Economic Growth

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In a paper published in 1988, economist Robert Lucas wrote that once you start to think about economic growth, you are unable to think about anything else. “The consequences for human welfare involved in questions like these are simply staggering,” he wrote, while comparing India’s growth with that of countries that were growing at a faster rate. Just a few years later, India’s growth rate accelerated, performing even better than the countries Lucas was comparing India to. The pursuit of economic growth is perhaps the most important a country can have. It correlates with other aspects of material well-being. It forms the foundation for building capabilities that can be leveraged in the international realm. It is also essential to pursue meaningful social equity.

This collection of essays from the newsletter Ideas and Institutions, is a journey through the multifaceted domain of economic growth, a pivotal force that shapes the destinies of nations and the well-being of their citizens. Comprising eleven essays, this compendium delves into the complexities, debates, and nuances of economic development. From discourse surrounding the necessity and sufficiency of economic growth, to the intricate relationship between corruption and development, each essay in this compendium offers insight into the nature of economic progress. For the foreseeable future, this will be a pertinent topic, given that India’s GDP per capita is currently at a level comparable to that of the United States in the late-1890s. Economic growth must be a priority for India.

The first essay is an overview of a recent paper by Lant Pritchett and Addison that discusses the association between GDP per capita and indicators of “basic material wellbeing.” The paper asserts that GDP per capita is not just necessary but also sufficient to explain the differences in basic material wellbeing across countries. It dwells on India’s stage of development on those measures in the context of its GDP per capita.
The next two essays are reviews of two books that present interesting theories of economic growth. Consider the long view of the economic history of the world. Standards of living remained more or less the same for much of recorded human history, up until two centuries ago, when sustained economic growth began. Since the 1800s, the standards of living have improved sharply, but there has been a huge rise in inequality across countries, owing to the uneven nature of this rise.

The second essay is a review of economist Oded Galor’s book *The Journey of Humanity: The Origins of Wealth and Inequality*, which offers a “unified growth theory” that seeks to explain the experience of growth in the long run. While a long-term perspective of the kind that Galor offers is useful to place efforts into perspective, one has to contend with interests that dominate in a political economy in the short to medium term. These interests are represented by the elites in a society. Democracies prefer not to acknowledge the existence of elites, and elites in democracies prefer not to see themselves as such. But this group of people do exist, and they matter. The third essay is a review of Stefan Dercon’s book *Gambling on Development*. The book focuses on the role that the elites play in the pursuit of economic development.

The fourth essay presents a literature review on the question: When did India transition to a high growth regime? Different papers identify different years, and this review concludes by mildly endorsing a paper that overcomes the methodological problems of the previous papers. It identifies 1993 as the year when India’s economy transitioned to a high growth regime. The fifth essay presents an overview of India’s GDP per capita from the time India gained independence, with a comparative picture for each decade since then.

The key to sustained growth is co-evolution of institutions to meet the challenges of a growing economy. Misreading institutional requirements, or failure to allow adaptive institutional change could harm growth. The sixth and seventh essays present analysis on issues that have come to the forefront in India’s political economy in recent years—bureaucratic corruption and tax avoidance. The sixth essay considers the intensification of anti-corruption enforcement in the last decade and speculates about its consequences. The seventh essay discusses rising disputes in direct taxes in India and interprets the phenomenon in the context of India’s political economy.

The eighth essay presents a reflection on India’s growth opportunities based on its standing on the Economic Complexity Outlook Index (COI) developed by Ricardo Hausmann, Cesar Hidalgo, and their colleagues. They study economic development in terms of productive capabilities (know-how) that go into making products. From this perspective, economic development can be seen as the transformation of a country’s economy towards the production and export of more complex products. These products are more valuable and offer better employment opportunities. COI measures how well a country is positioned to grow its economy through diversification into more complex products. It does so by quantifying how technologically similar the products it makes are to the products that it does not make, weighted by how complex those products are. Interestingly, India has ranked number one on this index for many years.
The ninth essay, when read with the eighth essay, presents a puzzle: Why has India’s export performance been disappointing despite ample opportunity to pursue export-led growth through its existing technological knowhow? The essay analyzes the pattern of export growth in recent years. Barring a few quarters of robust performance in recent years, the plausible reasons for which are described in the essay, India’s performance in growing merchandise exports has not been satisfactory.

