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Subir Gokarn: Time for a national policy agenda

Explicit policy commitments by parties will contribute to an improved long-term investment climate

Subir Gokarn | New Delhi February 11, 2013 Last Updated at 00:30 IST

The advance estimates for India's GDP put growth during the current year at five per cent. Even if this is an underestimate based on methodological problems, the fact is that the actual number isn't going to be very much higher. While the debate on the primary causes of such a sharp slowdown over the past two years rages on, one undeniable correlate is the deceleration in investment activity. The investment-to-GDP ratio, which peaked at around 38 per cent just before the crisis of 2008-09, is down to a bit over 30 per cent now. Not only does this adversely impact growth in the short term, it also does not bode well for any significant acceleration over the longer term. There is no question, then, that a massive turnaround in investment activity will be the key metric of this and future governments' effectiveness in generating and sustaining rapid growth.

Such a discontinuity in the investment rate is not a fantasy. It actually happened in the transition to the high-growth phase of 2003-08. The investment-to-GDP ratio was relatively stable around 27 per cent in the few years before that period, but accelerated sharply to cross 30 per cent, peaking at 38 per cent, as I indicated earlier, in 2007-08. Now, there is a complex story behind this transformation, which only a much longer piece would do justice to. But there is one very important dimension to it, which is what I want to focus on here.

A striking feature of the nexus between economic policy and performance in India after 1991 was the implicit commitment to a broad policy agenda by successive governments. Between 1991 and 2009, India had five regime changes (seven, if you count the 13-day National Democratic Alliance regime in 1996 and the transition in the United Front government in 1997). Other than the first, which itself bordered on a minority government, all were coalitions involving multiple partners. In theory, the most likely outcome of such a political environment would have been policy gridlock and extreme uncertainty about outcomes, as bargains were struck between disparate coalition members.

However, virtually the opposite happened. Every successive regime showed some commitment to the broad policy agenda that had been laid out by the Congress government of 1991-96. On fiscal matters, industrial policy, trade and foreign investment and financial sector development, notwithstanding individual party rhetoric, the broad thrust and direction of policy remained constant. And as we look back over that period, there are strong reasons to attribute the surge in investment activity that began in 2003 to this continuity. Other factors certainly played their roles, but the broad commitment across the political spectrum to a policy agenda would have hugely mitigated several long-term risks, in turn boosting investor confidence.

In the post-crisis period, many of those other enabling factors have unquestionably turned adverse. High inflation, the fiscal situation, the balance of payments situation and global conditions are all detracting from the relatively stable long-term outlook that stimulates investment activity. However, there are deeper questions here. In the eyes of those who make investment decisions, has the implicit commitment to a long-term policy agenda broken down? If so, can one be sure that actions taken by one government will not be reversed or at least de-prioritised by its successors? Even if governments are committed to an agenda, does the decision-making and governance framework ensure delivery on these commitments?

Large commitments of capital, which pay off over long periods of time, are unquestionably deterred by risks in the policy environment. Such investments are critical in the Indian context to accelerating and sustaining growth. The government cannot afford to make more than a small proportion of what is required, which means that there is high dependence on private investors, domestic and foreign. If they are to make concrete commitments, this group will need quick and credible answers to those deeper questions.

There is, indeed, substantial evidence from recent developments to suggest that the answers to those questions are all negative. The vehement opposition to fiscal correction through a reduction in subsidies, both from the Opposition and within the United Progressive Alliance (UPA) coalition, points to this, as does the heat generated over foreign investment in retail. The unfolding of the spectrum and coal allocations raises questions about both process and the reliability of outcomes. Challenges to project viability in the face of unanticipated regulatory hurdles are a huge deterrent to future plans of existing and potential investors.

However, there are also some indications that cross-party convergence on critical issues can be achieved. The recent agreement on the goods and services tax (GST), which is potentially a very significant contributor to rapid fiscal consolidation, is an extremely important demonstration of this. Although the implementation is still in prospect, the success of the process of reaching a generally acceptable formula certainly opens up the possibility of replicating it over a range of other issues.

To revive investment, we need to provide assurance to investors that a commitment to a core economic policy agenda will be maintained by all political formations. For this to happen, the GST cannot remain the single achievement, the notable exception to an otherwise divided and contentious rule. So, can we visualise an expression of commitment across parties, at least those that expect to be part of a ruling coalition over the coming years, to a national policy agenda?

Let's remember that explicit collective platforms have provided the basis for coalition governments in India. In 1999, the NDA government articulated its collective approach through the National Agenda for Governance. In 2004, the UPA government, likewise, came up with its Common Minimum Programme, on the basis of which the Left provided outside support. Both these reflect efforts by multiple parties to bargain and negotiate in pursuit of common ground, however far apart they may have been to begin with.

Given these precedents, a national policy agenda, in which parties in power and in opposition articulate commitments to policy positions on a small number of key issues, as well as to institutional structures that will be accountable for delivering on them, doesn't seem to be that much of a stretch. Effectively, this is exactly what happened between 1991 and 2008, except that the commitment was not explicit. Implicit commitments have their value, but once they are violated, trust and confidence are difficult to restore. Explicit commitments may help to do that and, in the process, make a significant difference to the investment climate.

The writer is former Deputy Governor of the Reserve Bank of India. These views are his own