

January 10, 2024

## India is at an Economic Crossroads: How Does it go Forward?

By: Andaleeb Rahman

*An elegant restatement of the need for appropriate policy to accelerate India's development falls short of offering a detailed plan.*

There are global bets on India and the sustainability of its economic might. A leader in high-end services, an enormously large consumer base for domestic and international markets, its geographical proximity to China, and an increasingly engaged diaspora have elevated India to a unique position in the world order. Can India deliver on its potential? Does it have an economic blueprint, policy direction, and a vision for its future? If yes, does it continue with what worked in the past or 'break the mould' with newer strategies, pathways, and frameworks?

Raghuram Rajan, a former Reserve Bank of India governor and currently a professor at the University of Chicago's Booth School of Business, and Rohit Lamba, a professor of economics at Pennsylvania State University, engage with these questions in their latest book, *Breaking the Mold: Reimagining India's Economic Future*. They don twin hats, of scholars and of concerned citizens, to build a convincing narrative that avoids economic dogmas—relics of economic planning or free rein to market forces—and reimagines the role of state, society, and markets for a changing India.

Rajan and Lamba find the Indian economy at a crossroads, where unemployment and disguised unemployment typically characterise the labour market. The way forward requires us to embark on an 'Indian way' – where people abide by the rule of law, believe in democratic consultation, and the politicians are ready to accept criticism, they argue.

|| The key to unlocking India's potential lies in investing in its citizens by improving their human capabilities [and] promoting high-end services.

Contrary to how other countries have grown into prosperity, Rajan and Lamba claim that the key to unlocking India's potential lies in investing in its citizens by improving their human capabilities, promoting high-end services (aiming to design mobile phones and semiconductor chips instead of being a production line) which stimulate manufacturing, fostering a culture of entrepreneurship and innovation, and a more ambitious national aspiration of commanding a premier place in the global world order. They exhort policy to focus on path-breaking innovations in science rather than incremental breakthroughs, as it must adapt to a changing world where labour may not be the most useful asset but its capabilities.

### Growth in a new age

Today's advanced nations transitioned gradually from agriculture-based to industrialised societies where manufacturing absorbed surplus unskilled labour, created a durable base of middle-class citizens, and provided them with social security and dignified employment. The spread of education, innovation, and specialisation of labour (all contributing to higher productivity) led to a greater share of the service sector in total output.

Most developing countries in an increasingly globalised world have not been able to develop a strong manufacturing sector, thanks to China's cheap exports. Arguments for a service-driven economic transformation have [existed for a while](#). But the features of industrialisation, which created scale, innovation, and most importantly job creation for unskilled labour, remain unrealised.

|| There is today a broken bridge of opportunity, caused by a widening gulf between those part of the dollar economy [...] and those in the rupee economy.

India's challenge and service-driven growth are no different in this regard. The country has leapfrogged the [structural transformation](#) and has had a service-driven economy since the 1990s. Given this unconventional path, the largest share of workers has skills unsuitable for a service-based economy. There is today a [broken bridge of opportunity](#), caused by a widening gulf between those part of the dollar economy (high-value services primarily driven by outsourcing of jobs) and those in the rupee economy (largely informal domestically created jobs).

While by any metric, India currently has lower levels of poverty than before, the difference between the poorest and richest has arguably widened. These higher levels of inequality mean India's economic potential would remain unrealised.

Rajan and Lamba allay this pessimism. India can certainly ride on the wave of a services-driven economy, provided it can contribute to high-value services and attract the talent and entrepreneurship to unleash such innovation. The private and public sectors need to work together, with the latter becoming more efficient and propelling the pace of the former's growth.

### The governance challenge

The authors (re-)imagine the role of government as a facilitator rather than a direct provider to enable this transformation. They argue that if the government can invest in people, harness their creativity, and improve labour productivity through high-quality education, better health infrastructure, and improved public services, India can achieve its rightful position in the multi-polar global order of the future.