It has been more than nine years since Prime Minister Narendra Modi launched the Make in India initiative to boost manufacturing. Every now and then we hear news reports of new investments and successful initiatives in promoting manufacturing. The tenth essay presents an analysis of this initiative, using aggregate indicators such as the share of manufacturing in gross value added, employment in manufacturing, gross fixed capital formation in manufacturing, and so on. It then unpacks a puzzle: why is there a disconnect between the news of manufacturing investments and initiatives and the aggregate indicators of manufacturing success?

The final essay explores how China’s cities have spurred economic growth through the endogenous development of property rights regimes. This is contrary to the binary debate of strong individual rights versus state eminent domain that is seen in countries like India. Drawing from Meg E. Rithmire’s book, “Land Bargains and Chinese Capitalism,” Burman illustrates this with the examples of Dalian, Harbin, and Changchun. They utilized local negotiations and innovations within the framework of public land ownership to mobilize land for urban development and economic expansion. This approach, characterized by local government flexibility, experimentation, and adaptation to national policies and global capital, contrasts with the exogenous imposition of property rights regimes.
The Necessity and Sufficiency of Economic Growth

Suyash Rai | March 7, 2023

A major debate in development is around the importance of economic growth for other developmental outcomes and vice versa. In India, a version of this played out about a decade ago in the famous Amartya Sen–Jagdish Bhagwati debate. Bhagwati highlighted the primacy of economic growth for achieving developmental outcomes, while Sen advocated for investments in human development, which may also be growth-enhancing. One way to understand the difference in their positions is in terms of the direction of causality they presume. Bhagwati seemed to emphasize a causality between growth and other aspects of development, arguing that growth generates resources that can then be used for social sector schemes. Sen, based on the capability approach that he has long advocated, emphasized the need to invest in capabilities of humans, which would improve their productivity.

To frame such debates, it is important to understand the empirical relationship between GDP per capita and other measures of development. A recent paper by Lant Pritchett and Addison Lewis goes a long way in explaining the association between economic growth and indicators of “basic material wellbeing.” They consider the following measures of basic material wellbeing:

A. Living conditions
   - Material resources: Poverty rate at national poverty lines, poverty rates at $1.90 a day, $3.20 a day, and $5.50 a day, households with a refrigerator, and the ability to live on household income and to source emergency funds
   - Nutrition: Availability of adequate food, undernourishment, wasting in children
aged under five years, and stunting in children aged under five years

• Shelter: Availability of adequate shelter, housing deprivation, access to clean fuels and technologies for cooking, and indoor air quality

• Basic services: Access to electricity, basic water services, piped water, basic sanitation services, unsafe water, and sanitation or hygiene.

• Connectedness: Access to a bank account, use of digital payments, access to a cell-phone, rural access to roads, satisfaction with public transportation, and satisfaction with roads and highways

• Protection from harm: Death and injury from road traffic accidents, death and injury from forces of nature, unintentional death and injury, and occupational mortality

B. Health

• Preventive interventions: Diphtheria immunization, measles immunization, hepatitis immunization, contraceptive prevalence, antenatal care coverage, and existence of national screening programs

• Health care services: Healthcare coverage, health facilities, health practitioners and staff, births attended by skilled staff, tuberculosis treatment coverage, antiretroviral HIV therapy, and satisfaction with healthcare

• Physical health: Physical pain, health problems, communicable diseases, non-communicable diseases, and raised blood pressure

• Life expectancy: Maternal mortality, under-five mortality, five-to-fourteen mortality, fifteen-to-sixty mortality, and life expectancy at sixty

C. Education

• Pre-primary: Pre-primary enrolment (net)

• Primary: Primary enrolment, primary completion, and primary education quality

• Secondary: Secondary school enrolment, lower-secondary completion, access to quality education, and the quality of secondary education

• Adult skills: Adult literacy, education level of adult population, women’s average years in school, education inequality, and digital skills among population
The paper uses the Legatum Prosperity Index for data on these measures of basic material wellbeing and presents four key findings.

First, all these measures of basic material wellbeing are highly correlated with GDP per capita. Nearly all cross-national variation in these measures is associated with variation in GDP per capita.

Second, the relationship is nonlinear, with a stronger elasticity of basic material wellbeing at lower than higher levels of GDP per capita. So, the improvements in GDP per capita are associated with much larger improvements in measures of basic material wellbeing in lower-income countries than in higher-income countries.

