The 2012 K R Narayanan Oration

The Indian Economy: Rising to Global Challenges

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[This is the revised version of the K R Narayanan lecture that I delivered in Canberra on June 1st, 2012. At the time of the lecture, and up to July 31st, I was the Chief Economic Adviser to the Government of India, Ministry of Finance. The final revisions in preparing the written version were made on 25 August, 2012. At the end of the lecture in Canberra there was a remarkably engaged discussion with the audience. This provided valuable inputs for my subsequent revision and in writing up the lecture as a paper. I am grateful to the members of my audience for their interest. I would also like to record my thanks to Supriyo De Priya Mukherjee for research assistance and advice.]

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I. Prelude

I feel honoured to be here in Canberra to deliver the K R Narayanan lecture both because of the person after whom this lecture series has been named and because of the amazingly distinguished list of speakers who have lectured in the series before me. I am grateful to Australia's High Commissioner to India, H.E. Peter Varghese, who first conveyed to me the invitation to deliver the lecture and also for the many engaging discussions I have had with him over the years concerning policymaking in India and Australia. I am grateful to the Indian High Commissioner to Australia, H.E. Biren Nanda, the Vice Chancellor of Australian National University, Professor Ian Young, Professor Raghbendra Jha and to Australia's Department of Foreign Affairs and Trade and to the Australian National University for the hospitality here in Canberra.

Kocheril Raman Narayanan was a remarkable man. He was born in a Dalit family in a small village in Kerala's Kottayam district and spent his early years suffering all the ignominies that this implied in those times. His school experience exemplified this well. Given his superior intellect, school was where he faced for the first time the excitement of learning, but it was also a place where he faced discrimination and the embarrassment of his parents' frequent inability to pay his school fees, which meant that he had to sit outside the classroom. Among political leaders of that generation in emerging economies, there is often competition for how far one had to walk to get to school. With 15 kilometres daily, Narayanan would certainly be among the leaders.

That a person would rise from this background to being a star student at the London School of Economics, a distinguished diplomat, India's ambassador to several countries and, ultimately, President of India, is a truly rare feat. I had direct interaction with him on only a few occasions, after I returned from the London School of Economics and began teaching in New Delhi. What impressed me most was his keen intellect — he was a favourite student of the famed Harold Laski — and his natural humility.

Ladies and gentlemen, I am honoured and humbled to be giving this lecture.

My lecture is about the Indian economy, its unexpected arrival on the global stage and the challenges and responsibilities that arise from this. But before launching into it, I want to say a word about Australia. In recent years, the Australia story has stood out as one of the success stories in the world. Contemporary Australia has managed to combine a culture of vibrant democracy, strong civil rights and a progressive social agenda, alongside a vibrant economy. Even though, as with the rest of the world, its growth has been slow in recent years, it nevertheless stands out as one of the best managed economies amidst today's global gloom. Even during my brief visits to Australia, it has been evident what has contributed to this success. It is a progressive and inclusive economic policy agenda, along with an effort to draw some of the best professional minds to the task of designing and implementing economic policy. We all have a lot to learn from this.

I believe that the scope for collaboration and cooperation between India and Australia is enormous. The two nations have deep similarities, such as our democracy, our vibrant media and our commitment to secularism. We also share several common social problems such as that of having people, in fact some of the earliest settlers on our lands, who have been discriminated against historically, and of the consequent responsibility of trying to draw them and other discriminated groups into mainstream life. We are also two countries with deep commitments to higher education. There is a substantial flow of expertise, skills and students between the two nations. The potential for collaboration in this area is large. There is also increasing trade and the movement of capital in both directions between India and Australia. By further nurturing economic and strategic relations between the two nations there is a lot is to be gained by not just India and Australia, but by the world at large.

II. The India Story: Backdrop

The paper is concerned with India's growth and globalization. Lest the reader misreads my attention to these as a reflection of a fundamental normative concern, let me clarify that I view growth to be of value only for instrumental reasons. The ultimate aim of any nation should be to build an equitable, humane, secular and tolerant society, where human beings achieve a decent standard of living. As such, as policymakers, our focus should be on the poorest and weakest segments of the population. India should be deemed as doing well to the extent that the bottom segment is doing well. And, if the nation grows rapidly but the poorest people remain as poor and miserable as before, I would refrain from describing that as a success. In brief, we must learn to judge a nation by how its poorest and most miserable human beings have fared.

