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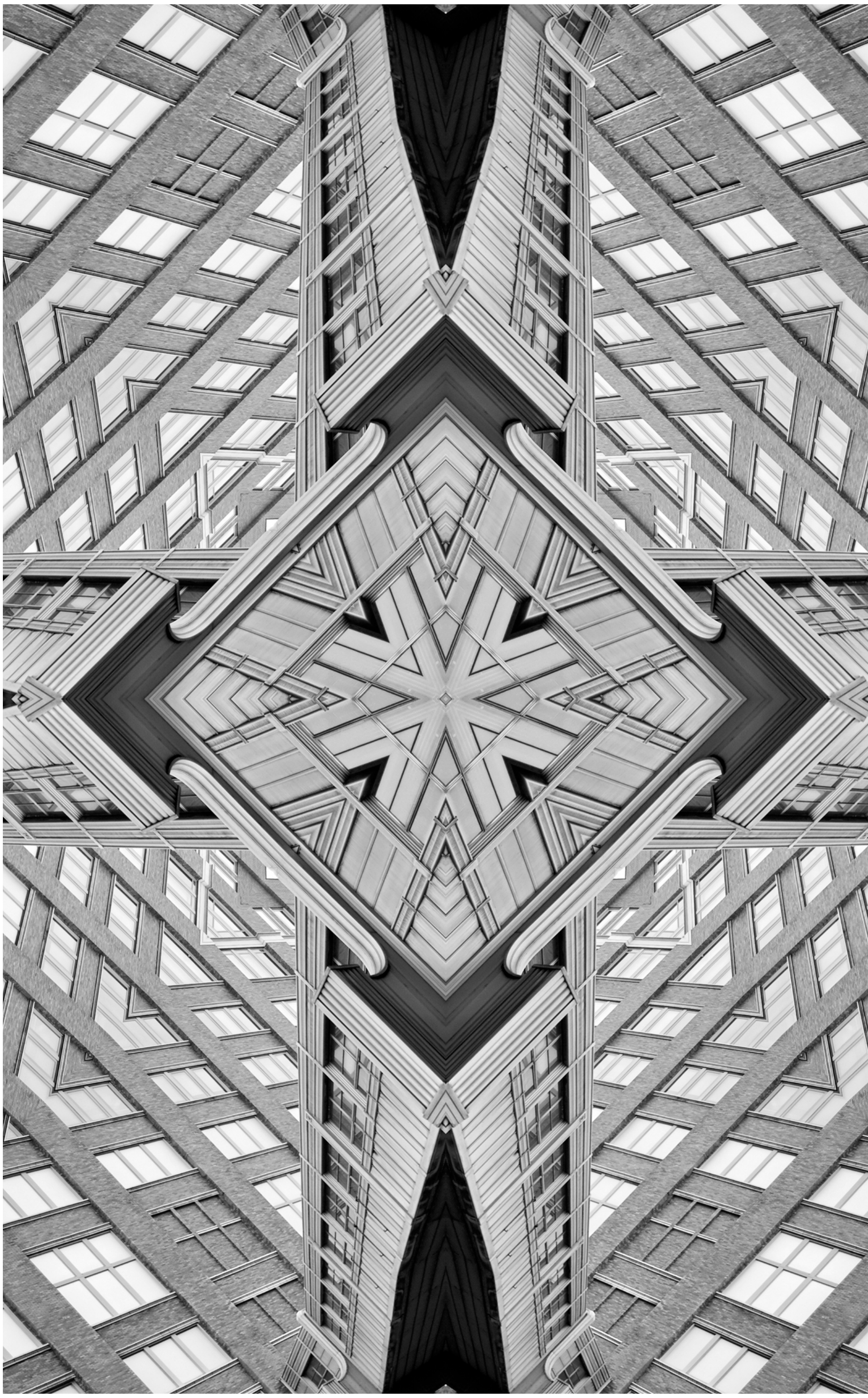

Consensus: A New Approach in Economic Reforms for Modi 3.0

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Abstract

This forward-looking brief examines India's economic reforms over the past decade and argues that in his third term, Prime Minister Narendra Modi would need to shift gears. Working to his advantage is the expectation of political and policy continuity. This must now be tempered by the slightly weaker political mandate. In the past 10 years, Modi moved the reforms needle with his dexterous stance; he now needs to work with a new idea—that of consensus.

