India
The Challenges of Reform
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Context for reform in India

India has an enormous, and growing, English-capable, tech-savvy middle class. It has global linkages through its diaspora. It is democratic and largely stable, with an active domestic market. However, for decades, India’s relatively low growth rate has indicated the existence of systemic barriers to economic progress. For those barriers to be cleared away, large-scale reforms are required.

Before seeing how successful, or not, the reforms of the current Indian Prime Minister Narendra Modi have been, it’s worth taking a look at the causes of those barriers, and the outcomes of previous attempts to clear them away.

Roots of systemic barriers to growth

Under the later phases of British colonial rule in what is now India, administrators were given extensive discretionary powers. In order to mitigate the temptation for corruption that could come with that kind of power, British officials posted to India were well paid, but severely punished (at least in theory) for dishonesty. This carrot and stick approach tended to curb at least some of the excesses.

After Indian independence in 1947, India’s first Prime Minister, Jawaharlal Nehru, retained much of the colonial administrative model giving Indian officials nearly unfettered rights to intervene in many aspects of commercial and social affairs. However, he combined that with a dramatic reduction in public sector salaries and little effective oversight.

What evolved was an almost inevitable system in which many poorly paid yet powerful civil servants used their positions of administrative coercion to supplement their salaries. For example, even as late as 2009, Mumbai policemen were given a mere $45 a month in housing allowances to live in one of the world’s most expensive cities. Unsurprisingly, unofficial fines at traffic stops, etc., were rife. In the already lethargic Indian legal system, underpaid law clerks, prosecutors and lawyers wealthy accused can give bribes for bail or for indefinite order stay orders.

This dynamic was replicated throughout Indian administrative systems. Particularly problematic for business development has been the tax system. The discretionary powers of tax collectors made them an economic force unto themselves. This combined with exceptionally high tax rates (in parts of the 1970s highest earners were taxed at 93.5% -- with combined wealth and income taxes occasionally exceeding actual income) to embed tax evasion through corruption into the system on a massive scale.

Additionally, many profitable sectors were tightly controlled by the government, for example the sale of liquor, giving rise to the ‘licensing raj’, and its not infrequent byproduct, collusion between some politicians and organized crime. This dovetailed with the challenges of campaign financing. The costs of running for office are high, however the legal spending limits are low. This means many politicians are tainted from the beginning of their careers by taking and distributing illegal money to run their campaigns. If elected, the politician is then open to blackmail as well as having to ‘repay’ in some form or another the funding. They may also be concerned with using their time in office (potentially only 4 years) to secure their family’s future by whichever means they deem necessary.

All of this has combined to make India’s economy opaque and convoluted, slowing growth and stifling progress. However, there have been waves of reform to try to address these issues.
Reform in India

Beginning in 1992, the economic liberalization policy of Indian Prime Minister P.V. Narasimha Rao began to dilute public control of the ‘commanding heights’ of the economy. However, many of the beneficiaries of that liberalization were individuals who were close to government. In what can be termed ‘influence-based capitalism’, many well-connected companies expanded quickly, and in turn used their influence to effectuate policy changes that would favor their businesses.

In the meantime, smaller and less well-connected companies still found their economic prospects constrained, with regulations and administrative oversight continuing to stifle growth. It was once new sectors came along, ones that the regulators hadn’t yet latched on to such as IT and the service industry, that India started to see real growth.

These new sectors succeeded not through corruption, but in spite of it, to become global players. They are now among the most vocal for reforms. They are part of the growing English-speaking and social media savvy middle class, who want the same efficiencies and freedoms they’ve seen elsewhere to be available in India.

What now?

A key 2014 Lok Sabha (lower house) campaign promise of Narendra Modi was economic growth through tackling corruption and reform. He used his track record as the Chief Minister of Gujarat to show that he could be serious about transforming systems. His BJP’s overwhelming win in the 2014 elections gave him a clear mandate.

While there have been many high-profile reform projects under the current Indian government, the unifying trend has been the emphasis on the use of technology to bypass hierarchies, speed processes, increase transparency and make corruption most difficult.

This has taken its most obvious form in the mainstreaming of the Aadhaar program, in which every Indian is assigned a twelve-digit number secured by their biometrics. Reportedly over 99% of Indians over 18 are enrolled in the program. This is set to facilitate and automate the delivery of a range of government services, restricting previous opportunities for corruption (though not perhaps eliminating them completely).

As for the reforms themselves, fundamentally, there are two types of reforms: administrative reform that can happen without the legislature; and legislative reform that requires the support of both houses.

Administrative reform is, of course, easier. Successful recent examples have been the dramatic increase in e-services in the railways, telecoms, and passports and visas. Similar upcoming reforms include electronic land and share transfers. Another administrative initiative has been the popular Pradhan Mantri Mudra Yojana micro-loan program, which has driven economic growth at the village level.

Legislative reform can be more complicated. In some cases, politically sensitive reforms, such as labor sector reforms, are being pioneered in the State Assemblies instead. For example, Rajasthan, Gujarat, Maharashtra, and Andhra Pradesh have all enacted labor reforms in order to give themselves an economic edge for investors.
Constitutional reform is limited as the constitution itself is fairly flexible and the courts, which are strong in this respect, are sensitive about touching it.

Committees as such tend to have limited influence except in the rare cases that the entire Committee agrees. This is because they are normally composed of a mixture of members from the ruling and opposition parties, and so tend to focus more on political point getting than effectuating change. While individuals on Committees may occasionally provide inputs, the reforms themselves tend to be shaped by bureaucrats and politicians.

Typically, opposition parties will try to make schemes and reforms fail but if public likes the plan they tend to withdraw opposition. That is happening frequently now because the main opposition, the Congress Party, is weak and at the same time the Modi Government is using its massive social media reach to sell its schemes and reforms effectively.

As for the ability of India itself to change, there have been two recent major national level changes that have tested the Indian system’s resilience. The first was demonetization. While not a reform per se, it showed the entire country could absorb a major economic shock. It likely slowed economic growth, hitting the informal economy hard. However, it also spurred an energized take-up of the electronic economy – which feeds into the overall goal of increasing transparency and reducing corruption through technology.

The second major reform was the ‘one country, one tax’ introduction of the GST. Again the uptake was relatively quiet, however it is a complex system, with relatively high rates in some sectors, and it is unclear what the long-term effect will be. It will take time to see if the goal of bringing more taxpayers into the system will yield the desired results, or hamper growth, especially among small operators.

This is typical of major reforms in India. Typically, once a reform is adopted, it can take around one to three years for bugs and glitches to run through the systems. Everyone in huge machine has to become accustomed to the changes. And sometimes tweaks are introduced along the way, slowing implementation. As a result, normally the first year or two (and sometimes three) of major reforms in India do not run smoothly, however things tend to settle in after that.

What next?

Modi’s BJP controls the Lower House. The states influence the composition of the Upper House, and more states are coming under BJP governments (see images below). This means that by mid-2018, the BJP may well have control of both Houses and it will be easier to implement legislative reform, especially if Modi wins a second term in 2019.

There is clearly a political desire for more economic reforms, but the administration is often slow to give up accrued influence and there are degrees of obstructionism, often in collusion with opposition parties and politically linked media. The highlighting of the role of technology to bypass that obstruction may be the silver bullet that the Indian economy has been waiting for. But it will take time.
India General election results 2009 and 2014

Current Indian state ruling parties