Inappropriate template for a legitimate target

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"The Economic Survey, while rightly calling for a rise in private investment, incongruously invokes the East Asian model."

The recently-released Economic Survey either glosses over or ignores many acute challenges faced by the Indian economy — like the severe agrarian crisis; the troubles of loss-making and debt-ridden public sector units; and the issues plaguing public sector banks.

While the Survey is not incorrect in highlighting the importance of incorporating insights from psychology into economics, it is odd that this has been done so late in the day. Many other countries like the U.K., Australia and Singapore have for long being applying such points to policy design and implementation areas and the issue has been discussed in India over the last few years as well. It is unclear what added value the report truly has to offer here.

One issue that the Survey rightly underlines is the need for India to revive private investment if it is to achieve the magical $5-trillion economy status by 2024-25. However, what is odd here is that to stress this, the document invokes the age-old comparison between India and East Asian countries. It is rather strange that the Survey brings up something that has been taught in economic development classes over the last two decades.

How the NIEs prospered

Here, a question that arises is: Can the East Asian model help revive India's floundering investment rates? Some crucial reminders are worth underlining.

The East Asian model was largely a story driven by the newly industrialised economies (NIEs) of Singapore, Hong Kong, South Korea and Taiwan, and Japan earlier.

Specifically, the prime goal in various NIEs from 1960s through to the 1990s (prior to the Asian Financial Crisis) was to raise gross savings rates. While the rise in household savings was partly due to the positive demographic dividend, a variety of other factors, including macroeconomic stability, low inflation, lack of social safety nets, inability to leverage (due to a highly regulated banking system) and forced savings (fully-funded Provident Funds) also played a role. State-owned enterprises had to operate with budget constraints. This, coupled with the fiscal discipline practised by the economies, ensured that the public sector did not crowd out private savings and, in some cases, actually added to national savings.

Another goal was to ensure that the private savings were actually intermediated into the formal financial system, failing which the cost of capital would remain high and the availability of capital for investment would be low. To achieve this, importance was given to the establishment of a safe and secure public sector banking system (usually in the form of postal savings networks) where deposits were guaranteed by the central bank and interest incomes was taxed lightly, if at all. The state-owned banks were tightly regulated as financial stability was the cornerstone of overall macroeconomic stability.

Financial inclusion was encouraged, though the focus was on actual use of the deposit accounts rather than just their opening. While the manufacturing sector was viewed as a growth engine and open to export competition, the banking sector, in all economies apart from Hong Kong, remained tightly regulated and closed to foreign banks. Even Singapore initially adopted a dual banking structure that sheltered the domestic economy largely from significant short-term bank flows. It resorted to a calibrated policy to allow fully licensed foreign banks only in the late 1990s.

Tight financial oversight

So, while these economies were generally successful in encouraging savings, the cost of capital was rather high, not unlike the problem in India today. To tackle this, the East Asian economies undertook financial repression — conventionally understood as a ceiling price keeping lending rates lower than market equilibrium.

This, in normal circumstances, would have led to disintermediation from the formal financial system, a consequent reduction in the quantity of financing and the creation of a shadow banking system. However, central banks of these economies maintained tight oversight, and selective capital controls ensured that the low-yielding savings did not leave their countries of origin, while limited financial development forestalled the possibility of people looking for savings alternatives.

Along with these, the governments undertook sophisticated industrial policies to promote domestic investment, much of which was export-led (though not necessarily free-market based). The governments understood that a vertical industrial policy (of 'picking winners') would not work without a sound horizontal industrial policy (dealing with labour and land reforms, bringing about basic literacy and raising women's participation in the labour force). Besides, incentives also had clear guidelines and sunset clauses and mechanisms were in place to phase out support. Thus, winners prospered while losers were allowed to fail.

In addition, the bureaucracies of these East Asian economies had what Berkeley sociologist Peter Evans referred to as "embedded autonomy". This allowed the state to be autonomous, yet embedded within the private sector and enabled the two to work together to develop policies or change course if the policies did not work. This made industrial policy operate as a process of self-discovery, as emphasised by Harvard economist Dani Rodrik. It is the lack of this embedded autonomy in the next-tier NIEs of Malaysia, Thailand and Indonesia that has been partly responsible for them being stuck in the 'middle income trap'.

Heterodox policies, reforms

Thus, much of the investment and export acceleration in East Asian countries was due to heterodox policies and reforms that were carefully calibrated, well-sequenced and implemented at a time when the external environment was far less hostile than it is today. These measures allowed the nations to benefit from their demographic dividends and transform themselves into developed economies in record time.