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Introduction

The past 10 years under Prime Minister Narendra Modi saw a series of crucial economic reforms that include the Goods and Services Tax[1] and the Insolvency and Bankruptcy Code[2] around easing doing business; and the Jan Dhan Yojana[3] and the Direct Benefit Transfer[4] aimed at facilitating financial inclusion (see Table 1). Given the verdict and past track record, economic reforms are likely to continue through 2029.

Table 1. Key Economic Reforms (2014-2024)

Jan Dhan Yojana
Hydrocarbons Exploration and Licensing Policy
Aadhaar
Insolvency and Bankruptcy Code
Real Regulator
Goods and Services Tax
Ayushman Bharat
Repeal of Obsolete Laws
Asset Monetisation
Labour Reforms
Agricultural Reforms
Decriminalisation of Economic Offences
Atmanirbhar Bharat (COVID-19 crisis reforms)
Payments System
Direct Benefit Transfer
Power Sector Revamp
Production Linked Incentive Scheme

Source: Chikermane (2022)

In 2014, when Modi began his first term, he inherited a GDP of US$2.04 trillion. Over the eight years till 2022, India's GDP grew by 70 percent to reach US$3.4 trillion; global GDP, meanwhile, rose by a far lower 26 percent to US$100.9 trillion over the same period.[5] For the fiscal year 2023-'24, India's nominal GDP was estimated at INR 293.90 lakh crore[6] (nearly US$4 trillion),[7] rising by 9.1 percent over the previous FY.

The momentum of past reforms will only continue to power India's growth. A number of these reforms were structural in nature, impacting the economy through institutions and easing the regulatory framework for doing business.[8] To accelerate the pace, the Modi government will need to push harder politically, dive deeper economically, and deliver more administratively. The imperative is to drive an economic consensus in two areas: first, with political allies and partners; and second, with state governments, both those governed by the National Democratic Alliance (NDA) led by the Bharatiya Janata Party (BJP) and those that are not.

In his first two terms, the prime minister showed will to pursue reforms in order to serve the country's development goals. In his third term, Modi will need to muster the third component of India's reforms trinity. Following a dexterous stance to push reforms that flowed from the constraints of 1991 and the convictions of 2014-24, he will have to work on building consensus between 2024 and 2029. Being dependent on NDA partners, notably Telugu Desam Party with 16 seats and Janata Dal (United) with 12 seats,[9] the Modi government's reforms will have to be powered and tempered by political persuasions.

Recommendations for Policy Continuity

In his third term, PM Modi must deliver policy continuity alongside political dynamism. He will need to do this on four fronts.