Third, economic growth is empirically necessary for improvements in basic material wellbeing. There are no countries with (very) low levels of GDP per capita with high levels of basic material wellbeing.

Fourth, economic growth is empirically sufficient. At any level of GDP per capita, there are countries with somewhat higher or lower values on other measures of basic material wellbeing, but there are no countries with high level of GDP per capita that are at a low level on basic material wellbeing.

The paper does not make causal claims between economic growth and improvements in basic material wellbeing. The causal pathways are likely to be complex, as improvements in some measures of basic material wellbeing may boost economic growth or give impetus to other processes that in turn boost economic growth. However, the authors clearly state that it is very difficult to achieve significant improvements in these measures without also raising GDP per capita. There is a genre of argument in the development discourse that the authors are trying to counter—the one that downplays the role of economic growth in achieving other developmental outcomes.

Now, let us consider India’s standing on these measures. In 2021, according to the IMF’s latest World Economic Outlook, India’s GDP per capita in purchasing power parity terms was at the thirty-second percentile (ranked at 130 among 193 countries). The following is India’s standing on the measures of basic material wellbeing as reported in the Legatum Prosperity Index 2021:

A. Living conditions
   - Material resources: twenty-seventh percentile
   - Nutrition: fifth percentile
   - Shelter: twenty-ninth percentile
   - Basic services: thirty-first percentile
On eight out of fourteen sets of measures of basic material wellbeing, India’s performance is what its GDP per capita predicts (plus or minus fifth percentile). Only on two sets of measures—nutrition and protection from harm—India’s performance is much worse than expected at its level of GDP per capita. On two other sets of measures—pre-primary education and adult skills—India’s performance is somewhat worse than expected. However, on connectedness and preventive interventions, India does much better than expected.

One way to put such analysis to use is by making it the basis for making the medium-term developmental priorities. Priority should be given to areas of basic material wellbeing where India is doing worse than expected at its level of GDP per capita. Since these measures are strongly associated with GDP per capita, a country that is doing much worse than predicted for its level of GDP per capita should focus on addressing the problems that may be leading to this phenomenon.

The main takeaway from the paper is that without raising GDP per capita, it will be difficult to achieve significant improvements in most of the measures of material wellbeing. Keeping this broader perspective in mind is useful when we debate the many issues in development. Being in the bottom three in the world in terms of GDP per capita, India must achieve sustained economic growth if it is to achieve significant improvements in other measures of basic material wellbeing.
ESSAY 2

Oded Galor’s Theory of Everything

Suyash Rai | January 10, 2023

If we take a long view of the economic history of the world, two remarkable phenomena immediately stand out, thereby leading us to see economic history in two phases.

First, the standards of living were more or less the same for much of recorded human history but have improved sharply in the last two centuries. In the long Malthusian phase, any rise in income due to technological change and cultural adaptation was soon reversed by a rise in population, and average standards of living usually reversed to near-subsistence levels. So, although technology advanced gradually, its gains cannot be seen in terms of per capita incomes, except for short periods of time before population grew to claim the increased resources. There was not much inequality across countries, as most countries shared in the Malthusian misery.

Second, since the rise in standards of living has been uneven, the last two centuries have seen a huge rise in inequality across countries. The growth phase that began with the industrial revolution has been marked by a sharp rise in incomes and considerable improvements in standards of living in countries that were able to achieve this growth—average per capita incomes across the world have risen by a factor of fourteen, and life expectancy has more than doubled. However, per capita income in the richest country is almost a hundred times that in the poorest one.

The economist Oded Galor has spent many years working on a unified growth theory that seeks to explain both these phases of economic history. In a recent book *The Journey of Humanity: The Origins of Wealth and Inequality*, he offers an account of his grand theory. Back in 2011, Galor had published a book on his unified growth theory, and the recent book can be seen as a more accessible version of the earlier book.
Galor presents the aforementioned phenomena as mysteries—the mystery of growth (why did standards of living rise after countless years of stagnation?) and the mystery of inequality (why has this rise in standards been so uneven?). He seeks to resolve these mysteries.

