Moderator

K.P. KRISHNAN
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Panelists

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Former Adviser to the Finance Minister of India

ASHOK CHAWLA
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POLICY ROUNDTABLE 1

Future of India's Economic Reforms: 30 Years after "*Bata Teri Raza Kya Hai (What's Your Wish?)*," Looking Back to Look Ahead

Introduction

In the first of the IPF 2021 Policy Roundtables, four esteemed panelists explored and drew lessons from the reforms in the year 1991, which marked a paradigm shift in India's economic policies, and identified core areas of reforms for the future. After their initial remarks, the panelists were joined by other participants in a lively discussion. This is a short summary of the Roundtable. For a complete rendition, please view the session video hyperlinked at the end of this summary.

K.P. Krishnan

Moderator

K.P. Krishnan kicked off the Policy Roundtable by quoting the famous line from Allama Iqbal's *shayari* "*Khudī ko kar buland itnā ki har taqdīr se pahle ḳhudā bande se ḳhud pūchhe batā terī razā kyā hai*" that Dr Manmohan Singh, the then Minister of Finance, had cited at the conclusion of his 1991 Budget speech. The quote may be translated as "*Make yourself so strong that the Lord himself will ask you, the human being, 'please tell me what is the fate that you desire*?'" He acknowledged that 1991 marked a paradigm shift in the Indian policy reforms—a country which had steadfastly avoided markets and embraced the "socialist model", with the State playing a dominant role in the economy, had made a decisive shift. Following are the four major changes that he highlighted:

a. Exchange rate flexibility,
b. Opening up to foreign trade,
c. Giving up industrial licensing, and
d. Reforming the equities market.

These reforms were actually announced without any immediate pre-consultations or consensus-building. One could argue in retrospect that there appeared to be, or there was perhaps, a majority view, and perhaps a lot of debate on these issues for the entire decade preceding the actual announcement, but formally, the Prime Minister, the Finance Minister, the then Commerce Minister, and the then Principal Secretary to the Prime Minister decided and announced these reforms. If one looks at current growth rates even after excluding the pandemic period, and if they were to have been high and comparable with the average of the decade till 2014, perhaps most of us would not be bothered and one could say that the process does not really matter, as long as there are outcomes. However, we now have a situation where outcomes do not appear to be entirely satisfactory, in terms of growth, in terms of employment, in terms of private capital investment, and a process that does not *prima facie* seem inclusive, participatory, or consultative.

Perhaps, even worse, we seem to be going back on some of these reforms. For instance, there appear to be signs of greater protectionism, shutting off of international competition, and perhaps, almost no serious financial sector reforms. Now, to give the present Government of India credit where it is due—the Constitutional amendments and legislations on GST are an excellent example of cooperative federalism. The Insolvency and Bankruptcy Code is a second example. Inflation targeting for the Reserve Bank of India (RBI) through an amendment of the legislation were tough reforms. The point of worry is the sustainability of the reform momentum. For example, the recent pushback on GST and the pushback on farm reforms are matters of concern.

The key questions posed to the panelists were: Do they agree with the mentioned characterization of poor outcomes, broken process, and unravelling of the reform process which began early in this regime, in 2014? What are the learnings, if any, from the past reforms exercise and what is likely to be useful going ahead? Why did the Government ignore the farm sector, education, health, and governance, and the required State capacity to handle these sectors back in 1991?

T.V. Somanathan

What may seem impossible at one time may become feasible later

T.V. Somanathan was convinced that there is actually no Gresham's law in reform—bad ideas do not necessarily drive out the good. The good ideas survive and come back from time to time. Speaking for the people who work within the system, he mentioned that the sense of hope that it is worth trying something and pushing the horizon is both useful to have and true. According to him, there are two main buckets of reform that India needs presently. First, the fiscal house needs to be set in order, and should also provide for the many things that governments should legitimately provide. Subsidies—farm, food, fertilizer, and others—need to be reformed. The second need is to improve the efficiency of public expenditure on education, health, and infrastructure. In his opinion, these are areas where the system faces the most difficulties in terms of getting things done.