Enable, not Stall, the Rise of Wealth- and Job-creators

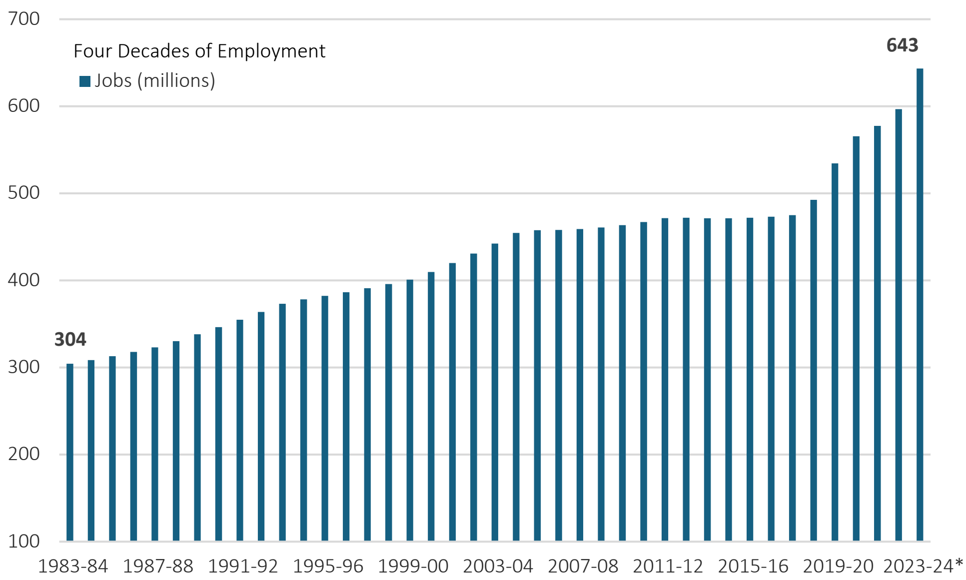
Between 2014 and 2024, Modi 1.0 and Modi 2.0 rejected so-called 'povertarian' policies and continued with welfare economics though not at the cost of wealth creation. Modi 3.0 must continue on this path with greater conviction and draw lessons from the experiences of countries that have adopted socialist policies that failed to bring growth to their economies and prosperity to their people: from Argentina[10] to Venezuela,[11] and North Korea[12] to pre-1991 India,[13] these countries witnessed shortages,[14] poverty,[15] and a deep suspicion of private enterprises.[16]

The lessons from Prime Minister P.V. Narasimha Rao's economic reforms of 1991 are clear: welfare schemes for the poorest bottom of the growth pyramid cannot and must not come by expropriating from the richest top—that would be a return to India's povertarian past. Growth is the only path to both wealth and welfare. Growth has eliminated extreme poverty in India.[17] Policy tools such as taxation and investments, combined with efficient public expenditure and job creation, are the way forward.

Burdening a rising nation with redistribution rhetoric or penalising wealth- and job-creators for the risks they take and the returns some of them gather will take India back to the repressive first four decades post-Independence. The contempt for and urge to cut down large corporations must end. It must be economically understood, and politically communicated, that it is large corporations, not small and medium enterprises, that become most competitive internationally, even in labour using industries, and are also able to progressively ascend the technology ladder.[18] Finally, for all the political virtues of going small and staying small, it is only large companies on whom labour laws, particularly on worker protection and security, apply. Modi 3.0 must end the policy disincentives that discourage firms from growing.

To put this in perspective, India is home to 63 million enterprises. Of these, there are only 1 million, or 1.6 percent of the total, formal employers. Because more than 98 percent of Indian employers stay small by choice, their access to formal banking finance, top talent, cutting-edge technology or complex supply chains gets limited. As far as job creation goes, not only do most of them employ fewer than three employees on an average, they do not need to follow laws on minimum wages or social security. Small companies want to remain small not because they want to evade laws but because compliances on the formal sector have become monstrous and their breach beyond manageable. One figure illustrates this point—400: the moment an entrepreneur becomes part of the formal economy, it can lead to more than 400 compliances a year that become applicable as soon as the setup is formalised.[19] The 21st-century India will be a game of scale and Modi 3.0 has his policy task cut out through compliance reforms,[20] a statistically-insignificant beginning of which has been made,[21] but the mass morass continues to float and slow the rise of India.

Fig. 1. Four Decades of Jobs



Source: Reserve Bank of India

Despite this, not only has the economy been growing, jobs are being created in tandem. As a Reserve Bank of India report notes,[22] between April 2023 and March 2024, India created 46.7 million new jobs.[23] This has taken the total number of "provisional jobs" in 27 industries[24] across agriculture, manufacturing and services to 643.3 million, a rise of 7.8 percent over the previous year's number of 596.7 million (see Figure 1). The jobless growth narrative needs a deeper discussion. This discussion must include employers, anecdotal evidence from whom, across sectors such as corporations, traders, and shopkeepers, suggests a shortage of manpower and not jobs. Yet this is an issue that is not restricted to India[25] but has become a global challenge.[26]