Rajan and Lamba expect greater decentralisation to spur competition between politicians to improve the delivery of public services such as health and education.

The authors take the issue of governance head-on. They distinguish between the 'structure' and the 'process' of governance. The structure refers to the power bestowed on the ruling government in a democracy. This power, when absolute, can subvert democratic norms, undermine existing institutions, and lower human freedom. All of this diminishes the very same human capability potential central to India's promise.

Transferring power to people through the multiple layers of government – from centre to states and to local governments – is key to emboldening democracy for improved governance, the book argues. This would allow for more tailored solutions to the local needs, along with creating a virtuous cycle of spatial competition as well as learning (especially from south to north Indian states) to improve public service delivery and citizen empowerment. (The authors do note that greater decentralisation without adequate governance capacity in terms of a committed, capable, and sufficient administrative staff may render decentralisation ineffective.)

Rajan and Lamba expect greater decentralisation to spur competition between politicians to improve the delivery of public services such as health and education. They view solutions such as in-kind subsidies and transfers as myopic, deflecting attention away from the real needs of the people. Such arguments, while plausible, remain inadequate explanations for why [paternalistic welfare transfers](#) (especially of the kind which receives the authors' scepticism) have emerged as the cornerstone of electoral politics in the last decade.

Messianic interventions cannot be an organic solution to governance failures. The state's intention influences the structure and process of governance.

The authors praise The India Stack – a combination of Aadhar, mobile phones, and bank accounts – for creating an enabling framework to improve the quality of governance. (They do express concern that the India Stack could be misused by the government or even private agencies in the absence of strong data protection laws and call for a better regulatory framework.) While it is not difficult to see the point, their faith in technocratic solutions – as an improvement in the governance process – might be undone by an antiquated governance structure disempowering citizens. . For example, the way citizens were forced to download the Arogya Setu app despite its [questionable legality](#) highlights the discretionary governance process driven by the structure of governance where citizen interests, privacy, or voice are secondary to state coercion. The Digital Personal Data Protection Bill, 2023, further does not empower citizens.

Rajan and Lamba further argue that fair and competitive markets are an essential enabling framework for better governance-led growth. To curb monopolistic practices, they suggest breaking up some of the big business conglomerates in the country. However, they do not have a clear solution to achieve that. The authors hope that able reformers will emerge and champion such reforms. Here, they refer to T.N. Seshan's cleaning up the Election Commission in the 1990s.

However, messianic interventions cannot be an organic solution to governance failures. The state's intention influences the structure and process of governance, and I wish the authors had articulated a more nuanced diagnosis of the Indian state. For example, economists Daron Acemoglu and James Robinson characterise the current governance situation in India as a '[paper leviathan](#)' state, where the government does not want citizens to mobilise. This leads to reduced public accountability and allows the government to continue exploiting clientelist relations and build capacity for greater control. If the last 75 years of independent rule have not created a sense of

civic-minded government, how can India break from the shackles of the past, which Rajan and Lamba appeal for?

### Rising inequality amidst poverty decline

The social question in Indian policy has traditionally been addressed through reservation policies for backward castes. Rajan and Lamba call for "reservation plus" added support to marginalised caste groups through personalised training and remedial courses for them to compete equally with others once they have passed any competitive exam. They want better public services for all, which will level the playing field for the social groups that lag, and a periodic re-look at the reserved categories to identify groups that have benefitted more than others in the same category. The authors also appeal to the private sector to demonstrate greater concern for diversity while recruiting staff.

Rajan and Lamba reiterate what political scientist Atul Kohli calls for sustainable poverty reduction – "a broad social and political process that goes to the heart of the issue of how state and class power in a society are organised."