Growth is important because it enables us to do more for such people. If we grow rapidly but fail to distribute the spoils among the most wretched of the nation, we may lead the global growth charts, but by the values that this paper espouses, we will not be considered a success.[1]

The big story about India since the early nineties has been its unexpectedly rapid economic growth. The trajectory of the Indian economy after 1994 shows a clear breaking of trend with what had happened prior to that. While there had been an occasional year of high growth prior to that, like the 9% growth in 1975–76 and 10.5% in 1988–89, it is only from the mid nineteen nineties that India seemed to have moved to a sustained high growth path, achieving approximately 7% per annum growth for three consecutive years, beginning in 1994.

There would be some growth interruption in 1997, when the East Asian crisis came ashore in India, past our gates of capital control and slowed us down somewhat. Growth picked up further at the start of the 21st century. It moved up to around 8% by 2003 and over 9% by 2005, with the phenomenal growth of around 9.5% during each of the three years 2005 to 2008. There was a brief interruption again in 2008–09 as we were rocked severely by the global financial crisis that began with the sub-prime mortgage crisis in the US; but growth picked up quickly in response to a stimulus package that was implemented part deliberately but part unwittingly, and India grew by a remarkable 8.4% in 2009–10 and 2010–11, despite the headwinds of a global slowdown.

This growth trajectory is a remarkable story but what is even more remarkable and has not been commented on enough is India's globalisation since the early 1990s. While India was always an open society and polity, through a strange process of competitive politics and faulty thinking, the economy had become increasingly closed. The first Gulf War of 1990–91 and the subsequent economic crisis — one of the deepest that India had witnessed since the country's independence in 1947 — jolted India out of its closed-economy stupor. Reforms were undertaken to open up the economy and the subsequent globalisation that India witnessed stands out as a rare event.

In the mid-1990s, India's exports plus imports of goods as a ratio of GDP stood at approximately 18%. By 2010–11 this had jumped to 37.5%. In the mid-1990s India's exports plus import of services was around 4% of GDP. By 2010–11 this had risen to 12.9%. In the middle of the 1990s the gross

[1] The formal analysis associated with this is fully spelt out in Basu (2001).

capital outflows and inflows to India stood at approximately 15% of the country's GDP. By 2010–11 this had risen to an astonishing 53.9% (Government of India, 2012).

With this rapid growth and even more rapid globalisation, India has been drawn to the global round table of policymaking and strategizing more suddenly than anyone would have anticipated. We are today an important and verbose member of G-20, BRICS and other international clusters. Even though the verbosity may have nothing to do with growth performance and globalisation, but a socio-cultural propensity of little consequence, the membership in these important global bodies and India's visible participation in them is testimony to our nation's rapid integration with the global economy. It is indeed remarkable that in both the BRICS cluster and the G-20, India is both a very prominent member and the poorest nation by a wide margin in terms of per-capita income.

All these pose challenges and responsibilities which could not have been anticipated of even fifteen years ago; and it is these responsibilities and challenges that I plan to delineate, analyze and discuss in the remainder of this lecture.

III. Choppy Waters

Over the last year the Indian economy's journey turned choppy, with growth in 2011–12 slowing down to 6.5%, with the last quarter of that year registering a growth of 5.3%. A sector-wise analysis is worrying because manufacturing — the one sector where our comparative advantage is arguably the greatest — has slowed down sharply. It is indeed a matter of some concern that India's share of the manufacturing sector in the GDP has declined from 16% four years ago to 15%. Over the last eight years, India's exports grew faster than in any comparable period in the independent nation's history. But this has also slowed down to virtually zero over the last three quarters.

I do not believe there is any reason to treat the slowdown as anything more than a periodic downturn that occurs in any economy. This is not to absolve policymakers of mistakes and minimize the imperative of taking corrective measures, but recognition of the fact that mistakes do occur periodically in economic policymaking, which is not surprising given that economics is still a very young science and its prescriptions are often cast aside by considerations of politics.