Deepen the Union-States economic partnership

Modi 3.0 must ensure that the reforms delivered by Modi 1.0 and Modi 2.0 trickle down to the states with equal conviction. The alpha of India's combined growth will come from a number of more progressive states. If India is to be a US$10-trillion economy by 2032, it cannot do so without Maharashtra, Uttar Pradesh, Tamil Nadu, Gujarat, and Karnataka becoming the core drivers of growth. All five states will need to grow at nominal rates of between 10 and 12 percent per annum or higher to become US$600-billion to US$1-trillion economies by 2032. Against their combined GDP of US$4.5 trillion, the balance of US$5.4 trillion needs to come from other states. Although every state is attempting to attract investments that create jobs, not all are, or will be, in tune with the national growth aspiration—such is the nature of India's political economy and the accompanying layers in its democracy.

Table 2. The Ten Biggest States of India and their GSDP

State	GSDP *	GSDP #
Maharashtra	31,08,022	372
Tamil Nadu	20,71,286	248
Uttar Pradesh	19,74,532	237
Karnataka	19,62,725	235
Gujarat	19,37,066	232
West Bengal	13,63,926	163

State	GSDP *	GSDP #
Rajasthan	12,18,193	146
Madhya Pradesh	11,36,137	136
Andhra Pradesh	11,33,837	136
Telangana	11,28,907	135
Base 2011-12 for the Year 2021-22 * In Rs Crore; # In $ Billion		

Source: Reserve Bank of India

The top five largest states of India are the economic equivalents of several countries—Maharashtra is about the size of South Africa, Tamil Nadu is almost as large as New Zealand, Uttar Pradesh and Karnataka are around the size of Greece, and Gujarat is larger than Hungary. If Maharashtra grows by 10 percent per annum, it will be as large as Saudi Arabia today, a trillion-dollar state, by 2034, while Gujarat will become a US$660-billion economy, larger than Argentina today. During the same period, at the same growth rates, mid-sized states such as Rajasthan would be close to Viet Nam, and Telangana larger than South Africa.[a,27]

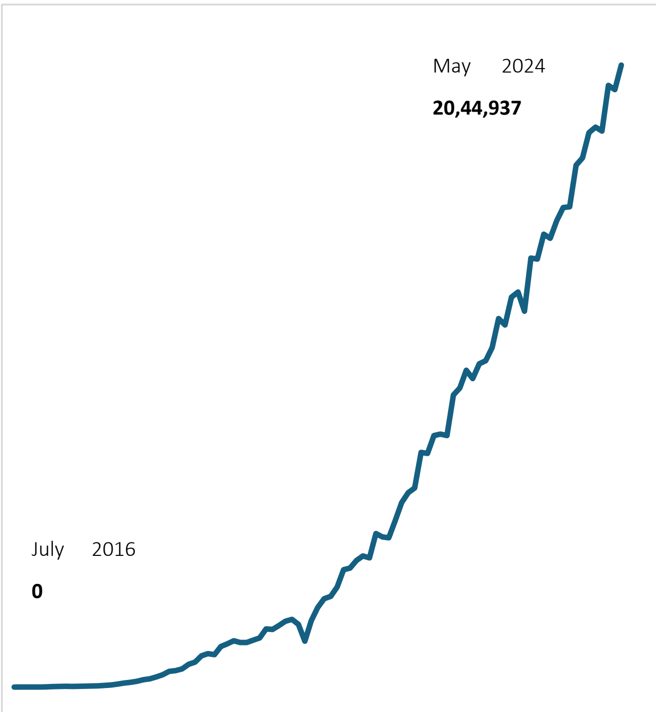
As far as politics goes, Modi 3.0 can nudge for a national alignment and push for higher growth in states. If politics remains a hurdle, he could focus on and push NDA-governed state governments to work with the Union government. While the big three—Maharashtra, Uttar Pradesh, and Gujarat—can provide the scale, states such as Rajasthan, Madhya Pradesh, and Haryana can offer growth spurts because of their smaller bases. A consensus around economic growth can also create competitive federalism among other states. Factor market reforms such as those around land, labour and agriculture, need political and administrative support of state governments for implementation. Further, within states, cities have to become more liveable, efficient and dynamic hubs of education, healthcare, and entertainment. To attract top talent, both domestic and global, they need to come around industrial clusters,[28] organically or as planned topographies, but preferably the latter.

a This author is not suggesting that an economy grows in a linear, predictable manner, but is only highlighting indicative trend lines.