On the first reform area, he highlighted that while subsidy reforms may be easy to carry out from the administrative point of view, these are, however, difficult political decisions. On the other hand, the second area of reform, which is improving the efficiency of public expenditure and getting better value for what is spent on education, health, and infrastructure, is easier political decisions. While no political party is opposed to these reforms, they are difficult to execute in terms of generating better efficiency of education expenditure, providing better quality education in schools, and using expenditure on health to generate better health outcomes. Further, making doctors, nurses, and teachers turn up in clinics, hospitals, and schools, respectively, is hard to do partly because it is not something that can be done by the Central Government alone. It requires collaboration across the range of the Central, State, and local governments, implying that the number of agents who have to coordinate amongst each other is much higher. As such, there is a paradox regarding the two categories of reforms: easy-to-announce but hard-to-do reforms, the ones that governments keep announcing but that are not seen through, and the hard-to-announce but easy-to-do reforms, which are never announced.

The other dimension that he emphasized upon, as compared to the situation in 1991, is the increasing dependence on State and local governments for success. These are not things that the Centre can simply lead by example, or announce a policy or start a Centrally-sponsored scheme for it to happen magically.

On the issue of prior consultations and the general decision-making processes, he stated some lesser-known facts. Before each of the last two Budgets, the Prime Minister and the Finance Minister interacted with 30-40 economists in an open house session organized by the NITI Aayog, where every attendee got a chance to highlight their opinions for three to four minutes each. Prior to the Atmanirbhar Bharat announcements in the months of May and June 2020 also, the Prime Minister personally attended video conferences with experts across India and outside India on a variety of subjects. The second point he made is that India's health and agriculture policies have benefited from in-house experts, such as members of the NITI Aayog. The Monetary Policy Committee and Committee on the inflation targeting system are two other expert committees. In sum, experts are consulted, but are often not unanimous in their suggestions. Ultimately, the final call is that of the elected executive.

Montek Singh Ahluwalia

Look at what the young people are saying, they are the ones that have to inherit the future

Montek Singh Ahluwalia disagreed on the proposition that the Government never focused on farm problems. One of the things that was quite categorically said during the reforms was that reduction of protection for Indian industry would actually favor Indian agriculture because a high level of protection for industry, in effect, amounts to dis-protection of agriculture. It is also a penalty on exports and both these points were emphasized at the time. Rather than focusing on smaller schemes, it was felt that interventions such as the devaluation of the rupee, combined with the shift to a flexible exchange rate, would hugely increase the profitability of agriculture and so it did. In the period after the reforms, agriculture did quite well and agricultural exports began to grow. In essence, the government at the time did have a view on farm sector reforms and it addressed a very critical part of the whole picture, though it was not continuously emphasized as such. The impact of lower protection and a market-determined exchange rate on agriculture was a very important part of the whole reform process. Health and education, however, were not at the top of the reforms list. The focus on these came much later, after Amartya Sen began sensitizing everyone that India's performance on education and health was a serious impediment to good growth. This further led to the emphasis on strengthening primary education.

Manmohan Singh was the principal architect, and Narasimha Rao was actually the political underpinning of the reforms process. The economy had been stabilized by 1993 but the reforms continued in a bit of a gradualist kind of way. The consequence of such gradualism was that it allowed a lot of time for discussion after the reform ideas were unveiled. Manmohan Singh took on the task of laying out the reforms, debating them in the Parliament and explaining them to people and the bureaucratic levels quite extensively. During this time, he delivered a lot of lectures in Indian universities. The faculty, which would be opposed to the reforms prior to his lectures, would vote in favor after. Montek Singh recommended that one should always look at what the young people are saying because they are the ones who have to inherit the future and have a better sense of what needs to be done.