A careful look at investor behaviour confirms that the last year is being treated as a periodic downturn and not a reflection of any long-run proclivity of the Indian economy. In the last financial year, 2011–12, foreign direct investment (FDI) into India was a record 46.8 billion dollars. This outstrips the previous high by approximately 5 billion dollars. This happened even while investment from foreign institutional investors (FIIs) dropped off sharply. Once we take account of the fact that FDI entails fixed costs by the investor and therefore reflects long-run bets being taken on the economy and FII money is relatively costless to bring in and take out, it is evident that the simultaneous occurrence of increased FDI and decreased FII inflows reflects concerns about the Indian economy in the short-run and confidence in the Indian economy in the medium and the long run.

There are several reasons behind this recent slowdown in growth but what is essential to remember is that we are no longer impervious to what is happening in the global economy the way we used to be in India's pre-globalization days.[2] With the global economy slowing down sharply in 2011 and the first quarter of 2012, it is not surprising that India is also slowing down. Indeed, in terms of relative

[2] For an explicit discussion of how the global financial crisis affected India and a robust rejection of the decoupling hypothesis, see Subbarao (2011).

growth, India stands roughly where it did two years ago. In the first quarter of 2012, among the G20 countries, for instance, India recorded the third highest growth, behind China (8.1%) and Indonesia (6.3%). With the exception of Australia which grew by 4.3% most industrialised nations were virtually grinding to a halt. Indeed the Eurozone nations collectively had a growth of 0%.

One consequence of the rapid globalization achieved by India over the last two decades, as noted above, is that now on both global buoyancy and global depression will impact us with much greater severity than was the case earlier.[3] It is probably true that no country in the world, with the possible exception of North Korea, can escape the crisis that is paralyzing the Eurozone economies. But what is also true is that the impact this time on India is harder than what would have been the case even a decade earlier.

As a consequence, we have to learn the art of making policy, ranging from monetary and fiscal measures to the making of law and regulation, in a relatively open economy. This is something new for us, because India has never been anywhere nearly as open as it is today in its six odd decades since independence. In adjusting to this changed scenario there will of course be some missteps and some missteps (let me call them that) there have been. But if India gets its act right, the opportunities that lie ahead for India are beyond what it has ever had in the past. India has the potential to be the forerunner among emerging and developing nations of the world.

If I were to use a somewhat blunt comparison with China, both nations began structural reforms since the late 1940s. Through ups and downs, China has managed to get its economic house in fair order and pursued good economic policies over the last three decades. India, on the other hand, has managed to get its political house in reasonable order. It has a functioning democracy, a vibrant media, a vocal civil society, and an independent judiciary. Given that getting ones political house in order is arguably the harder task than getting ones economic policies in order, the expectation that India will rise through the current tribulations of the economy to a phase of steady and rapid growth seems like a reasonable forecast.

IV. Pro-Active Policymaking

One reason why the Eurozone crisis has affected us so deeply and, in fact, more in terms of morale than actual economic indicators is that India is new to the art of policymaking in an open globalized economy. For many years, the global aspect of making policy was so marginal to India that this is not an art in which we are well practised. Much of our policies, be they in international political relations or international economics, were reactive. A proposal came from some nation or some international body and we decided whether to go along with it or not.

The dramatic change in the structure of the Indian economy over the last decade or two has made it incumbent on us to move from being a reactive to a pro-active agent in the international domain. There is a need to define our national prerogatives in the international arena and pursue these actively. India has to move from being a nation that accepts or rejects agenda developed by others to a nation that creates some of that agenda and begins to take up the role of initiator in some of these foreign policy and strategic economic matters. It is important for India to do some strategic thinking in terms of who should be our partners and friends in the global space and then take the first steps to bring

[3] This is often further exacerbated by the fact that India runs a large current account deficit. Every time there is a slowdown in capital inflows, this creates a pressure on the exchange rate, resulting in depreciation of the rupee. This can give rise to troublesome volatility (Gokarn, 2012).

these to fruition, instead of waiting for all the initiative to come from elsewhere. It is in this spirit and not just to celebrate the location of the Narayanan lecture that I suggested the need to promote greater economic and strategic engagement with Australia.

