

R.K. Talwar Memorial Lecture 2018

The Reform Agenda

By: Bibek Debroy*

Mr. Rajnish Kumar, Dr. Misra, Members of the Talwar Family, ladies and gentlemen, let me first thank the Institute and SBI for having shown the honour of inviting me to deliver the 9th R K Talwar Memorial Lecture. Thank you, and I accept it with all humility because, even before I came here, I knew about the illustrious list of my predecessors.

I have a feeling that the Institute actually expected me or wanted me to talk on banking and finance, but I chose the topic “The Reform Agenda”. I wish I had thought of a better title and I did think of a better title while I was watching the corporate film on IIBF, because what I am going to talk about would have been better titled “The legacy of the past and the vision for the future”. That’s the sum and the substance of my talk. It is an unstructured talk but hopefully what I will be able to do is to persuade you to look at the big picture and there is a big picture away from the important, but somewhat narrow domain of Banking and Finance.

Reforms – what do Reforms mean? It entirely depends on who you ask because whenever we look, whenever we confront the word reform, our take on reforms has a certain perception, has a certain subjective bias depending on the prism with which we are looking at it and part of the prism understandably so is what has happened since 1991, which is what Mr. Rajnish Kumar had also mentioned. But if you stand back and think, to my mind, reforms are about markets, reforms are about competition, and reforms are about what the role of the government should be.

Whichever way you look at it, whichever aspects of reforms you have in mind, these are fundamentally the questions. Have you made markets function? How do you have a regulatory structure for those markets? How do you ensure competition and what should government be doing? To that, I will add another one and I will elaborate on this later and that is - what should we be doing as citizens?

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Recently, you may have noticed in the newspapers that India has now become the 6th largest economy in the world, according to official exchange rates. On PPP exchange rates (Purchasing Power Parity exchange rates), it had already happened, this is by using official exchange rates. It feels good - 6th largest economy in the world.

What is India's per capita income? Well, the income, the per capita income or the income of any country in the world is expressed in domestic currency. But, to make cross country comparisons realistic, you need a common numeral and traditionally that's been the US Dollar, so in USD terms, what is India's per capita income using official exchange rates, not PPP? India's per capita income is just about 2000 USD. Is 2000 USD high, is 2000 USD low? I do not really know.

There is a famous economist Lord Keynes, whose first book was on Indian monetary policy. Anything that is cleverly said in the area of economics, money, finance; you don't know who said it, it is ascribed to Lord Keynes. Just as in the area of literature, something clever, you don't know who said it, ascribe it to 'Oscar Wilde', so like that in the area of economics, money and finance anything that sounds clever, you do not know who said it, ascribe it to Lord Keynes.

2000 USD, is that high, low? Many things in life are relative. Apparently, Lord Keynes was once asked "How is your wife?" and he said compared to whose wife? So exactly in that way, 2000 USD high, low? Well it so transpires that, as of today, the richest country in the world has a per capita income of 175,000 USD.

175,000 USD to 2000 USD – So all said and done, India is still a relatively poor country. Quite often, some of you will travel to the United States, will travel to Western Europe and you will legitimately come back and complain and say why can't India be like the US? Why can't India be like Western Europe and again I will come back to this. But just so that you make an apple to apple comparison and do not make an apple to orange comparison, the per capita income of the United State in the 1870's (and not in 1970's) was 3000 USD, India today is 2000 USD.

What is per capita income? Per capita income is nothing but the average productivity of citizens of India So, if you are going to increase the per capita income, the average productivity

of Indian citizens needs to improve. There can be no debate about this. How does productivity improve? Everyone who has studied economics, first year, will say output depends on 4 things, Capital, Labour, Entrepreneurship and Productivity. So, therefore, if productivity is going to increase we must have greater efficiency in Capital Markets, we must have greater efficiency in Land Markets, we must have greater efficiency in Labour Markets, we must enable entrepreneurship and we must have technological changes that lead to what economists refer to as total factor productivity. It's as simple as that. What is complicated is how do we ensure this? I mentioned markets, I mentioned competition, but markets are not the neighbourhood fish market where you walk in and transact – purchase and sell. That is not what a market is.

