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Don't expect a grand vision from the next budget: Eswar Prasad

What is most important from the budget is to make sure that the government stays on the path of fiscal discipline, says the senior professor from Cornell University

Eswar Prasad, a senior professor of trade policy at Cornell University and a senior fellow at the Brookings Institution. Photo: Sneha Srivastava/Mint

New Delhi: Eswar Prasad , a senior professor of trade policy at Cornell University and a senior fellow at the Brookings Institution, is an expert on both the Indian and the Chinese economies, as well as global financial regulations. In Delhi to speak at the Delhi Economics Conclave organized by the finance ministry, Prasad spoke about his perception of the Narendra Modi-led government, the reforms that India needs and what India can learn from China. Edited excerpts:

The Narendra Modi government recently completed six months in power. How would you rate its performance?

The Modi government got off to a rather slow start. Many of us were hoping for a barrage of very large reforms, but as the government continues its programme of reforms, I am beginning to see more of a logic to it. I think Modi seems to have decided that he is going to focus on some key priorities, especially trying to improve governance, deal with issues like corruption and make the government work a lot better. The focus on things like sanitation are ultimately going to be very important because it manages to give the people a sense that reforms are not just for the benefit of the political and economic elite, but are going to benefit even the poor people. After all, sanitation, ultimately, is not just a matter of economics, but also a matter of women's dignity and a matter of health, and all these will make the country work better.

On the financial market reforms, he has been making some progress. The support that he has been providing to RBI (Reserve Bank of India) in its fight against inflation seems very sensible. Labour market reforms are beginning to get under way. Although it has been a slow start, he has gotten the country to move in the right direction.

What are some of the big-ticket reforms you would like to see going ahead?

Labour market reforms are going to be crucial for India because it is going to be very difficult for India to sustain a manufacturing sector revival unless the labour market works a lot better. The fact (is) that you have very rigid labour laws that make it difficult for manufacturing firms to benefit from economies of scale. The opening up of the economy to trade and finance is a very good thing and it has created a lot of benefits for India, especially in terms of greater competition, greater access to foreign technology and more access to foreign markets and that is certainly going to help, and Modi seems to be moving in that direction.

Financial market reforms, especially the programme for financial inclusion, making sure that more people are attached to the formal financial system, is going to be very important for India because one of the key challenges India faces is channelling of all the domestic savings effectively into domestic investment, and we have very large investment needs especially in infrastructure. These are some of the reform challenges that Modi faces. But the bigger issue is making sure that government acts as an enabler for the tremendous dynamism that is latent in the Indian economy. Government has in many cases in the past prevented dynamism and entrepreneurship from coming to the fore. Modi does seem to be aware of that particular challenge.

A lot is expected from finance minister Arun Jaitley's second budget? Do you think it will meet expectations?

Both Modi and Jaitley have made it clear that they are not going to come forward with big-bang reforms package. What they want to do is make promises that they can deliver on and they will be judged not so much in terms of promises they make, but in terms of the implementation of those promises. My suspicion is that we are not going to see a grand vision being laid out in the next budget, but essentially incremental progress along the same path that they have already set out on. What is most important from the budget, of course, is to make sure that the government stays on the path of fiscal discipline because this has been a big constraint on growth in India. The fact that we have very high levels of public deficit and debt have held back growth and led to inflationary pressures. Other than that, certainly there are many issues, even on the incremental side, they can add to a lot to what they have started with in terms of reforms, in terms of easing of labour laws, financial market reforms, more redirection of public funds towards infrastructure. So, a lot of small-ticket (items) rather than a few big-ticket items is what I am expecting to see.

When people compare India and China, they say democracy in India has become a big drag on sustaining the high growth momentum. Do you agree with that?

One could certainly argue that in a democratic system, there is much more emphasis on redistributive policies rather than policies that promote growth. But my sense is, a democratic system has worked well in India because ultimately growth has to be good for the broader population. Sometimes, this has led to policies that are not necessarily, in either the short-term or long-term interest, even of the poor. But the good thing about a democratic system is that it does have a self-correcting tendency over time. We have seen this in India repeatedly, when a particular political party does not deliver the economic goods, then they end up not remaining in power for very long.

Having said that, even in China, the central government does not have as much power as one might think in order to influence the provincial government. The provincial governments are very powerful, the state-owned local enterprises, the state-owned banks are very powerful politically. So even in China, it is very important for the political leadership to build broad support for its reforms.

What are the lessons that India can draw from China’s experience?

There are two or three lessons from China that are very important for India. First, to create a framework for reforms. When one thinks of what China did in February 2013, when it announced plans to reduce inequality, that worried some people including me because when the government says we are going to reduce inequality, usually that does not lead to good policies. But when one looked at the specific policies, it was policies to make state enterprises more like commercial enterprises, increase labour mobility by easing restrictions on inter-provincial or intra-provincial migration and reforming the financial system.

All these are reforms that are necessary for China, but by couching it in the context of inequality, the government managed to make the point that these are really meant for the masses. Second, China is very committed to reforms, even in difficult times, it has been eager to push forward reforms, especially financial market and other market-oriented reforms. The Chinese have been very effective at sort of learning by doing. They try out reforms in a particular province, try to learn from the good or bad thing that has come out from that experience, and then expand it nationwide. Third, (the Chinese have succeeded in) trying to create a narrative that powers these reforms along. For example, when they talk about making the Chinese currency renminbi an international reserve currency, the Chinese have been very clear that it is a very mixed blessing, but it provides a very nice framework for thinking about what China needs to do for its own benefit.

India has joined two multilateral banks, the BRICS New Development Bank and the Asian Infrastructure Investment Bank (AIIB) which China is leading. Do you think India is playing second fiddle to Chinese ambitions to make renminbi an international currency?

What is the ultimate motive of China in pushing forward these institutions? China is clearly crucial in terms of providing money and leadership in these institutions. My own sense is that there are some benefits in having new institutions like BRICS New Development Bank and AIIB because it provides competition in the international monetary system.

Right now, we have a system that is in many ways dysfunctional, for example, the International Monetary Fund where I used to work, is an institution that could do a lot of good, but the emerging market economies do not trust it. They see it as an institution that is run largely by the advanced economies for the benefit of the advanced economies. So, I think it is a good sort of response by the emerging market economies rather than just complaining about the unfulfilled promises by the advanced economies. So, this competition is good: it will catalyze governance reforms in the existing institutions.

Now, China certainly has a very clear set of objectives, both economic and strategic, in order to use these institutions to expand its influence in the Asian region and more widely. I don’t think it will be entirely productive for India to stand at the sidelines and watch it happen. So, perhaps by getting more involved, India can move these institutions in the right direction. But certainly, there is the danger that India becomes an enabler to Chinese expansionist plans in the region. My sense is India can prove to be a useful counterweight and I think it gives many other countries in the region some confidence in these institutions because India is involved as well.