The need for pro-active engagement is true in many different ways — ranging from policies in our neck of the woods to larger international issues such as the ones that come up in G20 meetings. Our neck of the woods refers to South Asia, where India needs to play a much more active role than it does currently. The scope for collaboration and trade in South Asia is vast. Trade routes opened up through India's north-eastern neighbours — such as Bangladesh and Myanmar — can energize our neighbouring economies and unleash the potential of India's own north-eastern states which have, for far too long, relied on dole outs from Delhi. This is a region of India with high literacy and plenty of enterprise. Once we facilitate the development of the region, it will move on auto pilot. There are lessons to be learnt from the success of cooperation in the Mekong Delta. Power generation using Nepal's unexploited potential for hydro power can help Nepal and India. All such projects require strategic activism, involving the Ministry of Finance, the Ministry of External Affairs and the Export Import Bank of India.

Done correctly, this can promote development not only in India but in our neighbouring countries. Given that South Asia is among the poorest regions of the world, this is worthwhile from a purely global, humanitarian point of view. In addition, this can contribute to political stability and peace in the region.

But I put this thought on the table not merely for engagement with South Asia and South East Asia but the world, and emphasize the need for India to take a more active role in choosing its strategic partners and promoting humanitarian global objectives.

V. Policy Imperatives

Before plunging into economics, let me deal with and put aside a matter which is essentially that of politics. Much has been made recently of the compulsions of coalition politics with many claiming that that is what is slowing down decision-making and reforms. Having to take one's coalition partners along means cajoling and compromise, often referred to in India as 'coalition dharma'. Whether or not this is used as an alibi for failures that have other causes, there is no doubt that such fractious politics does not help. What does one do about this? There is no doubt that greater idealism among political leaders and policymakers can help greatly. India needs a critical mass of political leaders who are prepared to lose the next election. To win the future you must have the courage to lose tomorrow.

While we can wish for such idealism, it will be foolish to rely on it. What we need to do in the meantime is to think of electoral systems which eliminate some of the extreme volatilities of coalition governments.

I have a simple suggestion, which is a modification of the system of run-offs that many nations use, to achieve this. Given that voting in India has increasingly moved on to electronic means, this is easy to implement. Let me clarify that I am suggesting this only for the national election and not for state or local-body elections.

Ask each voter to rank their top two candidates by putting down the numbers 1 and 2 next to the two names of their choice. After balloting is over, begin by ignoring people's number 2 votes. In other words, do the counting at first the way we currently do. Now fix a cut-off number of members from a single party below which the party is considered too small to be represented in parliament. For the sake of illustration, take this to be 4%. Then all parties that get less than 4% of the seats in parliament on the basis of this first count are treated as disqualified from parliamentary representation. For all ballot papers which gave first preference to a candidate from these 'disqualified parties, count their second preferences as their true votes (except in cases where the second preference goes to a member of one of the disqualified parties, in which case just ignore such a ballot).

By this simple technique we will make sure that parliament will consist of fewer and more substantial parties. The agonies of coalition dharma will be reduced vastly. In fact, by making the cut-off higher than 4% it should be possible to virtually ensure that the ruling party has an actual majority in parliament.

I can see that a chorus of objections will be raised about this new system of balloting. But that is simply a reflection of our resistance to anything new. Of course, there is a need to debate the details; and these may be different from the precise formulation given above. But moving quickly to something like the above system will vastly improve the quality and efficiency of economic policymaking. Moreover, this will also alter the nature of politics. It will ensure that till political parties feel that they have managed to amass support beyond a critical level they will not find it worthwhile to contest elections. The tendency towards political and ideological agglomeration that this will give rise to would also be good for national unity, since small regional parties will be disadvantaged under this system and so will be incentivised to reach out to more people over larger tracts of the nation.

It is time to turn to matters of economic policy.[4] A basic principle that distinguishes sophisticated policy regimes from more feudal ones is based on the recognition of a simple fact, namely, that good economic policy does not consist of phoning and urging captains of industry and members of trade unions to deliver but on finding the vital levers and knobs of the economy and adjusting them to ensure that it is in the *interests* of industrialists and workers to deliver. This is at the heart of good policy design and most nations that have done well have at some point graduated to this realization.

