LIKE 1991, THE 2021 CRISIS PRESENTS AN OPPORTUNITY

Even if the economy grows at 8.7% in 2021-22, we may remain at the level we were in March 2020. We will need to run faster to stay where we are

It is important to create better and fairer conditions for doing business, build consensus on economic policies, and avoid socially divisive policies or actions.
Art: Ringa Ringa Roses by Gigi Scaria, 2018, Bronze

COURTESY: GIGI SCARIA/CHEMOULD PRESCOTT ROAD

C. Rangarajan
feedback@livemint.com

With the arrival of 2021, the liberalization regime launched in 1991 completes 30 years. 1991 was a landmark moment in India's post-independence history that changed the nature of the economy in fundamental ways. A severe balance of payments problem triggered an acute economic crisis that year. In response, India's economic establishment launched a multipronged reforms agenda to repair India's macroeconomic balance sheet and ignite growth.

Three decades later, the country faces another big test. The pandemic-induced lockdown brought the wheels of economic activity to a grinding halt, triggering a sharp economic contraction in the first half of the fiscal year. Despite an anticipated recovery in the second part of the fiscal, the National Statistical Office's (NSO) latest estimate suggests an annual contraction of 7.7%. If the Indian economy grows at 8.7% in 2021-22, we will be where we were at the end of 2019-20. As the saying goes, we need to run fast to stay where we are.

Can this contraction trigger another set of big-bang reforms? Can we get back to a sustained growth path? To answer these questions, it is important to understand the nature of the shift that 1991 signalled, and the differences between then and now.

Three decades later, we face another big test. The pandemic brought economic activity to a halt, triggering a contraction

India's post-1990 economic strategy entailed three important breaks with the past. One was to dismantle the vast network of controls and permits that dominated the economic system. The second was to redefine the role of the state as a facilitator of economic transactions and as a neutral regulator rather than the primary provider of goods and services. The third was to move away from a regime of import substitution and to integrate fully with the global trading system.

The 1991 reforms unleashed the energies of Indian entrepreneurs, gave untold choice to consumers and changed the face of the Indian economy. That reform agenda constituted a paradigm shift, and has defined the broad contours of economic policymaking for three decades. Liberalization was adopted as the guiding principle of governance and all governments since 1991, including the current one, have broadly stuck to that path.

Today we don't need a paradigm shift. We need to look at individual sectors and see which one of these needs reforms to create a competitive environment and improve efficiency. The power sector, the financial system, governance structures and even agricultural marketing need reforms.

Today's reforms also require much more discussion and consensus-building. The central government needs to work in tandem with state governments and consult different stakeholders impacted by reform decisions. Timing and sequencing are critically important in the new reforms agenda.

How criticism and protests are handled will be important. To ensure wider acceptance of reforms, it is important that they are seen as steps towards national progress. The protests over the recent farm bills are a case in point. The best course of action may be to leave these decisions at the level of state governments, which can choose which of the farm laws they want to implement. That will set the stage for state-level innovations in farm policies, and farmers would be able to see for themselves which set of laws and institutions work best for different crops and regions. We must not learn the wrong lessons from the 1991 moment. The 1991 reforms package faced heavy criticism as being dictated by the International Monetary Fund (IMF) and World Bank. Some of the reforms were criticized as a sellout to capitalists. Yet, under the shadow of a crisis, contentious reforms were pushed through. Such an approach won't work now.

Apart from reforming key institutions, the government will need to step up public investments to boost growth. In a developing economy, growth is sustained only by investment. What we have seen is a decline in the gross fixed capital formation (GFCF) rate, which has fallen from 29% of GDP in 2018-19 to 24.2% in 2020-21. We need to reverse this trend.

A proper climate for investment must be created. Changes in corporate tax rates announced some months ago will help once growth starts picking up. Other factors also impact investments. First, perceptions regarding growth prospects are key. Second, the policy framework must be supportive of fresh investments so that entrepreneurs are encouraged to take risks. Third, non-economic factors such as a peaceful environment and social cohesion are also relevant. The government must begin to act on all these fronts.

How criticism is handled is vital. To ensure wider acceptance of reforms, it is important they are seen as steps towards progress

Yet private investments might take time to recover. In the near term, the government will need to boost public investments. In a situation where the economy is stuck because of weak demand, the standard economic prescription has been to raise the level of public spending, to raise growth, and crowd in private investments. Earlier, economists did not distinguish between different types of government expenditures but most economists now advocate increase in capital expenditures, i.e., those expenditures which create assets and raise productivity.

Over the past few months, the government has announced several schemes to stimulate the economy but actual data on government spending conveys a different picture. According to NSO, government consumption expenditure has declined by 22% in the September quarter. Public administration, defence and other services declined by 10.3% in the June quarter, and by 12.2% in the September quarter. A strong effort must be made by the government to raise spending in the current quarter so that the contraction in 2020-21 as a whole can be contained.

The same logic extends to 2021-22. Because of the growth in the economy, albeit from a low base, revenues should pick up in 2021-22. The government should maintain its expenditure at a reasonably high level. The budget for 2021-22 should lay out clearly the investment plans of the government and public sector enterprises. A massive investment programme such as the Golden Quadrilateral highway project must be envisaged.

While it is desirable that the fiscal deficit be brought down, the scope for it is limited in 2021-22. It could still be around 7% of GDP. Going forward, a new map for fiscal consolidation must be drawn up.

Growth should become the top priority now, for the finance ministry and for the entire government. It is important to create better and fairer conditions for doing business, build consensus on economic policies and avoid socially divisive policies or actions. We can put the pandemic behind us if the government is able to focus single-mindedly on growth and economic progress.

C. Rangarajan is a former chairman of the Economic Advisory Council to the Prime Minister and former governor of the Reserve Bank of India. He played a key role in the two-step devaluation of the rupee in 1991, and in the transition to a market-determined exchange rate, two key components of India's liberalization agenda.