Political Economy of Transition from Manmohanomics to Modinomics

The inaugural budget of the NDA led government has been a cause of some surprise and disappointment amongst those who were eagerly expecting a new radical dose of neo-liberal reforms. It appeared that the 'policy paralysis' of the past government had survive the change brought about by the elections. However, the 'reform' process so far had already created great inequality which also eventually resulted in slowing down of investment and growth and other problems like inflation and external deficits. The limits to pushing ahead with such reforms in this background was what was reflected in the fact that the main budget has simply carried forward the measures of the interim budget – limits which could be sought to be eased by changing the political scenario of the country in particular directions.

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When Finance Minister Arun Jaitley completed his first budget speech in July this year, there was a clear sense of surprise and disappointment amongst many in the Indian elite who had so vociferously supported the formation of a Modi-led government. This was because both the form as well as the content of the budget appeared to reflect continuity more than the 'change' that they were impatiently anticipating. This disappointment was not on account of any perception that the new government was overturning the core thrust of economic policy making of the last two decades. No one had expected the Modi government to depart from maintaining and strengthening a liberal economic policy regime or abandoning fiscal conservatism and there was no indication in its policy pronouncements of any radical steps. The impatience instead was with the absence of any visible sign of the opposite kind of 'radicalism' – a significant departure from what was perceived to be a combination of 'policy paralysis' and 'populism' afflicting the previous UPA government which appeared to limit its ability to bring in more 'reforms' and contain the fiscal deficit. Characterizing the continuity was the fact that Mr. Jaitley could find very little in the UPA's interim budget for 2014-15 to change when finalizing the main budget. It seemed therefore that the change of the top political leadership and the transition to a government with a clear parliamentary majority was inconsequential for policy making and this was perplexing. Both this desperation for 'change' as well as its apparent absence can be seen as reflections of the same context which cannot easily coexist for too long and in time are likely to generate tendencies towards the undermining of Indian democracy and secularism.

Economic Realities and the BJP Election Victory

The formation of the Modi government was a result of the widespread dissatisfaction with the UPA II performance, particularly on the economic front. This dissatisfaction acquired a somewhat universal nature in a background where the economy was characterized by a long-term trend of sharply rising inequality and slowing investment and growth, galloping food inflation and large foreign exchange deficit. Those on both sides of that process of increasing economic divergence were unhappy with the UPA's performance, but for ***different*** rather than identical reasons.

The Modi led-BJP received widespread support among those who have gained enormously from the India's liberalization process in the last two decades, particularly of the corporate world and parts of the middle class who see their economic fortunes tied to that sector. Their expectation was that Modi would be more decisive in carrying forward the liberal reforms agenda and they hoped that this would end the slowdown that was adversely affecting the growth of their fortunes. The solid backing generated by this expectation, via the command over financial resources and media projection it implied gave the BJP a decisive edge in the election campaign.

Elections are never won purely on the basis of financial muscle and media support. Yet there is no doubt that this advantage provided by the support from a numerically small but powerful section of Indian society was important in enabling the BJP's appeal to extend beyond this narrow base and be successful in tapping most successfully the discontent that existed in the larger populace. It helped in projecting the BJP as the most promising prospect for even those to whom the last two plus decades of liberalization had not delivered any 'acche din'. The fact that despite its lead in money and media the BJP was not able to persuade over two thirds of the electorate to vote for it also, however, revealed the limits of achieving political success simply through such advantages. It was one thing to promise a better future to those whose actual experience under the old regime made them see no future. It was quite another thing to deliver it and not become a future victim of the same process that underlay the success.

The social support base that catapulted Narendra Modi to Prime Minister's position contains within itself conflicting interests on the economic front precisely because it includes sections on both sides of the economic divide. One needs to only recall the decisive and irreversible decline of the Congress support base following the big shift towards liberalization initiated by the Narasimha Rao government in the early 1990s and the equally decisive rejection of the Vajpayee-led NDA's 'Shining India' campaign in 2004 to appreciate this.

Narasimha Rao's minority government had been based on a larger national vote share than the Modi-led BJP managed in 2014 (over 36percent as compared to 31percent) but it fell dramatically to below 29percent in the 1996 elections. This loss was never recovered by the Congress and its vote share in every election since has been lower than in 1996 though it may have managed to lead two Governments thanks to the arithmetic of the first-past the post system and formation of coalitions. Similarly, the BJP's vote share had peaked in 1998 at close to 26percent but not only did it drop by nearly 4 percentage points by 2004 but went down further to below 19 per cent by 2009. In other words, the further sharp decline of the Congress vote share in 2014 and the BJP's equally dramatic comeback may just be two sides of the same process repeating itself - specific expressions of the trend visible throughout the last two decades.

