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Economic Imperatives of Modi 3.0

By Duvvuri Subbarao

SYNOPSIS

Contrary to pre-poll projections, the Bhartiya Janata Party (BJP) headed by Prime Minister Modi has failed to secure an absolute majority in the parliament. The prime minister will now have to depend on his coalition partners to run the government. Many view this reversal as a rejection by the electorate of the polarising campaign platform of the BJP and a message to the government to focus on bread-and-butter issues like jobs and prices. It is imperative for the new government to take this message seriously.

COMMENTARY

Prime Minister Narendra Modi has won a historic third five-year term in office, but as many have said, it feels like a defeat. This is because contrary to pre-poll projections and exit poll predictions of a landslide win for Modi's Bhartiya Janata Party (BJP), the mandate is in fact much weaker than in the earlier two rounds. The prime minister will now have to depend on his coalition partners for a parliamentary majority and will also need to be more accommodative to an empowered opposition.

What accounts for this reversal? A dominant view is that the BJP's campaign platform of the Hindu-Muslim divide and other polarising issues did not resonate with the public. Instead, the message from voters to the government is to focus on bread-and-butter issues like jobs and prices.

It's imperative therefore for the third term Modi government to leave the campaign rhetoric behind and apply itself to the task of accelerating growth and ensuring that the benefits of growth are widely shared. Here is a summary of the good, the bad and the ugly of the India growth story which should inform the way forward for the new government.

The Good, the Bad and the Ugly Aspects of India's Growth Story

The Good

The highlight of the “good” part of the story is that with growth averaging 7 per cent, India is the fastest growing large economy in the world today. This is a significant turnaround from ten years ago when growth was slowing, inflation was high, the rupee was volatile, and the government's fiscal position was worrying. A bad loan problem had sapped investor confidence and crippled bank balance sheets. The much-dreaded stagflation seemed a distinct possibility.

Ten years on, the India growth story is compelling. The country moved up the ranks from being the 11th largest to the 5th largest economy in the world. By way of GDP, it overtook the UK last year and is on course to surpass Japan in 2026 and Germany in 2027. Growth is strong, inflation is approaching the target, albeit unevenly, the rupee is stable and service exports of nearly 10 per cent of GDP are giving unexpected resilience to the external sector. The bad loan problem is resolved with bank and corporate balance sheets in robust health.

Public infrastructure is being built at a frantic pace making the crane a ubiquitous sight on our urban landscape. The digital revolution is enhancing productivity, creating jobs, and adding to government revenues. India landed a spacecraft on the Moon, turned its G-20 presidency last year into a celebration of India and birthed at least a dozen unicorns. Recent estimates suggest that extreme poverty is all but eliminated, a remarkable transformation for a country once synonymous with mass deprivation. Amid all the pessimism about global growth because of slowing trade, persistent inflation, rising public debt and deteriorating geopolitical tensions, India is gaining global heft as an emerging economic superpower.

The Bad

But here's where the “bad” part of the story chimes in calling for a reality check on the pace and quality of growth, raising two questions in particular – how robust is India's growth and can it maintain this momentum? Both defy clearly affirmative answers.

Economists who have dirtied their hands with numbers have questioned India's methodology of growth estimation which glosses over outsized discrepancies to generate a flattering headline number. If you net out the discrepancies, they argue, the underlying growth momentum is much less impressive.

There is also an argument that even as India's current growth sprint is grabbing headlines, unbridled jubilation is misplaced because much of it is “catch up” growth. Poor countries grow faster just as a child grows faster than an adult. The challenge lies in sustaining that pace over an extended period where our record has been unimpressive. According to IMF data, the economy clocked growth of over 7.6 percent just seven times since the 1991 reforms. But it could never sustain that pace for more than two consecutive years.

Could this time be different? That the country's current growth is being driven just by

public investment does not inspire confidence. It needs to be firing on all cylinders to have a fighting chance of winning the race.

Furthermore, that India's moving up the global league by way of output maybe cause for cheer but certainly not for celebration. India might be a large economy, mostly by virtue of its large population, but it is still a poor country. With a per capita income of US\$2730 in current dollars, India ranks 136th in the league of nations. It is the poorest country among BRICS, it is the poorest in the G-20 and has more poor people than any other country in the world.

The Ugly

That provides a segue to the "ugly" part of the story defined by two interrelated maladies – jobs and inequality. Contrary to the promise made by candidate Modi in the 2014 election campaign that jobs will be his top priority, the unemployment rate has barely budged in the last ten years.

Two things make the unemployment problem particularly distressing. The first is the size of youth unemployment; according to the India Employment Report produced by the ILO, more than 80 per cent of the country's unemployed are its youth. The second distressing feature of the unemployment scenario is the low female labour force participation rate which is lower than that of arguably more conservative counties like Bangladesh and Nepal. There is much hype over how we are poised for a huge demographic dividend, but we should also know that no jobs means no dividend.

Deepening inequality in the country is in some sense a corollary to rising unemployment. A recent report by the World Inequality Lab, co-authored by Thomas Piketty, says that income inequality in India is currently at its highest level since 1922, surpassing even the British colonial era. Household consumption expanding at just 3 per cent when the economy is sizzling at 7 per cent is evidence that the benefits of growth are bypassing the poor.

Inequalities are morally wrong and politically corrosive. They are also bad economics. The huge consumption base of the bottom half of India's population is its biggest growth driver. If they earn more, they will spend more which will in turn spur more production, more jobs and higher growth. If the economy can't put more incomes into their pockets, it will be a huge, missed opportunity.

While on the subject of inequality, it should be noted that it has more dimensions than just income. It also needs to encompass education and health inequalities. World Bank Research shows that in poor societies education has been the route for upward mobility across generations. If additional efforts are not made to improve the quality of education in the vast hinterland of the country, an entire generation of children might forfeit the opportunity to move up the income ladder. Likewise, poor children suffer learning disadvantages because of malnutrition and burden of disease which calls for improvement in public health and primary health care.

It's the Economy, Stupid

"It's the economy, stupid" has become a cliched phrase, but it's the message that the

Modi 3.0 government must take to heart as it gets down to business. That matters not just to 1.4 billion Indians, but increasingly even to the world.

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