Galor’s effort is obviously very ambitious. Generally, theories of growth and development have emphasized certain aspects of reality. Adam Smith emphasized the importance of trade. Robert Solow and his co-authors emphasized capital accumulation. Some like Paul Romer and Robert Lucas have emphasized endogenous sources of growth, such as investments in human capital, innovation, and knowledge. In recent decades, many economists have emphasized the role of institutions—Douglass North and Daron Acemoglu, for example. Galor seeks to offer a unified theory and starts the story from the very beginnings, drawing into his narrative the evolution of the human brain, the Neolithic revolution, the many technological changes, the tipping point around the industrial revolution, the changes in human capital investment, demographic transitions, and so on.

Galor shows that technological change has been relentless through much of human history, but it reached a tipping point in parts of Northern Europe in the eighteenth and nineteenth centuries. There was an intensification of technological innovations that fostered demand for “the skills and knowledge that would enable workers to navigate a technological environment that was not just new but continuously changing.” To equip their children for this world, Galor argues, parents increased the investment in their upbringing and education, and thus had fewer children. Life expectancy rose and child mortality declined, which increased the duration of the return on education. This further created the incentive to invest in human capital and reduce fertility.

All this triggered a demographic transition, which meant that the persistent positive association between economic growth and birth rates discontinued, allowing technological improvements to steadily raise prosperity. So, a better-quality workforce and higher investment in human capital helped with further technological progress, boosting living conditions and catalyzing sustained growth in income per capita. Galor argues convincingly that while the gains of this process have accrued unevenly across the world and within societies alongside temporary setbacks, the long-run trend is unmistakably one of improved standards of living for more and more people—propelled by the great cogs of technological progress and demographic change.

Galor then turns to the other mystery, that of inequality across countries. While his theory does allow for changes during critical junctures, it is broadly one that privileges path-dependent explanations, emphasizing social and cultural prerequisites for growth and drawing lines from millennia-old processes to the present. As Galor writes: “Institutional, cultural, geographical and societal characteristics that emerged in the distant past have propelled civilizations through their distinct historical routes and fostered the divergence in the wealth of nations.” While he concedes that “cultures and institutions conducive to economic prosperity can be gradually adopted and formed,” he does not seem to believe that any major break can be made unless the root causes are addressed.
Galor traces the roots of modern-day prosperity to the initial steps of the human species out of Africa, tens of thousands of years ago. Galor argues that the degree of diversity within each society, as determined partly by the events that happened thousands of years ago, has had a long-lasting effect on economic prosperity over the entire course of human history.

Galor identifies two layers of the roots of inequality. At the outer layer, he lists the asymmetric effects of globalization and colonization. As he argues, these processes intensified industrialization and development in Western European nations, while delaying the escape of less-developed societies from their poverty trap. The argument about the impact of colonialism on inequality seems plausible, but the impact of globalization has been much more complicated, as the latest phase of globalization seems to have helped countries like China and India achieve some convergence with the developed countries. Globalization need not necessarily increase cross-country inequality, as the impact would depend on the terms on which globalization is happening and how the developing countries participate in the process.

At the inner layer, Galor identifies factors rooted in geography and the distant past that underpinned the emergence of growth-enhancing cultural characteristics and political institutions in some regions of the world and growth-hindering ones in others. For instance, in Central America, the suitability of land for large plantations fostered the emergence and persistence of extractive political institutions characterized by exploitation, slavery, and inequity. In more fortunate regions, by contrast, favorable soil and climatic characteristics triggered the evolution of cultural traits conducive to development—greater inclination towards cooperation, trust, and gender equality and a stronger future-oriented mindset.

This, one may argue, goes against the experience of two of the most populous economies—China and India. China's per capita income rose eight times in real terms in just forty years, and India's has tripled in just twenty-five years. Both achieved some convergence with the developed countries during this time. However, Galor seems to suggest that such convergence can only go some distance, and ultimately deeper problems that come from a deep past need to be addressed.

Building theories of growth and development involves explaining something that is shaped by human decisions and actions in terms of objective, observable factors. Social, political, and economic phenomena are amenable to changes in relatively short periods based on social and political action that is notoriously difficult to observe until it has happened. So, the book should be read for what it is—an exercise in trying to understand the relatively more observable factors that may partly explain the two mysteries. To that extent, this is a very informative and though-provoking book that assimilates a great many research findings into one coherent theory.

And while masterfully covering all this, Galor achieves a rare feat—a book with an ingeniously vast scope that can be read in just one day.
Development is a problem of adaptation. As Albert Hirschman argued⁸ in his critique of the balanced-growth approach recommended by some economists, development is about changing what exists rather than superimposing something completely different. So, no recipes or “best practices” can be prescribed without a proper understanding of context-specific realities.