In contrast, due to political and other compulsions, India's reforms since 1991 have been rather haphazard and of a 'stop-and-go' nature with perverse consequences, all of which has made it much more challenging for the country to take full advantage of its demographic dividend.

Successive governments have neither had the tool-sets and the policy space nor the embedded autonomy needed to drive the industrial transformation as in the East Asian countries.

Though measures like reducing policy uncertainty; ensuring that the fiscal expenditures do not crowd out private savings and investment; enhancing the efficiency of financial intermediation; and dealing with land acquisition and environment clearances are all essential to reignite investment, we do not need to invoke the East Asian example to understand the importance of these.

Economic Review 2018-19

- The Union Minister for Finance and Corporate Affairs, Smt. Nirmala Sitharaman tabled the Economic Survey 2018-19 in the Parliament.
- From 'Beti Baco Beti Padhao' to 'BADLAV' (Beti Aapki Dhan Lakshmi Aur Vijay Lakshmi).
- From 'Swachh Bharat' to 'Sundar Bharat'.
- From 'Give it up" for the LPG subsidy to 'Think about the Subsidy'.
- From 'Tax evasion' to 'Tax compliance'.
- Contribution of dwarfs to employment is only 14% and to productivity is a mere 8%.
- Large firms (more than 100 employees) account for 75% employment and close to90% of productivity despite accounting for about 15% by number.

Main Point

- Sustained real GDP growth rate of 8% needed for a $5 trillion economy by 2024-25.
- Private investment- key driverfor demand, capacity, labor productivity, new technology, creative destruction and job creation.
- Survey departs from traditional Anglo-Saxon thinking by viewing the economy as being either in a virtuous or a vicious cycle, and thus never in equilibrium.

STATE OF ECONOMY

- India is still fast growing major economy in 2018-19.
- Growth rate of GDP grew from 6.8 percent in 2018-19 to 7.2 percent in 2017-18.
- The growth rate will increase in 2019-20 and it is estimated to be 7%.
- Seven percent growth rate means that India will continue with the fastest pace in the world. At the same time, there is a possibility of lower global growth.
- Inflation rate was limited to 3.4 percent in 2018-19.
- The debt trapped as a percentage of gross advances declined to 10.1 percent at the end of December, 2018, which was 11.5 percent in March 2018.
- Current account deficit is worth adjusting to 2.1 percent of GDP.
- The fiscal deficit of the central government decreased from 3.5 percent of GDP in 2017-18 to 3.4 percent in 2018-19.

Fiscal developments

- Finishing of fiscal year 2018-19 with a debt-GDP ratio of 3.4 percent of GDP and debt of 44.5 percent (Provisional)
- According to the percentage of GDP, the deficit of 0.3 percent in the total outlay of the central government in the provisional estimate of fiscal year 2018-19 compared to 2017-18:
- 0.4 percent reduction in revenue expenditure and 0.1 percent increase in capital expenditure

Goals for economic prosperity

- Presenting the data as a public object.
- Emphasis on legal reforms.
- Ensuring policy harmony
- Encourage behavior change using the principles of behavioral economy.
- Financing MSME to make more job creation more profitable.
- Reduce capital cost
- To make the risk in the business logical reason for investment.

Price and inflation rate

- The inflation rate based on CPIC has been steadily falling for the fifth consecutive year. For the last 2 years it has been less than 4 percent.
- The Consumer Food Price Index (CFPI) based food currency inflation has also been down for 5 consecutive years and it has been less than 2 percent during the last two years.
- During the year 2018-19, the main factors of CPI-C inflation are housing, fuel and others.

Industries and infrastructure

- In 2018-19, the total index of eight basic industries increased by 4.3 percent.
- World Bank's Business Facilitation Report in 2019, India reached 77th position in 190 countries of the world. Liking up 23 places in comparison to the previous.
- Power installed capacity was 3,56,100 megawatts in 2019, while in 2018 this was 3,44,002 MW.

Expected Questions (Prelims Exams)

1. In the context of Economic Survery 2018-19, consider the following statements-

1. In 2018-19 the growth rate of G.D.P. was 6.8 percent.
2. For making the Indian economy 5 trillion dollar economy by 2024-25 the sustainable real G.D.P. growth rate should be 8 percent.
3. The inflation rate in 2018-19 has been 3.4 percent.

Which of the above statement are correct?

(a) 1 and 2 (b) 2 and 3

(c) 1 and 3 (d) All of above

Expected Questions (Mains Exams)

Q. Discuss the East Asian Model in the context of neo industrial . **(250 Words)**

Note: Answer of Prelims Expected Question given on 18 July. is 1(D).