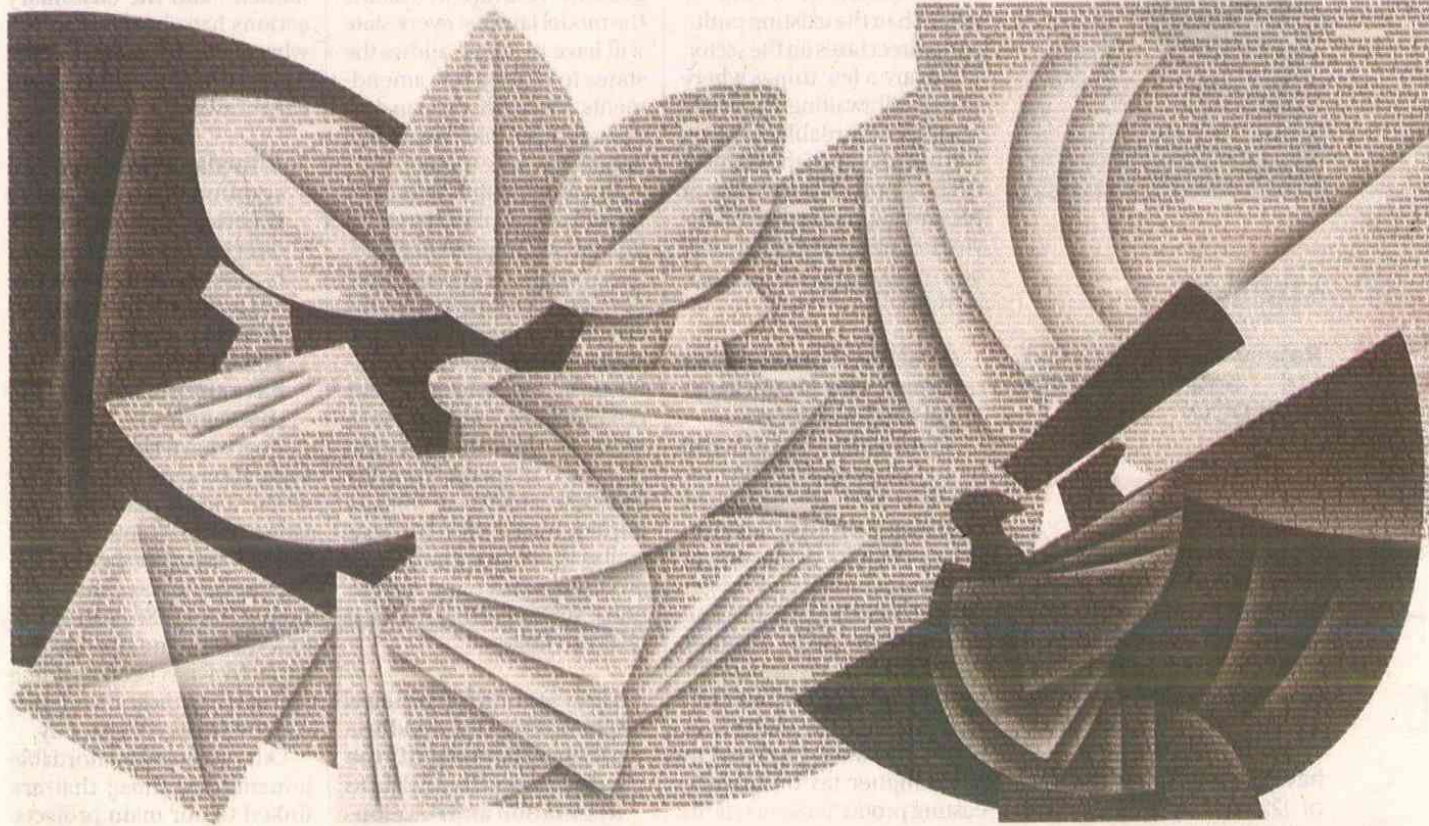


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Modi government: the next two years

The Modi government needs to now craft its own reforms playbook



JAYACHANDRAN/MINT

The Narendra Modi government completed three years in office last week. Any assessment of its economic performance should take into account what it inherited. India faced a near-crisis situation in 2013. Inflation had spun out of control. Public finances were a mess. The rupee was in free fall. Confidence was low owing to corruption scandals and economic mismanagement by the United Progressive Alliance (UPA) government in the years leading to the 2014 general election.

India has come a long way since then. The most important economic policy achievement of the past three years has been macroeconomic stability. Inflation is now under control. There has been a tentative recovery in economic growth. The balance of payments is comfortable. Part of this can be explained by the steep decline in global energy prices, but the retreat from loose monetary and fiscal policies has also been an important reason why the Indian economy is no longer fragile.

The reforms record has been a more mixed one—especially since Modi spoke on the campaign trail about minimum government and maximum governance.

The Modi government should be satisfied that the stage is now set for the implementation of the goods and services tax (GST). Even the flawed GST we are beginning with will boost overall efficiency in the economy. India now has a new monetary policy framework. The passage of the bankruptcy code will lead to more efficient allocation of capital. However, these policy initiatives were inherited from the UPA regime. The Modi government needs to now craft its own reforms playbook for the next decade.

There have been some important initiatives. A new fiscal framework is in the works. High-level corruption has almost disappeared. The auction of natural resources has been done in a transparent manner. The government has also taken a number of steps to check the flow of black money. However, the most radical move made by the Modi government was the withdrawal of high-value banknotes in November 2016. The benefits of the move are not yet clear, and will only be known in the years ahead.

The government has managed to bring down the fiscal deficit while increasing capital expenditure. A recent report by Deutsche Bank showed that government expenditure led by capital expenditure increased in the last two years of the term of every government since 1991, with the exception of UPA-II, when expenditure went up in the last year. However, barring UPA-I, higher expenditure did not result in a corresponding increase in the fiscal deficit.

It will be important for the Modi government to stick to the stated fiscal path, and not indulge in a spending spree like the UPA, as it could compromise the hard-won macroeconomic stability.

Along with maintaining fiscal discipline, the government will have to continue to work in areas that are holding back the economy. One of the reasons why growth has remained subdued in the last few years is the collapse in private sector investment. Policymakers have not been able to solve the twin balance sheet problem. A coherent strategy to clean up banks is still not in evidence. Privatization of public sector banks should be seriously considered.

Also, all efforts should be made to strengthen the corporate bond market in order to channelize long-term finance for Indian companies. This will also help boost activity in the infrastructure sector where private sector investment has been missing, partly because of the reluctance of banks to lend. An investment revival is critical for higher growth.

The government should now work on the next level of reforms. The Atal Bihari Vajpayee government managed to do a lot of things in the latter half of its tenure. For instance, the fiscal responsibility and budget management rules and pension reforms were implemented towards the end of its tenure. The looming political risk is that the job creation needed to maintain social stability cannot be addressed without reforms in factor markets. The complex web of laws does not allow enterprises to grow. The next level of reforms should simplify laws in the land and labour markets, which will significantly improve the ease of doing business in the country.

Finally, Modi should know by now that India is being held back by inadequate state capacity. The government does too much in some areas; and it does too little in others. It needs to build capabilities to manage the fastest growing large economy in the world—but not fall into the interventionist trap that it so often seems to be doing these days.

Recent history has clearly demonstrated that economic growth is the best solution for poverty alleviation and improving standards of living. Therefore, the challenge for the Modi government would be to take the Indian economy to a sustainable high growth path. And the next two years will be as important, if not more so, than the past three years.

What should the Modi government do to increase the rate of growth? Tell us at views@livemint.com