A market is a conceptual structure and every market functions in an institutional set up. The early economists appreciated the importance of institutions. After that, economists became too specialised and forgot about institutions. Economists are rediscovering institutions again. So, every market that we can think of, functions in a certain institutional context. So, even though, the templates for reforms may be the same across countries, within the templates, there will have to be variations that take into account the specific institutional context, the specific socio-cultural context, the historical context. And what is our institutional structure? Our institutional structure, today, is one that is governed by the Constitution.

It is a different matter that the Constitution that we have today is not exactly the Constitution that we enacted in the year 1950's and may be it is worth asking whether every amendment since 1950 was an amendment in the desirable direction or not. So, the constitution determines the institutional context of all reforms. What does the preamble to the constitution say? The preamble to the constitution says; "We the people", it does not say, "We the Government."

The World Bank has several measures of governance and it tries to correlate governance with the level of economic development and we find that there is a strong correlation between governance (however measured) and economic development (however measured). But, correlation does not imply causation. So, it is not quite obvious whether better governance (however defined) leads to economic development or whether higher levels of economic development stimulate better governance. Why am I harping on this? I am harping on this because of "We the people". We constantly complain that the government should do this, the government should do that. Sure, the complaints are sometimes legitimate. The government should indeed do this, the government should indeed do that. But I said, "We the people".

Countries do not change because of only what governments do. Countries change when you and I change.

Mr. Rajnish Kumar mentioned the reforms of 1991. Soon after that, in the year 1992, I did an experiment, a very minor almost juvenile kind of experiment. The year was 1992, just after the 1991 reforms. What kind of experiment did I do?

I went to FICCI and CII, got hold of the membership lists and drew up a hall of fame of Indian Industry 1000 and I wrote them letters. 92 members, those were not the days of emails, it was a time of faxes. I wrote to them complaining about trivial matters. What are trivial matters? Let me give you an example to illustrate. I wrote to Britannia saying I buy Bourbon cream biscuits and half the time, I find that the cream is on the wrong side. That kind of trivial complaint. I wrote to 1000 hall of fame. Exactly 4 replied. Out of 1000, 4 replied. Out of the 4 who replied, 3 said, we are very sorry to get your complaint, our authorised representative will call on you soon. I am still waiting, they have not turned up. Only one, Modi-Xerox came and attended to my complaint.

More recently, well it's just been told or you were told that I work for the government. What you have not been told, although it's obvious, is that I now live, we live (my wife and I), in government accommodation. I presume it must be same with PSBs. Certainly, if you live in government accommodation, the electricity bill is taken care of, in this particular case, by NITI Aayog. You do not own the house, you do not have an electricity bill in your name. You do not have a tenancy agreement. My wife and I, between us, we had accounts with 3 banks. All three are private banks. We shifted our residence, so like dutiful citizens, we wrote to the banks saying please note a change in address. I have since discovered that it is easier to open a new account than to get your address changed, and it went on and on -- where is the ownership deed to the house? where is the tenancy agreement? where is the electricity bill? where is the telephone bill? I rang up the Reserve Bank of India. Reserve Bank of India said all we require is that bank should visit you at your house and verify your antecedents, which they won't do. After this had gone on for about 4 months, my wife said on a Sunday evening, you are supposed to work for an important position in the Government and you cannot even get your address changed. In exasperation, I sent SMSs to the heads of the 3 banks, whom I happened to personally know, and on Monday morning, the addresses were changed.

I will give you one more anecdote. In 2015, after this government came into power, I was appointed the Chairman of a Committee that went into restructuring of Indian Railways. In the course of that, I travelled, sometimes with my wife, throughout India on trains, not the Rajdhani and the Shatabdi but slightly less luxurious trains, ordinary trains. On one of these trips, we were, on a not very high end train, at a station in Uttar Pradesh. And the train had stopped at 2 in the morning for a Rajdhani to pass. So, there was the train parked on the platform at 2 in the morning and my wife and I got down, to have a walk, stretch our legs along the completely deserted platform. Except that, there was a food stall that was open. A hefty burly man comes along, goes to the food stall, buys a packet of chips, eats the chips and throws the wrapper on the platform. And I can see my wife at my side, I know what is going to happen. So, I pretend I do not exist, I maintain a discrete distance. She goes up to this fellow, as said tall and hefty, taps him on the shoulder and said pick up the wrapper and throw it in the dustbin. I thought here we go. Man looks at her, picks it up, puts it in the garbage. We go up to the food stall owner who said this is remarkable. He said that before the Swachh Bharat Mission, this would not have happened.

