46. Modi 2.0 challenges

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Modi Government has been voted back to power with an unprecedented majority. Modi is an undisputed leader of not only the BJP or the National Democratic Alliance (NDA) but of the whole country. It is also expected that sometime in 2020 the NDA will also have a majority in the Rajya Sabha as well, something which eluded it during its last term in the government. This puts the incoming government in a very comfortable position to undertake structural economic reforms. Under the decisive leadership of Narendra Modi, the incoming government will take all the necessary measures.

The first term of Modi government was a success so far as macro-economic management was concerned. GDP growth was revived, inflation was tamed, the fiscal deficit was controlled and the balance of payment crises was averted. We will go for traditional economic reforms of lowering real interest rates, improving consumption demand and encouraging private investments. We have an aspirational middle class with an entrepreneurial zeal which can do wonders if the constraints are removed.

The economy continues to operate sub-optimally due to lack of reforms in all the factor market: land, labour and capital which is very important for the industrialisation of the country. Indian labour laws are considered complex and restrictive. One of its defining characteristics is the job security of workers covered under it. Complexity also implies a huge compliance burden for the companies. As a consequence of this, the labour to capital ratio is low despite the fact that India is a labour abundant and capital scarce country. Rigidities in the labour market have also ensured that the employment elasticity of Indian economy has remained low. Therefore, GDP growth does not lead to commensurate employment generation. Thus, a major challenge before the government is to reform and consolidate the labour laws. This reform will also be the most challenging politically and need to be handled deftly.

Land acquisition is a big problem for the industry and infrastructure project. The States have not come up with land lease agreement laws based on the Model Act of NITI Aayog and the government will have to encourage them to do so. Though it is a state subject, the Centre must also push for digitisation of land records. This will create better ownership of lands. Even in Ease Of Doing Business (EODB), transfer of title is an important consideration.

Cost and mobility of capital is another challenge. Unless, we reduce the rate of interest rate, our economy and industry etc. cannot grow. Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) has consistently overestimated the future inflation in the economy as a result of which RBI has kept the benchmark interest rate at an elevated level. This is clearly not warranted by the level of economic activity in the country. Moreover, whenever the RBI cuts the repo rate, it is not fully transmitted by the banking sector. As a result of these two factors, the investors in India face one of the highest real interest rates in the world. The Government and the RBI have to converge on monetary policy issues.

Cost of capital is also high because of some structural factors that the government can address on its own. The cost of funds of our banking industry comprises of the cost of deposits and the risk premium. Fixed interest rates on saving schemes like Post Office Deposits, PPF and EPF affect the cost of deposits for the banking institutions. The government needs to further rationalise them and control its own borrowings from the market.

The second important component of the lending rate is the risk premium determined by the probability of loan not being repaid due to various factors. Over the last five years, the government has focused on institutional mechanisms like IBC and NCLT to ensure that capital is not stuck in unviable and bankrupt projects. As a result of this, the risk premium is expected to come down. Certain bottlenecks and shortcomings in the IBC and NCLT have become evident which needs to be addressed.

Employment is an important catalyst for economic growth. With India being a fast growing economy of new jobs seekers, the focus has been on entrepreneurship and self-employment but the issue cannot be tackled without focusing on the manufacturing sector which has not performed as per government's expectation. It is hoped that the above factor will give a boost to the manufacturing sector. The challenge before the government will be to ensure that our manufacturing sector is internationally competitive so that it does need to hide behind protective tariffs.

Government's commitment to doubling of farmer's income by 2022 (from 2015-16 level), which has been reiterated in the 2019 manifesto of the Bharatiya Janata Party (BJP), remains a big challenge. The biggest problem in this sector is that all the agricultural policies are being formulated with a deficit management mindset. We had a deficit in food production since independence, but now our food grain production is in surplus. All our agriculture import-export policies are aligned with the requirement of the consumers; now the policy will ensure that the farmers get a better price for his produce. There is ample scope here as we have low inflation and high growth.

Most of the Financial Sector Legislative Reform Commission (FSLRC) recommendations have been implemented by the Modi government. However, the government's attempt to pass the Financial Resolution and Deposit Insurance (FRDI) Act had failed due to strong political opposition. There was a lot of misinformation about the Act that was deliberately spread. The incoming government will have to enact this law because without it the financial sector reforms will not be complete.

Increasing the efficiency of government expenditure is another major challenge before the government. The government must ensure that its borrowings are not used to finance revenue expenditure and are used for asset creation and infrastructure investments. Loss-making public sector enterprises are to be divested. It is heartening to see that steps for disinvestment of Air India are being taken up. The government will address the above challenges and make economic growth more broad-based, leading to a positive cycle of higher growth and higher demand, and put the Indian economy on a permanently high economic growth trajectory.