The clarity of their emphasis on equity is praiseworthy as it responds to dispels arguments that reservations are inefficient, and 'merit' should be the sole consideration. By emphasising the importance of public services, civic empowerment, and an efficient redistributive system, Rajan and Lamba reiterate what political scientist Atul Kohli calls for sustainable poverty reduction – "a broad social and political process that goes to the heart of the issue of how state and class power in a society are organised." Only then can sufficient human capital be built to shape a prosperous India.

Floundering human capital is an area which has mystified most of India's astute observers. This book builds upon the legacy of many others who have written extensively about India's [poor human development amidst economic growth](#), most notably Nobel laureate Amartya Sen and his frequent collaborator, Jean Dreze. It has a contemporary take on these issues but offers no fresh perspective.

Rajan and Lamba lament the gradually waning glory of some of the India's prestigious educational institutions, including the authors' respective alma maters. To build skills and harness creative potential, they propose a greater emphasis on vocational education, bigger universities (engulfing many of the smaller colleges which have proliferated over time), greater government support for research and development by setting up a National Research Foundation (on the lines of National Science Foundation and National Institutes of Health in the United States), competitive hiring of faculty by the universities, encouraging newer private universities, and greater collaboration between the universities and domestic industry.

At the primary and pre-primary level, they highlight the importance of improving the quality of nutritional support to the underprivileged at the *anganwadis*, providing better quality public schools, and encouraging the establishment of charter schools as Indian parents (even the poorer ones) prefer [private schools, believing them to be of better quality](#).

### Greater democratic ethos

E-governance is increasingly considered as the solution to all governance issues that have shackled the country's growth potential. Rajan and Lamba remind us that technocratic policy solutions are not the *sine qua non* for promoting broad-based prosperity. Economic growth can only be sustained by deepening democracy and egalitarian value systems. The intellectual honesty of the prose is gladdening. They have a firm conviction that an innovative and creative economy can be realised only in liberal, free-thinking, and independent-minded societies that quickly challenge conventional norms. The authors worry about the currently polarised politics and divisiveness.

They have a firm conviction that an innovative and creative economy can be realised only in liberal, free-thinking, and independent-minded societies.

The book devotes a full chapter framed as a dialogue between the authors and a hypothetical critic whose worldview is plagued by prevailing dogmas, cultural pride (read religious supremacy), conviction in a strong leader, and all the epithets which characterise a typical zealous ideologue of today. They provide a reasoned debate for the need for greater amity, transparency in governance, and democratic deliberations for fostering creativity. They warn against living in the past glory and celebrating India's rise too soon, given the gigantic challenge of reducing poverty, increasing economic opportunities, and creating a more egalitarian society. The authors' candour shines through.

Their concern for the rising authoritarianism and religious polarisation is heartwarming. It is also telling that even Chicago school economists and neoclassical economists (pun intended) believe that a deliberative democracy and an egalitarian social structure are central to sustainable economic growth.

### Summing up

*Breaking the Mould* is useful for rethinking policy priorities, but unfortunately, does not lay out a clear blueprint for achieving them, given India's precocious democracy. In terms of policy suggestions, Rajan and Lamba are eloquent and persuasive even when they lack a detailed plan. The fresh solutions they claim to offer for India's developmental problems have already been discussed by several scholars (albeit paywalled in academic journal publications).

The prose turns trite when the authors extoll India's historical virtue – a "spiritual centre of the world for centuries in the past," an "intellectual power house" with long-rooted democratic traditions – which will act as a source of inspiration for putting faith in India's future as an economic powerhouse.

It is here that one begins to wonder if the 'vision' presented for India is an imagination, a wishlist of policy directions which would somehow find policy traction, able bureaucrats, and citizen-minded politicians to implement. I would have rather we learned more about how this proposed vision is a 'break from the mould' when the iron cast itself – the idea of the nation – has begun to show signs of rust.

*Andaleeb Rahman is a development economist interested in the issues of social policy, food security, and identity politics. His first co-authored book on India's food systems came out in 2019 and his current book (in press) re-imagines the future of India's social welfare architecture.*