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What do India's citizens want?

5

If the general election of 2014 is anything to go by, development, governance, and corruption are the most important issues for Indian voters – though, in such a large and diverse country, there is huge variation. What India's citizens want therefore depends on where they happen to reside. Much of India remains outside the mainstream of growth and development. Out of its 676 districts, by any criterion, around 125 still remain deprived, and of 600,000 villages, around 100,000 remain deprived.

To understand this divide, the standard rural/urban lens is not sufficient. In the 2011 census, 72 percent of the population was classified as rural and 28 percent as urban. But this categorisation obscures the fact that, between 2001 and 2011, most urbanisation has occurred in what are known as “census towns” – that is, the part of India that is between rural and urban. These towns have transcended the rural governance structure of *panchayats* (village-level decision-making bodies), but are not yet municipalities.

Dividing India in terms of the neat administrative boundaries of states is also misleading for evaluating development or deprivation. Conventionally, some states have been regarded as backward – for instance, Bihar, Jharkhand, Chhattisgarh, Madhya Pradesh, Rajasthan, Uttar Pradesh, and Uttarakhand – and others as relatively advanced. But, since 2000, faster growth has occurred in some of these historically backward states, though the base levels of development remain low. In other words, they have caught up. State boundaries can also be misleading because there are intra-state differences.

Since economic liberalisation reforms started in 1991, the economic geography story has been one of increasing integration of districts and villages, as the radius of development expands. Many term this “inclusive development”, which emphasises equality in distribution of outcomes, including patterns of income. (For the record, subject to some data problems, India’s Gini coefficient of inequality in distribution of income is not inordinately high, at around 0.4.)

Yet while inequality is a relative concept, poverty is often considered to be absolute. If there is growth and development, poverty declines. Also, both poverty and inequality are dynamic concepts: they change over time. If there is growth and poverty declines, and if one thinks that one’s offspring will have a better life, there is less resentment about inequality.

The need for decentralisation and reform

More important is the question of why some people are poor. Mostly it is because they lack access to physical infrastructure (transport, water, electricity), social infrastructure (education, skills, health), financial products, natural resources, technology, information technology, the judicial system, and markets. Around 100,000 villages in India have a population of less than 500, and it is difficult to deliver goods and services there because the cost per unit of delivery is much higher.

For any government, the priority should be to deliver these goods and services. This is a shared responsibility of sub-national governments as well as the central government. India is a federal country (though, for technical reasons, the word “federal” isn’t used in the constitution). In May 2014, a new central, or union, government was formed in New Delhi. However, many changes can only be implemented by states (under the constitution, most factor markets are in the State or Concurrent Lists – i.e. the states have the power to legislate on them) and most public goods and services are delivered by local bodies (villages and municipalities). Historically, India has been too centralised. Decentralisation and devolution to the state level, including fiscal devolution, are desirable, and this has started. For instance, land and labour legislation will primarily be reformed at state level. To the extent that central-government legislation is involved, any reform has to wind its way through the democratic processes of parliament.

More importantly, these goods and services have to be financed. There is a clear need to eliminate exemptions and reform subsidies – both on consumption and production. India has a pending agenda of both direct and indirect tax reform. Tax simplification is impossible, in both cases, without the elimination of exemptions. With both central and state governments included, the tax/GDP ratio is around 18 percent. Subsidies, both explicit and implicit, amount to 14 percent of GDP. This can't be sustainable. In addition, total tax exemptions amount to more than 5 percent of GDP. A lot has been written on the Goods and Services Tax (GST), expected to come into force from 1 April 2017. This is only the beginning of a process to reform indirect taxes, which will take more than 10 years to complete. However, governments at all levels lack the administrative and governance capacity to make the necessary reforms.

India should therefore do three things. First, where there are no clear instances of market failure, governments (at all three levels) need to liberalise entry and allow markets to flourish. This doesn't imply an absence of regulation, but regulation should not be an excuse for excessive government control. This liberalisation can be interpreted as reducing the malign role of government. Some initiatives of the new central government can be seen in this light, though some areas also fall under states' remit, so it will be necessary to devise means of incentivising states to act. This doesn't mean liberalisation for foreign direct investment (FDI) alone. Yes, FDI is important. But it is only a means to make efficiency gains and not an end in itself. There is much more to the broad canvas of reforming the Indian economy. Nor is liberalisation something to benefit the corporate manufacturing sector alone. Poverty reduction and employment generation are also a function of the form of growth, and, for both, reform of the rural economy is exceedingly important.

Second, the government should cut subsidies. Resources spent on subsidies can't be spent on public goods and services. India is often described as a young society, though this window of demographic transition won't remain open much beyond 2035. Among the young, and especially among villages that have become integrated into the mainstream and in urban and semi-urban India, there is recognition of the "dole versus development" trade-off. Although one shouldn't oversimplify, and there are pockets where mindsets haven't changed, the preference for economic development over handouts was responsible for part of the electoral success of the Indian People's Party (Bharatiya Janata Party, BJP) in 2014.

Third, the government can also play a benign role, because in the interim some poor people, suitably identified, will still require subsidies.

India must also deal with five other issues. First, it cannot prosper until its eastern and north-eastern regions develop, and there is the related issue of India's economic integration with neighbouring countries and the need to build transport networks. Second, shortfalls in the workforce's skill base place a significant constraint not only on wages but also on entrepreneurship. Third, female work-participation rates, which are low for a host of reasons, need to increase. Fourth, development must occur without endangering the environment, and ensuring environmental protection is often a function of setting appropriate prices and decentralising public property rights. Fifth, corruption is a key issue, as noted at the beginning of this chapter, and has several dimensions. Some types of corruption can be reduced by eliminating shortages, limiting the scope for discretion by officials, and using information technology to oversee interactions.

Choice drives efficiency

I have not mentioned the obvious indicators like growth or inflation, because higher growth and lower inflation will follow directly from some of the reforms mentioned here. Irrespective of whether one uses the new or old GDP calculation method, the growth record has improved. Irrespective of which indicator one uses, inflation rates have declined. Other indicators have improved too, but expectations are disproportionately high. Since the legacy of more than six decades is being questioned, the delivery won't happen in the space of a year alone – it will take more than ten.

This government has launched a plan to carry out individual identification of the poor without intermediate layers of administration, and to ensure their inclusion in the financial system by giving them access to bank accounts and transferring subsidies directly to these accounts. That is, even when subsidies are necessary, they can be given through government financing, rather than government performing a service provider role. These three strands form part of the new government's philosophy, sometimes explicitly stated, sometimes less so. The idea is that choice should drive efficiency. Why must healthcare be delivered through primary health centres that don't function well? Why can't the poor obtain subsidised and cashless medical treatment at an institution of their choice, including private hospitals?

However, one must remember that there are political and economic factors driving resistance and that change often takes place at state level. It is therefore going to be a long haul, not an overnight wave of the magic wand. But the silver lining is that much of young India wants what the New Delhi government wants.