A corollary of this is that when inflation occurs, you do not say it is caused by traders trying to earn larger profits and urge them to change their behavior. That may be true, but since traders always try to make more profits, to identify that as a cause, and appeal to them or pass a diktat against this is as useful as saying that the collapse of the building was caused by gravity and trying to alter that. To be successful, we need to locate the key features of the economy that must have changed and made it possible for or incentivized traders to raise prices in a sustained way and cause inflation.

Stated in such a stark way, this basic principle of economic policy, important though it is, seems to suggest too mechanistic and mean a view of humans and makes people out to be devoid of emotions beyond greed and acquisition. Economics as a profession has rightly been held guilty of such a mechanistic approach. But since I do not want to be held guilty of such a mechanistic approach, let me clarify.

[4] Some of the technical backdrop for what is argued here occurs in Basu (2012).

When I say that we must craft policy keeping in mind the interests of individuals, I do not want to make the mistake that textbook economics often made, namely, that of treating these interests as entirely centred on the self and inspired by nothing but greed. We must realize that individuals are endowed with varying degrees of altruism, trustworthiness, integrity and other-regardingness, and also that these qualities can be nurtured or dampened (see Basu, 2011). What is being argued is that, whatever these interests are, we must realistically take account of them in designing policy.

Take India's current system of food rationing for the poor. The method that is followed is for government to announce a "minimum support price" (MSP) for some essential foods, like rice and wheat, and have the Food Corporation of India to procure food from farmers at the MSP. A part of this is released to 500,000 Public Distribution System (PDS) stores or ration shops scattered all over the nation with the instruction that the PDS stores must sell the grain at special low prices to households that are below the poverty line (BPL) and some other specially vulnerable categories. At this point, we run up against the interest of the PDS store owner. If he can sell some of this subsidized food on the open market and turn away the BPL customers, or sell them foodgrain that is adulterated with stone shavings, he can make a lot of money. Indeed, evidence suggests this happens in fairly handsome measure. More than 40% of the foodgrain meant for the poor does not reach the poor (see Khera, 2011). This colossal waste causes our fiscal deficit to rise and much more importantly, leaves the poor ill-served.

The folly of this policy lies in the assumption that those supposed to sell to the poor will carry out their duty, irrespective of their self-interest. I am not assuming that human beings can never be selfless and committed to their work professionally with no regard to self-interest. In which areas we hold back our self-interest and live by other rules or custom, however, differs from one society to another[5] and also over time. It is critical to assess this correctly and to make allowance for them.

If we were talking about Norway or Japan, it may have been a fair assumption to make that a ration shop owner when told to sell rations to poor households will do precisely that. But that is not everywhere and always the case. While we must not forget that social norms can be moulded and altered, at any point of time they are given, shaped by history and environment. As policymakers we have to be realistic about the way they are *and keeping that in mind* design policies that will be incentive compatible.

It is important in India to try to nurture and build the kind of social norms that lead to progress and development. But to assume that certain norms are in place when they are not is to design policy interventions that will be defective and will fail to deliver efficiently.

The recognition that social norms and culture play an important role in economic outcomes that goes back to the works of at least Polanyi (1944) and Granovetter (1985) is at times viewed as politically regressive on the presumption that these norms may be hardwired into societies. There is, however, plenty of reason to reject such a presumption. There is enough evidence from around the world that norms are malleable. As the environment changes, norms can mutate and vanish and new norms can emerge.

There are plenty of examples of this but a most striking one that I have discussed elsewhere is to do with punctuality in Japan. Japan is arguably the world's most punctual society — some would argue

[5] Illustrative examples occur in Basu (2011a).

over-punctual, with individuals incurring excessive costs to avoid the charge of tardiness. It therefore comes as a surprise to learn that this was not the case as recently as a hundred years ago. Here is a description of Japan, which makes it clear that there is little difference between Japan of a century ago and the most tardy nations of today. I present the quote suppressing the reference to Japan to make it more striking.

