India's tryst with long-term economic growth: a policy case for (restrained) economic populism?

*Whilst the rise of political populism has been recognised as a growing menace across the globe, in the run up to the release of the budget, **Deepanshu Mohan** makes the case for economic populism as a potential solution to India's slowed economic growth.*

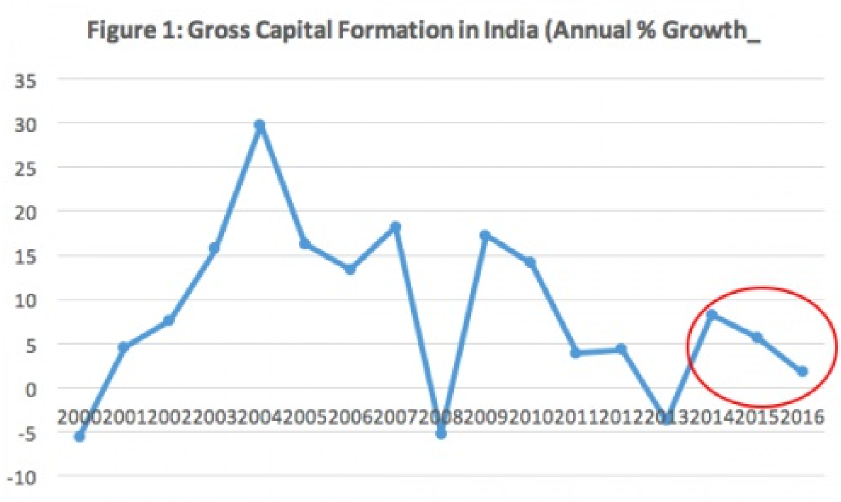
The rise of political populism can unquestionably be recognised as a growing menace across the world, impinging costs on institutional autonomy, democratic freedom of citizens and independence of non-state actors (including the civil society and media). However, exemplifying Dani Rodrik's argument here, in a recent article, I made a case for developing countries like India to occasionally defend economic populism. Economic restraints imposed on domestic economic policy (in certain cases) in areas such as (domestic) investment flows, tax reforms and exchange rate management, may be seen as desirable whilst being contrary to the impositions (and expectations) from global trade and foreign capital market.

If we look at the nature of investment flows in India, recent policies enticing foreign investors to increase capital investment into the country as against pushing for greater domestic private investment can be cited as just one case where one may recognize how a certain economic restraint (i.e. towards foreign investment) may help with India's own macroeconomic fundamentals. The obsession with drawing Foreign Direct Investment (FDI) & Foreign Institutional Investment (FIIs) across sectors *sans* growth in domestic private investment opportunities, poses long term risks in sustaining capital flows within (and from) the economy. A similar case can be made for reforms in India's exchange rate system (i.e. INR-USD rate) where a more under-valued Rupee may help in boosting India's export product demand, as discussed here.

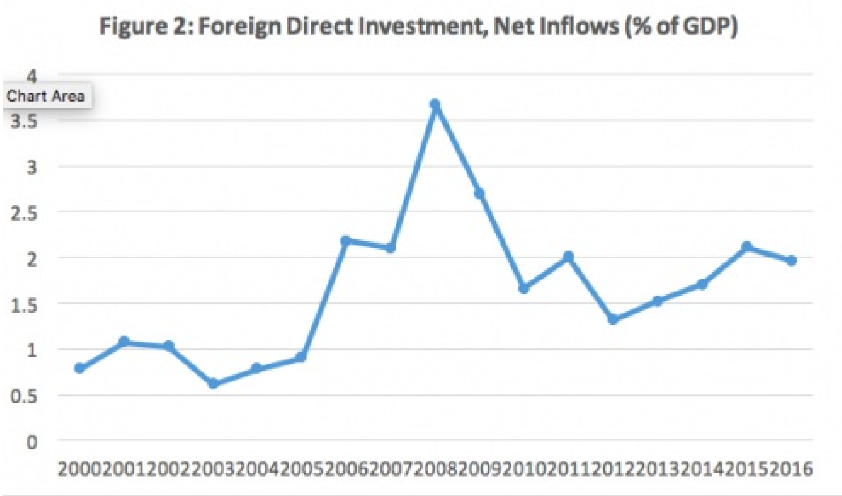
The upcoming Budget offers an opportunity for the current government to prioritize and practice a certain degree of economic populism in driving domestic private investment through the budgetary tools available and reduce overt dependence on foreign capital for sustaining growth capacities.

The Domestic Private Investment Scenario

The growth in India's gross capital formation (in annual % terms – see Figure 1) has been sharply falling due to low domestic private investment levels across sectors (argued here). Post 2014 (i.e. since the current government came in power at the Union level), the macro-economic problem persisted which has further pushed the government to look for more foreign (direct) investment opportunities across services and manufacturing (through schemes like Make in India and disinvestment). Recently, the decision to allow 100% FDI in single-brand retail (through Automatic Route) is a step made in the same direction.