Continue to Lead Financial Reforms…

Barring full convertibility, capital as the third leg of factor markets is largely in place, and in some areas such as payments, India is the world leader. On the last, India's UPI (unified payments interface) system is not only the world's benchmark, it is also the fastest-growing and the largest such system. To illustrate the scale of this achievement, what India transacts on UPI in one month is greater than the GDPs of several nations—in May 2022, at US$125 billion, it was around the GDP of Ethiopia; in May 2023 (US$179 billion), nearly the GDP of Hungary; and in May 2024 (US$245 billion, see Fig. 2), approximately the GDP of New Zealand.[29] The transactions on UPI over the past 12 months (US$2.4 trillion) were greater than the respective GDPs of Russia, Canada, or Italy.

Fig. 2. Value of Monthly Transactions on UPI, in INR crore (July 2016 – May 2024)



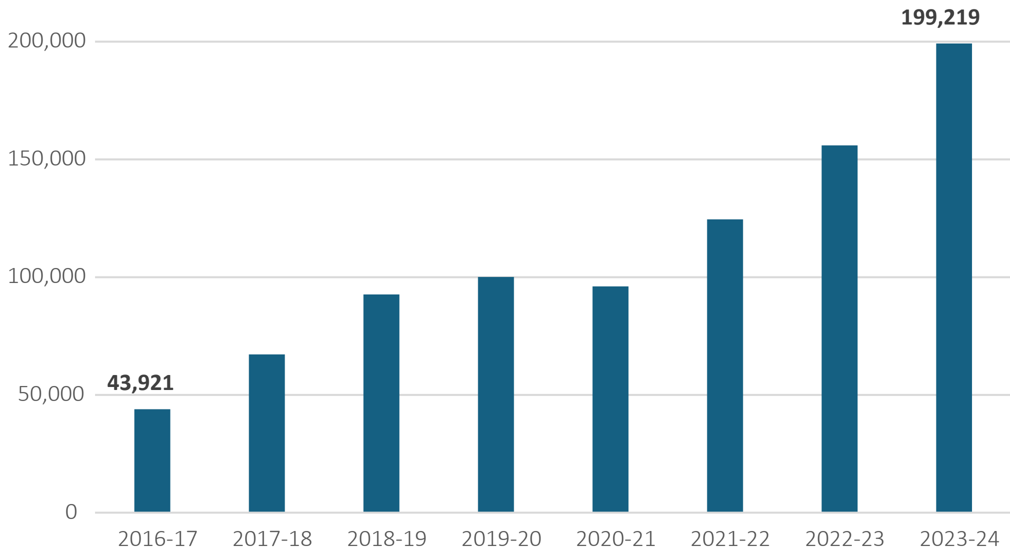
Source: National Payments Corporation of India

This is India's digital public infrastructure at play and one that is becoming the country's soft export in seven countries so far,[30] including France and Singapore. These incremental reforms need to continue, as India becomes a global financial centre through the International Financial Services Centre[31] at GIFT City.[32]

As far as financial reforms go, they have been and continue to lead. The Reserve Bank of India has changed from what it was and has delivered a balance between driving growth and providing stability, the most important of which has been to ensure inflation targeting of 4 percent with a band of +/-2 percent.[33]

The Securities and Exchange Board of India (SEBI) has created one of the world's most robust markets, keeping investors sharply in focus. The speed with which investors have embraced equities over the past seven years through systematic investment plans (SIP)[34] is just one small metric of SEBI creating trust in the market (see Fig. 3). During 2023-24, the SIP book stood close to INR 200,000 crore or US$24 billion, rising by 24 percent per annum over the past seven years and creating a stability buffer against the more volatile foreign portfolio investors.[35] This money is now looking for new investible avenues, which will follow as India's growing economy seeks it through capital markets.