> In his published memoir, Kattendyke (an European visiting Japan) cited a series of events to illustrate the frustrating slowness of the nation. For example, the supplies necessary to make repairs, which he had specifically ordered to be delivered at high tide, did not arrive on time; one worker showed up just once and never returned ... . Kattendyke's frustrations were in fact shared by most of the foreign engineers in the country ... . They often found themselves vexed by the work habits of the locals, and the main reason for their vexation was the apparent lack of any sense of time. To these foreigners, the locals worked with an apparent indifference to the clock (Hashimoto, 2008).

India's other and not unrelated hurdle to more rapid development is its large transactions and bureaucratic costs and the culture of "permissionism" that pervades our system. In this regard, reforms are needed, small and big. Let me first give an example from the small. Small clutter in the bureaucracy is quite pervasive in India. We need to go through the slew of all our bureaucratic practises and try to weed out all the debris from the old license control raj days, when procedures were put together for functions or intentions that are no longer — and may be never were—relevant.[6] Take an example which appears to be unique to India — namely, the stamping of baggage labels after security screening. We Indians take it for granted that for safety we need to put our baggage through security screening like everywhere in the world and, unlike anywhere else, have it stamped by a liveried officer, which means "checked and deemed safe". We are so used to it that once when I was boarding in Singapore, I found an Indian man making a big fuss insisting that the security personnel stamp his baggage tag. And when I told him that these officers would not understand what he was asking for and that he would be fine without a stamp, he refused to believe me. As I moved on, I heard him asking for the supervisor to whom he would complain.

The question is whether the Indian system which results in additional officers having to be employed and each passenger taking 5 to 10 seconds more at security, which in the aggregate is a colossal waste of time, serves any purpose. The answer is no, because it is too easy to create stamped tags.

Here is what you need to do. Take a soft bag full of trash paper. After it goes through security and the baggage tag is stamped, remove the stamped tag, throw away the trash paper, fold the soft bag and put it inside your other bag. You have created a stamped tag which you can put on any other bag that you may wish.

Some may object that there is no point in creating spare stamped tags, since anyway it is not possible to carry bombs and weaponry through security and into the terminal. But if that were so, then why do we have the system of stamping the tags in the first place? Conclusion: The practice of stamping baggage tags is a pointless exercise.

[6] Government intervention is often viewed as the more progressive policy, one that radical scholars should support. This is a highly mistaken view since it is permissionism and excessive control that usually results in capture by big businesses and leads to the worst form of a market economy, to wit, crony capitalism (Ahluwalia, 2010).

This is a minor example, but the reason I use up space here to outline it is because if we do not point these out on grounds of their being minor, our system will persist in being cluttered with the minor rules, which serve no purpose but, together, create substantial obstacles to efficiency and speed.

If we begin to move on these, there will be the additional benefit of these being treated as signals that India has woken to the need for greater bureaucratic efficiency. Declaring the people of some pre-specified countries do not need to apply for visas in advance, but can get visas on arrival in any of India's international airports is a case in point. If we make such an announcement, it may seem to have little connection with *economic* reform; yet it can have a large beneficial effect by signalling a changed attitude on the part of government.

Turning to large reforms and those that feed directly into economic functioning, the need is obvious by looking through any recent issue of **Doing Business** produced by the World Bank. In the list measuring "ease of doing business" on various counts, such as the time it takes to get permits to start a business, the amount of time it takes to close down a firm that has gone bankrupt, and the time taken to enforce a contract when someone tries to renege, India performs very poorly. We need an administrative reform to change this. The benefits of doing this right can be greater than virtually any other policy. Once we make it easy for people to go about their economic activities — working, trading, running a business and so on — a lot of the responsibilities that currently falls on the shoulders of the government will automatically be taken care of. Government can then use its precious resources and time for more critical activities, such as providing basic needs support for the poor, creating public goods, and investing in better infrastructure.

India has moved forward on all these fronts, especially since 1991, and it owes a large part of its arrival on the global scene and rapid growth since the mid-1990s to this; but there is still a distance to go in bringing greater professionalism and scientific knowledge into policymaking.