Now, I have given you these examples to illustrate that government does not exist in isolation, in a vacuum. You cannot realistically expect that suddenly the government will begin to exhibit all the trails of excellence when the ecosystem that we are functioning is an ecosystem that is inefficient and uncompetitive.

If you go back, look and read any of our historical texts like, let us say, Kautilya, you will find that several things were not done by government. Government did a set of very limited things. Dispute resolution, protection of property rights, internal security, external security and a lot was done by the Srenis, which in English would translate into Guilds. Who checked unfair trade practices and restricted business practices? There was no competition commission. The Srenis did it. Who set MRP? The Srenis did it. Who did skill formation? The Srenis did it.

We don't have to go back thousands of years. The British road gazetteers, initially for India and then for the states and those initial British Gazetteers for the Districts of India in the 1880s were a revelation. 1883, in the District of Rohtak, a canal had to be built costing Rs.45,000. The government paid Rs.20,000. Who paid the remaining Rs.25,000 in 1883? The community. You expect that today and hell will break lose.

So, in some sense, we as a community, we as a society, we as citizens, have abdicated our responsibilities. But let me come back to Government. What does Government mean? What is Government's responsibility? Government's responsibility is to deliver public goods and services. What are public goods and services? We can debate on this. Each one of us will have our own list of priorities. But at the end of it, hopefully in your list of priorities, right at the top, will be law and order and security because that is the reason why citizens throughout the globe elect governments - to ensure internal and external security.

Item Number 2 will be certain elements of physical infrastructure that the Private Sector will not deliver - rural roads, electricity, water. These are the kinds of things that the private sector is not going to deliver. Primary health centres, some elements of social infrastructure for schools, etc. There is a quote from Mahatma Gandhi "India lives in her villages". Everyone indiscriminately quotes this without necessarily reading the rest of the paragraph. In the rest of the paragraph, you have a precise listing of the number of villages that used to exist then. And how many villages used to exist when Mahatma Gandhi wrote that? – 700,000. How many villages we have in India now? – 600,000. Because for various reasons, over a period of time, villages become less in number. They are reclassified, some become un-inhabited, some become part of larger agglomeration of cities/ villages. Out of these 600,000 villages, until recently, 100,000 of them still lacked metal roads, electricity, transport connectivity, gas connection, primary health centres, schools - all these things that we take for granted. Any government, and I will qualify the word government later on, has limited capacity. It has limited fiscal and limited administrative capacity. The priority on fiscal grounds and the priority on administration grounds must be for these 100,000 odd villages, which seven decades after independence, are still deprived of various things that we take for granted.

I do not know how many of you are from the North East. If you are not from North East, you are probably familiar with the North East. You have no idea how important it is psychologically, even if not economically, for a citizen of a state in the North East, when he/she feels that, seven decades after independence, I have a railway connection in my state for the first time, I have an airport in my state for the first time, which brings me to another point and do not misunderstand what I am saying. I talked about efficient labour markets. Mr. Kumar mentioned GST. This is one country, one country does not mean only GST, one country also means that I have a unified land market throughout the country, that I have a unified labour market throughout the country, I have a unified capital market throughout the country. And do

not misunderstand, I am not talking only about article 370, I am also talking about other articles - article 371, which for those of you know, segments the country. If you segment parts of the country, those parts will never be main streamed. Just for argument's sake, imagine what would have happened if in 1961, we would have said that Goa is going to remain a separate entity. I do not think Goa would have been what Goa is today.