He said that India needs to get away from the long list of reforms approach and try to identify the critical reforms, given the current state of the economy. In his opinion, banking reforms are critical at present. Financial sector reforms were part of the agenda, but the more difficult part, which is putting the public sector banking system at par with private sector banking, was not done. Nevertheless, private sector banking was liberalized and allowed to expand. The public sector banks remained under strict government control. This feature merits rethinking now. A midway agenda may be needed–one that would reduce the control of the Finance Ministry on public sector banks. Such an agenda also ought to bring the regulatory powers of the RBI in relation to public sector banks on par with that of private sector banks. This is not politically complex and if the Government were convinced that it could do it, it is a sufficiently technical thing—its effects would become evident only over a longer time period. The second big reform that needs attention, according to him, is fixing of the GST. He suggested that there ought to be a system where the GST Council takes a look at a pretty comprehensive agenda of reforms of the GST, so that it can really be put on a very firm basis.

Vijay Kelkar

The politics, the political masters, are really what drive the reforms

Vijay Kelkar began with the example of the petroleum industry. He said that his Minister was clear in his mind that he wanted to make the Indian industry competitive. He thanked Mr Ahluwalia for reforms which led the economy to boom. Growth started taking place, leading to a rapid increase in the demand for energy, because of both the increase in income and structural change in the sector. He also recognized that in all the crises in India, the macro crash came from oil prices and oil dependency. This was so in 1970-1974, 1981, and pre-the 1991 reforms, when the crisis came from the oil sector. He remembered the lines he had then quoted to his Minister, "Mr Minister, to my mind, the binding constraint is India's private sector and public sector, and the monopoly. If you want to really get going, you must wholeheartedly agree to put your support." He remembered that the Oil and Natural Gas Corporation Limited (ONGC) was most reluctant to agree. The same was true of oil companies and their complete monopoly or oligopoly status. Certain markets had a complete monopoly. For instance, in the entire North India, the Indian Oil Corporation had the monopoly. They were also opposed to reforms. So were the unions. It was essentially a political issue. He confessed that the greatest supporter was the Finance Minister, Dr Manmohan Singh. So, if the government is not willing to commit capital, the reforms cannot take place.

On the tax reforms, he expressed appreciation for the then Finance Minister, Mr Jaswant Singh, who wanted India's taxes to be comparable with those in rest of the world. Mr Singh did not care if there was a strike, he was only concerned that tax rates should not become the instrument of tax policy. He wanted to use the tax machinery at par with rest of the world. Hence, reforms are essentially driven, in Kelkar's view, by political entrepreneurs or change agents.

Coming to the product market reforms, Dr Kelkar said that the impetus came from Mr Jaswant Singh. India had become a member of G-20 and the idea was that India's Minister of Finance can be no less than other contemporaries or those of the G-20. This led to a thin and simple report, called "Ministry of Finance for the 21st century" (2003-2004), which was based on only three points: first, to identify the functions that the Ministry was not doing and delete them; second, to identify the functions which it should be doing and add them; and third, to get rid of the others because the Ministry of Finance was a policymaking body, not an administrative one. Unfortunately, this report was never even considered, because Mr Jaswant Singh left and successive ministers have probably never had any sense of urgency or real desire for making these big changes in the various financial organizations.

Ashok Chawla

As one looks ahead, there is sufficient maturity in the equity market, but the banking sector needs a total makeover

Ashok Chawla recalled the Big Bang Reform of 1991 as the abolition of the Office of the Comptroller of Capital Issues (CCI) and setting up of Securities and Exchange Board of India (SEBI), first as an executive body and then as a statutory body. He was a part of the Office of the Comptroller of Capital Issues, the CCI, in the mid-1980s and 30 years later, he is in another CCI, the Competition Commission of India. According to him, this, in essence, is what is important—looking back to look ahead. He highlighted the changes in the securities market, including the setting up of the National Stock Exchange (NSE), the development of the National Securities Depository Limited (NSDL), and derivatives trading, among other things.