Let me give an example. Air India (AI) as a topic of discussion invariably leads to heat and dust in India. Should AI continue to be owned and managed by the state or should it be privatized? In India, as soon as this question raised that it runs into a storm. The debate takes the form of whether privatization amounts to selling off family jewellery to private agents or the refusal to privatize is a sign of state capture. The debate quickly reduces to ideology. If you are left-wing, you oppose privatization; if you belong to the right you support it. This is reminiscent of what Geoff Harcourt (1972) had once provocatively pointed out, namely, that in those days, once you knew an economist's position on the Vietnam war, you could pretty well guess what his or her position would be on several theoretical debates in economics, such as the capital controversy.

But this is not the way it ought to be (and one should hasten to add that there were prominent exceptions among those engaged in the capital controversy). Just as we are not able to tell from a physicist's research on the boson what her ideology is, or be able to tell from her ideology what position she takes on the God particle, we should not be able to correlate an economist's ideology with the economist's research findings. The ultimate decision we take on Air India would of course depend on one's normative line, but the pure analysis of the consequences of privatizing or not privatizing AI should have nothing to do with the analyst's ideology.

Once we keep this in mind, we can see more clearly what our current policy is doing. As things stand, Air India is run fairly inefficiently. With political leaders and the senior bureaucracy making demands on it, AI has for a long time been a loss making enterprise. As a consequence of this and also the shallowness of debate on this topic, the only cost of running Air India the way we currently do that is being talked about is the burden it places on the exchequer. So much of the debate turns on the question whether it is right to run a larger fiscal deficit in order to have AI in the state sector. This has obliterated other important and more complicated matters from the debate. One such matter pertains to the effect Air India has on the private sector in general.

One consequence of keeping Air India viable by subsidizing it that often goes unnoticed is its fallout on the private airline industry that competes with it. The assurance of state subsidy implies that AI need not do its commercial calculations too carefully. If it does its ticket pricing ‘wrong,’ is over-generous with its upgrades, pays too much to airline catering services or over pays its staff, it can still survive. But this ability to survive means that its competing airlines are forced to offer some of the same benefits to ensure that they find passengers, staff and catering services. Hence, the inefficiency spreads to other airlines, including the private sector. If the subsidies are too high, it becomes impossible for the private players to survive, since they do not have access to such state subsidies. They run up losses and may have to eventually close down.

That this is not mere theory and can happen in reality one can see by looking at India’s oil marketing companies. For a long time, we had a number of state-owned companies operating side by side with some private companies, such as Essar and Reliance. This was fine as long as government kept away from the scene. But, over time, the policy that has been followed is to hold down the price of petrol and diesel by fiat (though petrol was eventually freed in June 2010), impose some indirect taxes and, to make sure that the state-owned enterprises do not become unviable by notching up large losses or “under-recoveries”, as they are called, they were routinely subsidized by the government. This, of course, contributed in a big way to increasing the fiscal deficit, but that was not all. This combination of policies made it impossible for the private sector to survive; and indeed they have virtually all shut down.

This policy of tilting playing field can do large damage to efficiency. By driving out private competitors and ensuring that the state-owned firms are protected by the state’s policy of ensuring that their costs will be covered whatever they happen to be, you ensure that the costs will be large.

Before moving on, let me clarify that what we need to do in the fuel sector, such as diesel, is decontrol the sector, at least partially. This is not as obvious as appears at first sight. It has to be carefully designed and executed. Unfortunately, too much of the debate turns on whether or not government should raise the price by decree. It is true that this may be necessary in the short run, especially if we are deferring on decontrol. But what is more important to do is to fix the subsidy on diesel on a per litre basis, for certain pre-specified ranges of world crude prices and exchange rates; and also place some restrictions on how much price can rise and fall at one go. Moreover, both the taxes and subsidy should be placed on public and private sector firms. This levelling of the playing field will bring new entrants into this sector and make it more efficient. This is not an easy exercise but if it is done properly, the benefits of efficiency to the consumer can be large. It is important to understand that a reform of this kind will not necessarily cause the price of diesel to rise. It will mean that the price will fall and rise gently depending on global indicators; and the burden will be shared between consumers and the state. What is being suggested in terms of brakes on sudden rises in prices is somewhat akin to what most industrialized nations do to prevent ordinary home buyers from being exposed to the sudden volatilities in interest rates.

