Source : www.thehindu.com Date : 2019-09-29

INSTITUTIONS WEAKENED, ECONOMY CRIPPLED

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

Illustration and Painting

Nobel laureate Oliver Williamson pondered over an important question, around 25 years ago: “Why are the ambitions of economic development practitioners and reformers so often disappointed?” According to him, “one answer is that development policymakers and reformers are congenital optimists. Another answer is that good plans are regularly defeated by those who occupy strategic positions. An intermediate answer is that institutions are important, yet are persistently neglected in the planning process.”

The question and all the three answers assume relevance in the context of India’s recent economic performance. The slowdown in GDP growth rate has been dissected, digressed and disowned by analysts, commentators and policymakers. However, the diagnosis is far from complete and the growth engine is running out of fuel. Both the demand- and supply-side factors have been central in all the analyses, but the crucial role of institutions in shaping the outcomes of both the factors in this episode of slowdown has been neglected. This has resulted in a series of banal policy measures for reviving growth.

A market-centred economic model necessitates creating and sustaining credible institutions that further the efficiency of market mechanism. Given the possibility of ‘market failures’, such institutions assume a larger role in the economy in shaping expectations and decisions. Journalist Henry Hazlitt grouped the pillars of market economy into private property, free markets, competition, division and combination of labour and social cooperation. Institutions are needed to strengthen these foundational pillars are a prerequisite for markets to work.

The credibility of three such important institutions — the Reserve Bank of India (RBI); the Central Statistical Organisation (CSO); and the Planning Commission/NITI Aayog — has taken a beating in recent times.

The RBI, which was clamouring for more autonomy, has been systematically brought under the ambit of the Central government. Starting from the sidelining of the central bank on the important issue of currency demonetisation, the attempt has been to steadily erode the central bank’s independence. A three-pronged strategy resulted in this — first, the RBI was bypassed on matters relating to currency; second, its role as regulator of the banking sector was questioned when banks faltered; and, finally, its reserves were siphoned. The net result has been that the RBI has been reduced into an institution which presides over a limited space of monetary policy, that is, inflation targeting.

It is also interesting to note that the only major policy tool available in the RBI’s armoury is cutting repo rates, which the central bank did four times this year. The last time the RBI made so many back-to-back cuts was after the global financial crisis over a decade ago, when most major central banks were desperate to revive economic growth. However, rate cuts alone could not help India’s economy this time, as banks, saddled with bad debt, were slow to reduce lending rates. This provides a classic case of an institution’s weakening, leading to questions on its role and credibility.

Markets, which work on information and expectations, rely on official data to arrive at decisions. In an era of ‘big data’, we find that India’s official data procuring and publishing agency has been crippled. Often we find that the official series, ranging from national accounts to unemployment, has been smothered with repeated revisions and change of data definitions. When data that needs ‘approval’ before release, as in the case of the unemployment data, questions are bound to arise on the credibility of the numbers. The veracity of the data is to be tested by researchers and the public who consume the data and not by ‘approving agencies’. It is altogether another matter that had we had admitted that the rate of unemployment was high, perhaps more private investment could have come due the expectations of finding labour at lower wages. Such a possibility was shut out by an attitude of denial on the part of the government.

NITI Aayog presents the case of an institution that lost its character in the process of transformation. By abolishing the erstwhile Planning Commission and transforming it into the NITI Aayog, the government lost the space for mid-term appraisals of plans and policies. Course correction and taking stock of the economy have now become routine exercises, with uncritical acceptance due to a lack of well-researched documents.

As another Nobel laureate, Douglass North, opined: “Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction.” Institutions are formed to reduce uncertainty in human exchange. Together with the technology employed, they determine the costs of transacting (and producing). While the formal rules can be changed overnight, as has been practised by the present government, the informal norms change only gradually.

In this context, it is useful to focus on understanding and reforming the forces that keep bad institutions in place, especially political institutions and the distribution of political power. This requires understanding the complex relationship between political institutions and the political equilibrium. Sometimes, changing the political institutions may be insufficient, or even counterproductive, in leading to better economic outcomes as has been the case in India in recent times. The use of high-quality academic information, which the present establishment lacks, is valuable both to think about these issues and generate better policy advice.

M. Suresh Babu is a Professor at IIT-Madras

END