Fig. 3. The Rise of Systematic Investment Plans of Mutual Funds



Source: Association of Mutual Funds in India

The Pension Fund Regulatory and Development Authority is lagging behind in terms of being able to serve India's migratory population but overall has created a strong product in the National Pension System,[36] which needs to be strengthened and expanded. This troika of banking, securities, and pensions will need to keep up with the 'India story' and be far more nimble-footed, as technology simultaneously pushes new opportunities and creates more threats.

The sole laggard in financial sector reforms is the Insurance Regulatory and Development Authority of India, which continues to behave like an industry association[37] rather than a consumer-focused organisation. Curiously, this is the one regulator that successive governments have been unable to reform since it was born in 1999. It has become a body whose regulatory framework is behaving seemingly without control, serving the industry and its agents at the cost of consumers. Modi needs to focus policy attention on this entity and tame its behaviour, drawing investor-serving lessons from SEBI. The cost of this regulatory hijack to consumers has been estimated at INR 1.5 trillion between 2004-05 and 2011-12,[38] and would have grown sharply since then.

…but Pay Extra Policy Attention to Manufacturing

More than the third leg, capital, of factor markets, Modi 3.0 needs to pay greater policy attention and deliver more administrative successes in making India a global manufacturing hub for job creation and innovation-driven wealth creation. He has to devise policies and incentives that turn the first two factor markets—land and labour—more productive, both of which, like their sectoral first cousin agricultural reforms, are hugely emotional and political entities. For India to grow faster, these are crucial third-generation reforms. The task is simple: end excessive regulation and catalyse small firms to grow, and large companies to achieve global scale.

As discussed earlier and illustrated in Fig. 1, apart from flat jobs growth over 13 years, between 2004-05 and 2017-18 when they rose marginally from 455 million to 475 million, employment is again on the rise. That said, the big leap will come only when seeded with high-quality, high-paying jobs. This will see the shift of India's economic base towards manufacturing, from farms that support 54.6 percent of the population[39] but deliver a value added of just 16.7

percent.[b,40] Manufacturing jobs will first make agricultural labour a partner in India's progress; small and marginal farmers will follow once that progress is firmly established. The financial returns from such jobs will need to be greater than what they are receiving from agriculture; they will also have to be more stable. Melding land and agricultural reforms without the accompanying growth in manufacturing as a pillar of support will not work.

All analyses indicating that India has missed the manufacturing bus[41] are extrapolating the past on a future that has been completely disrupted. The fact is that there will be adequate manufacturing demand from the Asian markets alone over the next two decades.[42] India Inc simply has to leverage this demand and the Indian government will need to facilitate it.

First, hurdles to manufacturing must be removed at the Union and State levels through compliance reforms. Second, there is need for a focused skilling exercise that caters to specific jobs needed by industry. Third, the government should enable a visible and sustainable increase in manufacturing jobs that creates labour-capital trust. Lastly, agricultural labour should be eased into manufacturing. The two incentives—for entrepreneurs to invest risk capital and workers to transition into capacities created by that capital—need to work in tandem. The Union and state governments must also bring down the hurdle of corruption in the middle.

b The world average is 4.3 percent.

Conclusion: Build a New Economic Consensus

Despite the political differences India's rich and deep democracy throws up, economic unity is an essential component of *Viksit Bharat*—India's ambition to attain developed-country status by 2047, the centenary of Independence. As a corollary, the success of these policies is crucial to prevent a return to the past. The idea of creating wages through government jobs, wealth through public sector enterprises, and welfare through exchequer-funded largesse belongs to the 20th century. A dynamic country like 21st-century India will need to scrape the rust of the past. It must not encourage political, ideological or cultural inertia to get in the way of growth. The success of the alternative model of growth could bring a political consensus around the direction of a vibrant 'India 2047'. The Modi government owes it to the country to direct this dynamism, use this demography, and power the scale Bharat has reached as a US$4-trillion GDP to deliver high growth in every sector of the economy.