Let me now come back to something that I just said. The priority, as I said and you seem to agree, for any government, is internal and external security. I am sure, as citizens, you sometimes lobby for exemptions. How many times do you lobby for police reforms? How many times do you raise your voice to argue that the judicial system should become more efficient? We agreed those are priorities.

Let me go for an anecdote again. Several years ago, mid 1990s, I headed a project on Law reforms, in the course of which I met many interesting people. one of them was a gentleman named Lalbihari. What was interesting about him was that Lalbihari was alive, but he was also dead. Because, Lalbihari possessed an ancestral plot of land and his maternal uncle, who coveted that plot of land, bribed the Tehsildar to declare Lalbihari dead. So, Lalbihari was fighting a battle to prove that he was alive. When he did some research and discovered there were around another 25,000 such dead people floating around in U.P. and he thought he would synergize their attempts, he formed something known as Mritak Sangh, the Dead Man's Association. And Lalbihari became the founder President of that Mritak Sangh and he changed his name to Lalbihari Mritak. He used to be a government school teacher. So, he tried various things to prove that he was alive. He stood in the elections against the then P.M., he made his wife claim a widow's pension, he went and threw stones at the police so that the police would catch him. This is roughly the time I met Lalbihari. To cut the Lalbihari story short, I found Lalbihari's story so bizarre that I started writing about it. It was picked up by International Magazines. There is a genuine prize awarded every year out of Harvard known as the Ig Nobel Prize. The Ig Noble Prize is given to people who do strange things, so Lalbihari was awarded the Ig Nobel prize for peace. He could not receive the prize because he was not alive. But he became famous, in the process of which, Lalbihari was declared alive. What happened to the remaining 24,999? I do not know.

But, the point I am making is particularly police and judiciary. Governments do not reform just because governments suddenly decide to reform today. Governments reform when the

countervailing pressure starts from citizens. The Environment Protection Act of 1996 happened because of citizen movements. RTI happened because of that. The Consumer Protection Act happened because of that. How many times, as citizens do we push for either of the two – the police and the judiciary?

Now, let me come to the rest - the other public goods and services. Who delivers these public goods and services? I have been loosely using the word Government. What is Government? In terms of the constitution, there are 3 organs of state and we have talked briefly about them. One is the executive, the second is the judiciary and the third is the legislature. Well, I have not talked about the legislature but let me mention, there is another way to look at government and that is in the Constitution. We have a 3 layered structure of government - there is the Union Government, there is the State Government and there are the Local Governments. Who delivers these goods and services? Typically, unless I am talking about defence and security and things like that, typically these public goods and services are delivered by local governments -- The Panchayats and the Municipalities. Economists and Development Experts have argued for years that as a country, India is excessively centralised, even in comparison to a country like China. It became centralised during the colonial British period because of various reasons. It continued to be centralised post 1947, because of Industrial Policy, Planning Commission and a whole lot of things.

Now one of the really big institutional changes required is decentralisation of the country. And decentralisation of the country is not only fiscal devolution which the State Governments always talk about, nor is the fiscal devolution only union to state. The fiscal devolution is also within the State, which State Chief Ministers will typically not talk about. That decentralisation and fiscal devolution is something the State Chief Ministers will normally not talk about, but from the point of view of the citizen getting access to those better public goods and services, that decentralisation and devolution are needed.

I am sure, many of you have used the expression Centre-State relations. Why? Centre-State seems to suggest that there is a centre sitting there and everything else is a peripheral. Why do you use the expression centre-state? The expression centre is not there in the Constitution. The Constitution uses the word 'Union.' India is a Union of states. So, the simple point so far as this bit is concerned, – to ensure that reforms get traction, we need that decentralisation. But,

then, we come back to Government – overall government's resources and overall government's expenditure.

How much do India's citizens pay as taxes? Union and State Government taken together- 17% of GDP. It fluctuates a little bit from here to there, but roughly 17% of GDP. Look at the demands, in the public mind, 6% must be spent on education, 4% must be spent on health, we are at 10%, 10% must be spent on infrastructure, we are at 20%, 3% must be spent on defence, we are at 23%. NIPF has some estimates that subsidies account for about 10%. We are at 33% of GDP. So, we will expect all of those things because we are exposed to such things in terms of visiting Western Europe and the US, but we will not be prepared to pay.

