slowdown in growth, India's ability to reduce absolute poverty further is threatened, and it could be stuck in a lower middle income trap for decades.

With the prime minister just having returned from China it would be good to understand better how China sustained rapid growth and very rapid poverty reduction for over three decades.

China began its first generation reforms in 1980 under Deng Xiaoping, which allowed a market system to develop and the economy to start growing rapidly. Some 15 years later Premier Zhu Rongji carried out a sweeping reform of the bureaucracy and public administration to ensure that a more effective and smarter government emerged to meet China's new challenges. This helped China maintain the momentum to sustained growth for another two decades.

India started its liberalisation in 1991 with then Finance Minister Manmohan Singh as the principal architect of the reforms. This helped boost growth for a decade or so. But India missed the bus on the second round of reforms. Had India followed the Chinese pace it should have carried out such reforms in 2005-06, the period of the UPA-I government, but coalition realities probably held it back from doing so. India certainly had another opportunity to do so again when UPA-II came back to power but did not take up the challenge. Perhaps it was distracted by the global crisis and perhaps second-generation reforms are not politically easy for a democratically elected government.

With elections looming we must now hope that a new government emerges with sufficient political momentum to grasp the nettle. On top of any list of priorities would be a thorough reform of the government. We must realise that India grows in spite of its government. But at some point even those low hanging opportunities to grow diminish, corruption becomes too onerous, competitiveness suffers, foreign investors stop coming and even the domestic private sector starts to invest abroad.

What does reform of government entail? The size of India's government is not outlandishly large - but its scope is very wide and as a result its capabilities are declining over time. Despite the 1991 reforms, which rid us of the licence raj, the government still remains involved in too many things and its new regulatory structure has reverted to a pseudo licence raj that it thought it rid itself of in the 1990s. And now judicial activism triggered by brazen corruption (scams) creates its own uncertainty. As they say, in India, unlike in East Asia, even the corruption is unpredictable.

The size of the civil service is by itself not large but its composition needs a huge restructuring - too many clerical and administrative staff and too few technical experts, teachers and health workers. At the apex of this bureaucracy sits a mandarin-like elite administrative service who are extremely competent and smart but who are shuffled around like a deck of cards at a bridge game and therefore have no time to develop the in-depth expertise needed to remain abreast of global developments in those fields. They lack the technical edge required to lead India's government policy in their sectors to retain our competitive edge and they often suffer from excessive political interference in their functioning. A more professional, contract-based civil service with promotions based on regular testing rather than a time-bound lifelong sinecure is needed to maintain a meritocratic culture.

The new bureaucratic elite are the regulatory bodies - often headed by retired senior government officials, not by technically competent experts as is the case in most other parts of the world. We need a blueprint of a modern regulatory structure which can then be developed over the next five years in a systematic manner. We need a system that will minimise regulatory capture but that does not choke private investment and allocates resources in a transparent and efficient manner. This should also allow private investment in many sectors where it is currently restricted, including in natural resources and defence production, and help avoid coordination problems which have led to a situation in which India, with the second largest reserves in the world, now imports record levels of coal.

India is becoming a welfare state before becoming a developed state. The compulsions of its democratic system have forced it to address the problems of poverty with subsidies rather than more long term sustainable solutions. As a result India now spends almost 4 per cent of GDP on subsidies (almost as much as it spends on public education and health) - but also delivers them in a very ineffective manner with high leakages. Again, the contrast with China is striking which has addressed poverty by creating jobs and providing basic services - health, education, sanitation and not through subsidies.

Even those emerging market economies that use subsidies have shifted away from product-based subsidies (food, fuel, fertiliser, etc) to more people-based subsidies (cash transfers) to reduce costs and provide the poor more flexibility in their decision making. India must move in this direction, reduce its subsidy bill and release more resources for health, education, water and sanitation.

A review is also needed of the roles and responsibilities of the central, state and local government. The proliferation of national flagship schemes has blurred the role and responsibilities of the Centre and the states and diminished accountability. The idea that the Centre will design national schemes which will then be implemented in a proscribed manner by state governments and districts with huge variability in their capacity and governance quality is itself absurd.

India does not need a smaller government, but a more focused, smarter and more accountable government with much clearer roles and responsibilities.

Countries that have grasped this nettle have gone through the "middle income trap". China is on its way - but many others have floundered. Will India grasp the nettle in the coming year and revive its long-term prospects is a hope all of us must ensure. At 8-9 per cent GDP growth India can not only eliminate poverty but become an industrial country in three decades. At 4-5 per cent growth India is unfortunately stuck in the middle income trap for another 50 years.

Our future and those of our children lies in reforming government now for rapid, sustained long-term growth. No quick fixes will work.

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