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Indian Budget 2019

A real test of Modi's reform credentials

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For The Straits Times

The government's budget slated to be presented to the Indian Parliament next week will be a test of Mr Narendra Modi's reform credentials. Will the Prime Minister embrace politically difficult economic reforms to have a fighting chance of lifting his country of 1.3 billion people into middle-income status and thereby secure his legacy, or will he shy away from them to secure the next election?

Curiously, the campaign leading to the election last month that gave Mr Modi a stunning victory centred on a deft narrative spun by him around national security, global heft and religion-based muscular nationalism. The huge economic challenges staring India in the eye, such as deepening agricultural distress in rural areas and rising unemployment in urban areas, completely bypassed the debate.

Mr Modi and his Bharatiya Janata Party (BJP) might, therefore, be tempted to interpret this resounding mandate as an endorsement of the government's economic performance in its first term. That will be a serious miscalculation. Voters chose Mr Modi over a motley of opposition parties not because they saw any significant improvement in their economic circumstances but because they saw him as the only one capable of giving them an opportunity of securing their livelihoods. "It is the economy, sir" was the clear message.

Will Mr Modi heed the message?

If his first term is any guide, there is not much promise. Sure, it was his government that rolled out the nationwide goods and services tax that turned a fiscally balkanised country into a common market and enacted a bankruptcy code to fix errant investors.

But both these initiatives have been in the works for over a decade and it is happenstance that they culminated during his term. The only economic policy that Mr Modi championed – demonetising high denomination currency – proved to be self-defeating.

On the economic front, the government's first term record has been lacklustre. As per official data, the economy clocked an average growth of 7 per cent on Mr Modi's watch, giving India bragging rights as the fastest-growing large economy in the world.

Some economists have all along been sceptical about this claim, arguing that the aggregate growth rate does not square with more directly measurable variables such as imports, exports, credit flow, manufacturing output and job growth. That debate became wide open after a research paper published last week by Mr Arvind Subramanian, the government's former chief economist, arguing that India's economic growth during the five-year period (2011 to 2016) may have been overestimated by as much as 2.5 percentage points.

Many economists have since fiercely contested Mr Subramanian's methodology and conclusions. Given the joke in popular parlance that everywhere around the world, the future is uncertain, but in India, even the past is uncertain, this debate is unlikely to be settled soon.

Even assuming that the economy did in fact grow at 7 per cent, it was owing more to good luck – low oil prices and a benign global environment – rather than any bold policy during Mr Modi's first term. All current indications are that the economy is losing momentum, output growth is slowing, private investment is languishing, factory production is shrinking and rural wages are stagnant.

Shortly after being sworn in for his second term, Mr Modi set an ambitious target of a gross domestic product (GDP) of US$5 trillion (S$6.77 trillion) by 2024 which translates to near double-digit growth rates over the coming five years.

Next week's budget will be keenly watched for whether it will unveil an action plan for achieving that target. In particular, how will the budget address agriculture distress and unemployment?

Agriculture accounts for only 15 per cent of India's GDP, but as much as 55 per cent of the population is locked in this sector evidencing poor productivity. The BJP manifesto promised to double farmers' incomes by 2022 although how the government will achieve that is as yet unclear. A scheme of cash transfer to supplement farmers' incomes unveiled shortly before the elections is neither adequate nor a substitute for more sustainable solutions.

The unemployment problem is even more intractable. About 10 million join the labour force every year, but the economy is not able to create even half as many jobs. "Jobless growth" will be an extreme characterisation, but worryingly, the job intensity of growth has been on the decline.

If Mr Modi's challenges are clear-cut, so are the solutions. He should embrace second-generation reforms with energy and enthusiasm: Free up agricultural marketing to allow farmers to respond to market forces; reform land and labour laws that will encourage investment and job creation; privatise public enterprises, including some large government banks, fix the problems in the shadow banking sector and increase public and private investment in infrastructure. And all this without jeopardising macroeconomic stability or forsaking fiscal responsibility. The agenda is daunting if also politically complex.

Talking of economic reforms, Mr Jean-Claude Juncker, president of the European Union, famously said: "We all know what to do, we just don't know how to get re-elected after we've done it." Mr Modi has the challenge and the opportunity of proving him wrong.

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