Unlike in the first two terms of the prime minister, the currency of conviction may have already been exhausted. Under the current administration, convictions for economic reforms will be a necessary but not sufficient condition; it will need the support of a number of other conditions, among them astute political communication and the administrative delivery to support it. The prime minister has been able to do this with reforms such as Jan Dhan Yojana[43] for the unbanked, direct benefit transfers[44] for friction-free money flows, payments[45] for ease of transactions, and Ayushman Bharat[46] for secondary and tertiary healthcare.

Where the prime minister has failed is in reforming land[47] and agriculture.[48] If his incentives can speak directly to farm labour, he would be able to deliver the much needed human resource agriculture-to-manufacturing transition reforms. The tension between the state and the market has been manufactured by politics; easing it will also need to be produced there. Like in the recent past, every reform will have to clear the test of judicial scrutiny. As a result, it must be thought through till the last mile, through the last intermediary, for the last citizen.

Finally, Modi 3.0 must draft an industrial policy that takes India towards Viksit Bharat. Thus far, India has seen nine industrial policies, between 1944 and 1991 (see Table 3). Of the seven policies drafted in Independent India, six brought the economy to the edge of default. It was only in 1991, when PM Rao laid the Statement on Industrial Policy in Parliament, that growth began.

With 33 years of this policy behind, several incremental policies undertaken by subsequent prime ministers, and crucial reforms implemented between 2014 and 2024, it is time for Modi 3.0 to take these policies and reforms as read and prepare India for the next quarter century of growth through a new industrial policy.

Table 3. Industrial Policies (1944-1991)

Industrial Policies—1944 to 1991		
Policy	**Year**	**Prime Minister**
The Bombay Plan	1944/1945	Pre-Independence
Statement of Industrial Policy	1945	Pre-Independence
Resolution	1948	Jawaharlal Nehru
Industrial Policy Resolution	1956	Jawaharlal Nehru
Industrial Policy	1973	Indira Gandhi
Industrial Policy	1977	Morarji Desai
Statement on Industrial Policy	1980	Indira Gandhi
Industrial Policy	1990	Vishwanath Pratap Singh
Statement on Industrial Policy	1991	P.V. Narasimha Rao

Source: Chikermane (2022)[49]

Modi's industrial policy must take three new and important disruptions and divergences into account. By bringing wealth creators and the private sector into the national mainstream, he has made his policy intention clear and has taken the first steps in his first two terms.[50] His words must now translate into policy actions that support small and medium-sized businesses to bloom. Here, he needs to end last-mile corruption in mission mode, reduce the cost of doing business and make it more efficient. Second, he needs to continue to build stronger relations with an unpredictable West and a Russian Federation that has so far been dependable, all while managing China. And third, he needs to pay more attention to technology, particularly artificial intelligence. The imperative is to find balance between innovation and regulation.

Conclusion: Build a New Economic Consensus

His industrial policy needs to keep 'India 2047' in mind for the long term and plant the seeds of groundbreaking reforms. At the same time, he must power the journey to 2029 and beyond with short-term reforms. Both must balance wealth and welfare, growth and equality, enterprises and jobs—good politics working in tandem with good economics.

The reforms visible ahead which could face less challenges are: notification of the four labour codes;[51] realignment of direct taxes particularly around capital gains; simplification of the financialisation route by ending the tyranny of unending changes in KYC (know your customer) norms; speeding up compliance reforms that began in his previous term;[52] and creating a Unique Enterprise Number, an Aadhaar-like instrument for firms that would enable companies and governments to communicate around a single number for all their financial or regulatory requirements.[53] Any political space still left should be used to reform the two institutions in urgent need of change: the civil services and the judiciary.

While these could have been done in the previous 10 years, the potential pushes and pulls of coalition politics today would require Modi to harmonise these while climbing a steeper reforms slope. He will need to create an economic consensus amid political divergences; this could be the biggest challenge to reforms in the next five years.

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