Of course the BJP has a clear parliamentary majority this time and therefore not looking towards facing a general election for at least five years. While this may give it some breathing space in dealing with the contradiction underlying the political instability referred to above, what is also true is that this contradiction has been sharpened by the fact that the economy at an aggregative level is confronting a serious crisis. On the one side are the interests that seek their way out of the crisis through more reforms of the kind that have adversely hurt the economic interests of the majority. On the other side are those who expect Modi to address their exclusion from the benefits of economic growth. The slowdown additionally means that the government has much more limited room for manoeuvre than the UPA I government had enjoyed – when a high and in-egalitarian growth boosted government revenues and allowed some increase in public expenditure to happen alongside a process of curtailing the fiscal deficit. How does the government satisfy both sides in these circumstances? The UPA had tried its best to do so and ended up satisfying neither. That means the UPA's balancing act had already gone beyond what was possible in the given economic and political context. It is the presence of these limits that were reflected in Arun Jaitley's maiden budget being a virtual replica of what might have been the last budget presented by a veteran finance minister who till some time back was undoubtedly one of the poster boys of Indian liberalization.

Crisis and the Transition from 'Stimulus' to 'Austerity'

India's economic crisis has its own specific dimensions and is not simply reducible to being the direct fallout of the global crisis. Nevertheless it does show that the hopes created by the initial indications that India would escape the crisis were misplaced and India was unable to maintain the high-growth trajectory that had taken off in the early years of the current century – with the manufacturing sector being the worst hit. The sharp deceleration in corporate and manufacturing investment preceded the sustained slowdown of output growth, having begun immediately after the 2008 crisis. The high inflation levels particularly in the case of food that surfaced before the global crisis persisted despite this transition to a depressed output growth and investment scenario and prices in India moved up quicker than in the rest of the world. The tendency for India's imports to grow faster than exports had been visible even in the period of high growth before the global crisis and this too survived the slowdown leading to a widening current account deficit until the import compression in 2013-14. This deficit and high inflation made the rupee vulnerable to volatility and recurrent and the erratic behaviour of the foreign currency market has served to provide repeated reminders of this.

Globally, the outbreak of the crisis in 2008 induced a temporary withdrawal from the dominant ethos of economic policy under globalization as expansionary fiscal and monetary policies became the flavour of the day. Alarm bells about the rising levels of public debt, however, were rung soon enough and at least as far as fiscal policy was concerned there was a swift retreat to austerity even though no sustained recovery from the crisis was visible. India too followed a similar trajectory. After the enactment of the FRBM Act the fiscal deficit to GDP ratio had been brought down progressively to very low levels in 2007-08. In the post-crisis stimulus package, the tax concession element was greater than the expenditure expansion part but it had the same effect on the fiscal deficit which rose. In a very short time, however, the retreat from the stimulus and a return to fiscal consolidation was initiated - the slowdown in growth actually following from that. The high inflation levels and the vulnerability of the rupee meant that in the Indian case even monetary policy has been restrictive with a high interest rate regime being maintained apparently to cover for the limits achieved in fiscal consolidation.

The retreat from the stimulus dominated much of the UPA II's tenure. Contrary to all the talk of profligacy it was expenditure control rather than tax mobilisation which was prioritized in this attempt and the central government expenditure to GDP ratio was brought down to levels below that in 2007-08. Again in contrast to what the UPA's own rhetoric and the charge of populism against it suggested, it was precisely those expenditures with an important bearing on the lives of the 'aam aadmi' – agriculture and rural development; fertilizer and food subsidies; and social sector expenditures which bore the brunt of the expenditure control strategy along with capital expenditures. In real terms the annual expenditure on these heads was lower in the five years of UPA II than in the last year of UPA I and as a percentage of GDP fell from over 5.1 per cent in 2008-09 to just about 3.6 per cent in 2013-14. However, since tax revenues remained sluggish on account of the growth slowdown the pressure for further expenditure control persisted - more so because the slowdown also led to increased pressure for tax concessions while the threat to the rupee added to the pressure to curb the fiscal deficit. Expenditure control and a high interest rate regime reinforced the slowdown thus completing the vicious circle. The UPA's defeat had to do with the absence of 'populism'. It had done too well on the fiscal consolidation front by virtually exhausting all its possibilities in the current economic and political context - Mr. Jaitley got the job of Finance Minister precisely because his work was already done in a sense by the previous government. That is why he was left with so little to do in his first budget other than just putting his stamp on what was already there in the interim budget – which meant continuation of the same policy of fiscal consolidation but not any significant advance on that front.

Can the Limits to Fiscal Consolidation be Eased?