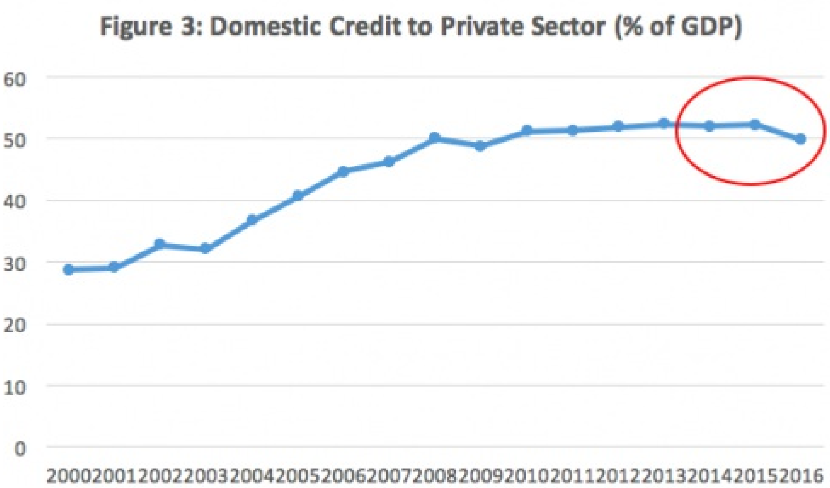
Source: Author's Calculations from World Bank Database



Source: Author's Calculations from World Bank Database

As Figure 2 illustrates, FDI levels in India (as % of GDP) have increased significantly since 2012, though the conventional wisdom on the effectiveness of FDI (Foreign Direct Investment) on creating higher investment opportunities for the domestic economy (i.e. in terms of job creation, higher income) has presented mixed evidence. The inflow of FDI (within India) is largely regionalized in its nature and factors like market size, quality of labor involved (in the business activity), infrastructural development plays a key role in driving investment and its impact on social and economic development indicators.

In India's own growth story (since the late 1980s), the performance of its overall production capacities (at a macro level) have rather been directly proportional to the amount of capital accumulated through its large domestic private sector (and not foreign capital alone) and the ease of domestic credit provided by banks to private enterprises. In Figure 1, we can also see this for the periods between 2000-2007 and 2009-2011 when the average growth rate was around 7-8% and capital formation growth was averaged between 15-20%. Similarly, Figure 3 (below) gives us an idea on the growth of domestic credit provided to the private sector (as a percentage value from the total GDP).



Source: Author's Calculations from World Bank Database

Since 2014, the growth level (in both these indicators) has stagnated and further started declining. This can be explained largely by the Non Performing Asset (NPA) debt crisis looming over the public banking sector which has dis-incentivized most banks in lending long-term loans to private sector enterprises (including start-up firs). The demand for loans from the private enterprises has also declined in the same period which has had (negative) spill-over effects on growth of employment opportunities and stagnation of wage levels across services and manufacturing.

Budget 2018

The annual financial statement of outlays to be presented by the Finance Minister on 1st February, 2018 offers a vital opportunity for addressing some of these urgent concerns affecting India's (future) growth prospects. An exercise of (restrained) economic populism in the upcoming Budget within following areas of policy focus may help:

- **Reduction in Corporate Income Tax Levels**: With the GST implemented in 2017 and now gradually improving the indirect tax compliance mechanism for firms (across sectors), a next move to reduce corporate income tax i.e. visible in form of a high average statutory tax rate of 34.47% may infuse some confidence amongst domestic industrial actors. A lower (corporate) tax rate without exemptions will allow a more equal tax incidence framework across businesses.Currently, the service sector has an effective tax rate of 30.3% compared to the 25.9% for the manufacturing sector. A lowering of tax rate to say 25% (from the current 34.47%), sectors such as the financial institutions, electronics, food processing may benefit more.

- **Easing Domestic Credit to Private Sector Enterprises:** Given the magnitude of the current NPA crisis and efforts taken to address it, easing domestic credit facilities (through public sector banks) will be a challenge for the government in 2018. The annual budget presentation exercise however, is more about creating and managing expectations for the year to come and targeted tax and spending based budgetary incentives to drive domestic private sector investment in small and medium scale industrial activities including textiles, food processing etc. (on similar lines from 2017-18) may help.

- **Increase Public Spending on Healthcare:** India spends the least on healthcare when compared to other developing countries like China, Thailand, Bhutan etc. Expanding vaccination programs across the country with a (fair) distribution of essential, generic drugs at affordable prices for (lower) middle income groups and the economically weaker sections are main areas where an increase in public healthcare spending by at least 30% (from current level) remains a must.

- **Greater Spending on Agri-Infrastructure & Agri-Research:** The stagnation seen in the performance of the agri-business sector and the farm employment levels has triggered a lot of chatter in recent months. While the government's narrow response so far has been to facilitate loan waivers (through state governments) and introduce reforms in agricultural marketing with limited local impact, public investments and a higher spending for farm education, research and extension will be seen as a positive move (in the short and long term). While the government seems to be considering initiating programmes on the implementation of sensors in agriculture, build and transfer post-harvest technology, and the use animal cloning for commercial application, an increase in spending on agricultural research (and education) across states and at a localized level would help farmers immensely.

Macroeconomic (fiscal) populism exercised in these regards may help the government not only to gain political points which it may seek to do with this year's budget (given the 2019 Lok Sabha elections) but will also allow some structural (macroeconomic) problems to be addressed for the longer run. While we should constantly be cautious and wary of (political) populism that stifles political pluralism and liberal democratic values; economic populism may at times, be seen as necessary.

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Cover image: Factory workers are addressed by Senator John Kerry during his visit to the Vibrant Gujarat seminar in 2015. Image source: US Department of State, Public Domain.

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