As far as the other changes in the Indian economy, other than those in the stock market, were concerned, the major change was that the insurance sector opened up and banking did so in a limited way. After 10-15 years down the path of liberalization, it was becoming increasingly evident that the financial sector, as it existed, was not equipped to respond adequately to the needs of a high-growth real sector, more so, since the period from early 2000 to 2008 was one where both globally and in India the growth levels were elevated. So how does one handle a financial sector which is not keeping pace with the real sector, particularly in relation to infrastructure financing, where the reliance was either on Development Financial Institutions (DFIs) or banks? For banks, lending for infrastructure is not easy, as everybody knows. The best way to go about it is through the tenor of lending and the tenor of requirement for the infrastructure projects.

He then talked about the ULIP controversy, which was an unfortunate battle between two regulators, one regulating the stock market and the other regulating the insurance sector. The question at hand was as to who should regulate such a product. Eventually, they went to the court since the matter was not getting settled. The Government intervened, with an ordinance, settling that in such a dispute between two regulators, the government will step in to take charge and decide. This controversy had a silver lining to it—the Financial Stability and Development Council (FSDC) was set up as a consequence, with the Finance Minister as the Chair, and financial stability, even otherwise apart from this issue between the two regulators, led to a trigger for this thing to happen. Financial stability was not really high on the agenda earlier, because the general perception used to be that if there is macroeconomic stability, and if there is price stability, financial stability is somewhat covered. However, the events of 2008 burst that myth and there had to be, necessarily, a focus on financial stability not just in India, but in the major economies of the world. Further, with the G-20 stepping in, the major focus was on financial stability. Twenty years down the road in 2011, it was time to look at the entire financial sector architecture as a whole and see what needed to be done.

The Budget announcement in 2010 took a holistic view of the financial sector. India already had three financial sector regulators–RBI, SEBI, and the Insurance Regulatory and Development Authority (IRDAI), while the Pension Fund Regulatory and Development Authority (PFRDA) was in the offing. The idea was to dive deep into financial sector legislation with the objective of making the sector more competitive and inclusive. It led to many things which are now part of the formal architecture—the focus on consumer protection, the merger of the forward market commission with SEBI (realizing and accepting that all transactions are financial in nature, be it in the securities market or the commodities market), inflation targeting and the Monetary Policy Committee, amendments to the Foreign Exchange Management Act (FEMA) (the equity capital part moved from RBI to the Government of India), and the separation of the Public Debt Office from the RBI.

As one looks ahead, there is sufficient maturity in the equity market, both in terms of regulation and operation, but the debt market, which serves the need of the real sector of business industry, is not that robust. As regards the banking sector, it needs a total makeover, in terms of both asset quality and the way it is governed. Next comes regulatory governance and accountability. In his opinion, these are very important features because of the nature of powers enjoyed by regulators—they perform legislative, executive, and judicial functions, and therefore, how they execute these functions is extremely important. Mr Chawla maintained that regulators ought to be transparent and have a high degree of acceptability and predictability.

Open Discussion with the Roundtable Panelists

The remarks by the five panelists were followed by a rich discussion led by participants in the Roundtable with prominent questions and interventions by **Karthik Muralidharan** on gradualism working better where he suggested that for something like fertilizer subsidy reforms, a glide path could be announced of say a 1-2 percent reduction over a 10-year period, which is then balanced off with Direct Benefit Transfer (DBT), so that people can see that this is fiscally neutral and not trying to hurt the farmer. He felt that building trust is as important as the policy itself. The second intervention that he made was that markets and citizens need a certain process of predictability so that they can optimize behavior in anticipation, as opposed to waiting for the next surprise that is going to come. So his broad single principle was transparency, gradualism, and predictability in some of the more difficult reforms. **Arvind Subramanian** asked what the current Finance Secretary would like to take with him following the discussion. **Deepti Bhaskaran** made a point about health insurance—the Government should prioritize the insurance sector primarily to strengthen health insurance.

The session ended with closing remarks on the Roundtable, and deep appreciation for the team at NCAER that had put together this virtual version of the IPF 2021.

For the full flavor of the richness of this Roundtable discussion, we invite you to view the video of this session using the links mentioned in the box below.

To view the video of this IPF Roundtable, please scan this QR code or use the following URL:
https://youtu.be/SnA2Stc6KnA