Since the expenditures on the so-called 'populist' heads is not zero, government still has a large number of employees who can be dispensed with if government regulation and public services and schemes were to be restrained or delivery mechanisms made more 'efficient'(though many of the scheme workers are already very poorly paid). There are still assets in the hand of government that it can sell and raise money in the short-term at least. Therefore, it appears to some that there is still scope for downsizing the government role in the economy – this is the content of the slogan of 'good government' instead of 'big government'. If that could be done then in the view of the same people, more tax concessions could be given, expenditure on infrastructure could be stepped up even while the fiscal deficit was reduced and this would revive growth and reduce inflation. The economic reasoning behind these propositions is questionable but it is not such a conviction which held back the

Modi government. The constraining factor was that the process of fiscal consolidation had already travelled the distance it could have before facing severe ***political*** limits – and the election results and the promises it had to make to get them were very recent reminders to the Government of the existence of these limits. Instead of making a choice in such circumstances of abandoning that path, what is more likely is that the Modi government will attempt to change those political limits including through non-fiscal measures to improve the 'sentiments' of private investors and stimulate growth.

Economic policy cast in a neo-liberal mould is in its very conception fundamentally oriented towards limiting or restricting the ability of Government to intervene as an autonomous actor in the economy and make its role one of facilitating the spontaneous tendencies present in the economy. If the economic structure, however, is characterized by inequalities in command over economic assets and resources then the drivers of the 'spontaneous' economic processes are those who exercise greater command while others have to be the passive recipients of a 'trickle-down'. Not only does the limiting of the state's actions constrain it from doing anything to address this fundamental inequality, it in fact reinforces it since governments can only influence the economy and the outcomes it generates through maintaining the 'state of confidence' of powerful domestic as well as foreign private actors. These actors thus acquire a greater leverage over the state. This explains why there has been such a massive explosion of corruption in India as the 'withdrawal' of government as well as its 'facilitating role' has opened up vast possibilities of private aggrandisement by the manipulation of public decision-making.

It is this very same process that has also created the crisis that India's economy faces. The neglect of agriculture and the consequent agrarian crisis along with limited growth of employment opportunities maintained a labour-market situation in which wages and other labour incomes could remain depressed. This wage depression contributed to the enrichment of the corporate sector and upper-income groups by squeezing the wage share in a rapidly growing corporate sector and ensuring the cheap availability of a whole range of labour and labour-intensive services. Food inflation and the emergence of a severe market constraint for the industrial sector were also, however, the eventual results of these imbalances. An increasingly top heavy expenditure structure meant that splurges of spending were possible sometimes purely speculation driven. However, this also meant an increasing proportion of services in consumption expenditure while expenditure on manufacturing intensive productive investment tended to hit a constraint because of the demand barrier facing the most important outlet for such investment – namely, the manufacturing sector. At the same time this expenditure and the production in response to it also tended to be more import-intensive while fiscal constraints prevented improvements in infrastructure that could make more of domestic production competitive and reduce the dependence on imports. In other words, the growth and investment slowdown and external payments problems also stem from the same fundamental imbalance. Moreover, in such a situation which includes a depressed world economy the present crisis may not be simply a temporary interlude but instead may be more long-term in nature.

Addressing the imbalances underlying India's economic crisis would involve changing the inequalities embedded within her economic structure and her position in the global economic order. These cannot be achieved under a liberal economic policy regime. Let alone any radical process of asset redistribution, even a limited redistribution in favour of the poor through fiscal policy is anathema to such a regime. In a crisis, the pressures that the same structure and context generates to not only maintain the policy regime but to pursue it more vigorously are all the more. It is only fundamental political changes in the correlation of forces in Indian society that can undo this lock. The advent of the Modi government can scarcely be described as reflection of such a fundamental political change – it is instead a reassertion of the inequalities in the economic structure. As an agent of that reassertion Narendra Modi is under pressure to be a radical 'reformer' and administer a bitter pill to the people whose support was crucial in bringing him to power. The compulsions of remaining such an agent in the present context however also limit his capacity to be such a reformer. The aura that has come to now surround Narendra Modi – where he is often virtually attributed with possessing a Midas touch – may thus not last very long unless some other basis can be found for securing and consolidating the political support he now enjoys and give him greater freedom in the domain of economic policy. To think that the growth performance associated with the so-called 'Gujarat model' can possibly be reproduced on the national scale is to indulge at the least in the fallacy of composition. But there are other elements in that 'model' which the BJP and its sister organizations might draw lessons from to try and ease the political limits that may currently hem Modi. In that case the compulsions of administering one kind of bitter pill may lead to them being accompanied by other equally bitter pills of other kinds.