Mr. Kumar again mentioned GST. On tax reforms, there is a direct tax agenda and there is an indirect tax agenda. If we look at the big picture, in the case of both, is elimination of exemptions. Until exemptions go on balance, I do not think compliance cost can come down as long as exemptions are there. Exemptions can potentially be subjected to abuse. Yet, every time there is a queue in front of North Block or in any other Ministry, the typical argument is please remove the exemptions for everyone else but retain them for me. The problem in that argument is if you grant an exemption to A, it is very difficult to prevent the exemption to B. Taken together, apart from what I have said about compliance cost, the exemptions come to about 5% of GDP. So, had those exemptions not been there, we would have been at $17\% + 5\% = 22\%$ of GDP. So far as the tax reform agenda is concerned, GST is work in progress. We are nowhere near a perfect GST. There is no country in the world who has overnight accomplished a perfect GST. The terminal goal is something that is known. The question to ask is, should we have waited for consensus and debated that perfect GST before proceeding or shall we start with it knowing full well that it is not perfect and gradually tweak it and improve as we go along. This particular government has decided on the latter course of action. So far as the direct tax file is concerned, as we are aware, a task force has been set up, which will bring a draft, which hopefully will incorporate elimination of exemptions.

I am coming to the end of whatever I want to say and now, I want to particularly address those who are younger. The reforms started in 1991. Soon after that, in 1993, the IMF brought out a report. In that report, the IMF asked a very simple question. How many years will it take for a country like India to halve, not eliminate, the gap in per capita incomes between India and the developed countries, assuming that the developed countries do not grow at all? Answer was

153 years. 153 years is too long, despite increases in life expectancy. In any event, we are not prepared to wait for 153 years. In the course of my work, I have to travel throughout India and whenever I travel throughout India, I sense a young India that is vibrant, that is pulsating with entrepreneurship, that is impatient. It no longer has a chip on its shoulder. When we were students and later on, when I was a teacher, the world was divided into 3 groups of countries. Developed Countries, and expressions that are no longer fashionable now but they used to be used then, Developing countries and the worst amongst the developing countries were known as LDC – Least Developed Countries.

When I began to teach, I realised that there was a fourth one which had only one country as a member, that was RDCs (Refusing to Develop Country) and that country of course was India. No one is disputing what India did in the 50s but the cost of intervention had to be less than the benefits. And increasingly, it became clear that the costs of these heavy handed intervention were far more than the benefits.

If you look at East Asia, in the early 60s, East Asia was comparable to India or rather India was comparable to East Asia. Believe it or not, per capita income and human development indicators in India were better than those in East Asia. The lost development decades were the second half of the 60s, 70s and 80s. But, coming back to the young India, when we were growing up, talk about India in the outside world, was generally about Yoga, a little bit about Indian cuisines and we were perpetually defensive as students. What is unique about young India is that young India does not have that chip on the shoulder. There is plenty of entrepreneurship in India and as bankers, you know the entrepreneurship is not in the corporate sector. If entrepreneurship is defined as risk taking, that is rarely a trait of the corporate sector. It is indeed the first time that the corporate sector has been threatened with the prospect of exit. Competition requires both entry and exit. It is for the first time they have actually been threatened with exit, which is why, there is a lot of screaming and shouting. The actual entrepreneurship is exhibited by the poor vendor on the streets, because he has to exhibit plenty of entrepreneurship to evade the cops and the municipal authorities. So, they display far more of entrepreneurship, except that, the formal Banking Sector will not normally lend to them. But that apart, it has often been said about India that the past was glorious, the future is glorious, the present alone is bleak. It is for the first time that I can see, because of what I said, the present blurring into the future. This India was given to us “in trust” by our ancestors. That India is now being handed over “in trust” to the younger ones and it is for you to demand the kinds of

reforms because, if you do not demand those reforms, the reforms will not happen and you have a vested interest in those reforms because you are the ones who will live in that posterity.

Thank you once again for having invited me.