If we are going to reform our administration and structures of governance, we have to get into many of the kinds of details discussed above, but there is also a broad guiding principle of decision-making in a democracy that needs to be kept in mind. In India, there is a propensity to think of democracy as a system where everybody is involved in every decision. That may indeed be one kind of democracy — I have elsewhere called it an overlapping democracy — one in which decision-making is perforce sluggish. A better democracy is one in which everybody has a domain where he or she has a say in decision-making but it is not that everyone has a say on every decision. I called it a partitioned democracy. This is what we must aspire towards. And there should be much more scope for single-person decisions. Thus when we form a commission to reform something — our administrative system, for instance — we should increasingly think of a commission where the ultimate report is the report of one person. Currently we tend to form all commissions in the form of multiple individuals entrusted to produce a consensus document. Instead, not everywhere but in many fields, we should have commissions which take the form of one commissioner and *n* advisers. The commissioner would consult all advisers but the ultimate report is the report of that one commissioner. This is likely to make these reports more full of content and dynamism than happens under the current system.

This broad principle should carry over to more areas of decision-making in government. We tend to form groups for every decision, giving each member effectively a veto power. This tilts the system towards status quo and that is what plagues India. If we partition the slew of decisions that government needs to make, giving one person or a small group the charge of decisions in each element of the partition, there will be some mistakes of course. But we will not have a system that is frozen by the fear of making mistakes.

VI. The Road Ahead

The challenges that India encounters today, some of which were discussed above, are, by way of challenges, the best. They arise from India's phenomenal and unexpected success of the past two decades. This has catapulted the Indian economy to a global perch with a suddenness for which few were prepared. There will no doubt be choppy waters that the nation will have to navigate but, at the same time, there is reason to believe that India has chosen an irrevocable path to becoming an industrialized nation.

Most observers, including experts, have a propensity to overreact to the current situation. Two years ago, many were forecasting that India will grow in double digits. With last year's slowdown, the same experts have swung to the gloom scenario. My own belief — one that I have maintained for a while, let me hasten to add — is it entirely possible for India to grow at 7% per annum, per capita, over the next two or three decades. This will mean that, notwithstanding the trials of the last year, India can join the cluster of industrialized nations, often demarcated by the crossover line of per capita income of ten thousand dollars, by the year 2039. This will be a remarkable achievement but we have to remember that this must not be treated as an end in itself. We will have to work hard to ensure that this translates into happier and more fulfilling lives; and also that this larger national income is better distributed across the population.

At the dawn of the nation in 1947, the founding fathers of India made a momentous decision — a commitment to democracy. There were very few role models for this — a vast, poor nation, making a commitment to democracy and secularism even before it had shown any stirrings of economic growth was certainly an uncharted course. Yet, it seems today that of the two reforms, those pertaining to economics and those to politics, the latter are the harder. Economic policies can be modified and corrected as one goes along. Delays do slow down development but they are rarely insurmountable. On the other hand, political participation and democracy, once left by the wayside, are very difficult to usher in at a later stage, and can give rise to occasional but much more insurmountable roadblocks. Effort to alter such a political structure can give rise to struggle and trauma.

Hence, we may conclude that when two roads diverged on the wooded path of independent India, the nation chose the path less travelled by; but luckily so, because that seems to have made all the difference. There will no doubt be many further political reforms that India will have to undertake; there are economic policy reforms that are awaiting implementation. But the most important planks and foundations are in place. The nation did stagger and stutter while they were being put in place and allowed to cement in. But starting approximately two decades ago, India began to move with firm steps and growth picked up with unmistakable firmness. Poverty, still large, is now beginning to slope off and literacy, which seemed stubbornly low for the first several decades, is suddenly rising. India seems set to take its place in the comity of nations. And when it does, it will be important to bear in mind that industrialization and wealth are not worth much in themselves if they do not allow us to create a more humane and tolerant society. It must then carry to the world the message of its founding fathers and poets, the message of universal tolerance, peace and sharing.

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