This way of thinking about development can be seen in a number of works published in recent years—Brian Levy’s Working with the Grain (2014),⁹ Jerry Hough and Robin Grier’s The Long Process of Development (2014),¹⁰ Yuen Yuen Ang’s How China Escaped the Poverty Trap (2016),¹¹ Lant Pritchett, Kunal Sen, and Eric Werker’s Deals and Development (2017),¹² among others—even though they differ in the aspects of reality they emphasize. In his recent book Gambling on Development: Why Some Countries Win and Others Lose, Stefan Dercon focuses on the role of the elites.¹³

Dercon observes that although much attention is paid to specific blueprints for development, successful countries appear to have pursued quite a diverse set of policies. Some enablers of growth and development are known—macroeconomic stability, investment in infrastructure and human capital, a reasonable environment for private investment, allowing the market to play a central role but with a suitable role for the state, focusing on international trade, and avoiding firms or families excessively cashing in on connections to the state, etc. But there does not seem to be any one particular cost-free path to development, and different ingredients have been deployed differently by countries in a time-varying manner.
Successful countries were able to experiment and learn from their mistakes. Dercon suggests that this calls for a better understanding of why some countries implemented sensible policies, while others never did. Ignorance about suitable policies seems too simplistic an explanation, as finding good advice is usually not that difficult. In his view, the answer lies in the presence of a development bargain, which he defines as “an underlying commitment to growth and development by members of a country’s elite”. The elites are “the people within the fabric of society, the economy, and politics who make decisions or can disproportionately influence them”. In his view, the key to development is a shared commitment of the elites.

Dercon deploys the language of game theory to describe an elite bargain as “an agreement that defines the nature of cooperation—a so-called cooperative equilibrium. It is a deal on the division of the gains (the pay-offs) from this political ‘game’. If the deal among the elite is credible, it will lead to limited violence, social order, and political stability. However, all elite bargains are not development bargains. Dercon suggests that three conditions need to be satisfied by a development bargain.

First, there should be durable political and economic deals among the elite, especially on peace and stability. Development takes a long time, and conflict and instability shorten the horizons of decision-making. For instance, foregoing consumption to invest requires a hopeful outlook toward the future, which requires some peace and stability. For this, the politics of the development bargain should be real and credible, and people should believe in it. Even when power changes hands, the bargain should continue without any major disruptions.

Second, there should be a mature and sensible state that finds a balance between what it should do and what it can do. To make progress, at any given point in time, the state should take up a role commensurate with its capabilities. So, while in some high state capacity contexts, an activist developmental state may be suitable for some time; in other contexts, it is better for the state to play a smaller role.

Third, decision-makers should be able to learn from mistakes and correct course. All successful countries have some mechanisms to correct course when growth and development are flagging. Since there is no recipe that is destined to work, development always involves a gamble by the elites that may or may not pay off. Even with the best intentions, development requires both virtus and fortuna. If success is not seen, confidence in leaders may be eroded. So, it is a risk for the elites. A development bargain allows for risk-taking and learning from failures.

When does such a development bargain emerge? Dercon highlights four factors that may (but not necessarily) enable the emergence of such a bargain. First, skills and ideas of particular leaders can help create a development bargain by making risky political deals and working with a competent group implementing the economic deal. While leaders are necessary for gaining and maintaining the support among the powerful, many others are also involved. Politically savvy technocrats often play an important role in supporting this process. Second, emergence from conflict or other extreme events can sometimes help shape
a development bargain by creating the incentives for more cooperative behavior. Third, a quest by the elite to gain legitimacy by delivering on development can help strike a development bargain. Fourth, the foresight among the elites that a better economic deal is likely to result from pursuing growth and development can help create the bargain.

None of these factors can straightaway lead to a development bargain. It will take effort to create and sustain it. Leadership skills are needed to “craft national narratives, build legitimacy, and persuade leading groups in society to choose the longer-term gains of growth and development over the immediate economic gains.”

Dercon’s perspective can be understood by the emphasis he places on certain drivers of development.

First, he thinks that while global markets often make it challenging for poor countries to succeed, the main challenges for development are within those countries. So, while he agrees with economists like Joseph Stiglitz and Dani Rodrik on the challenges posed by the way the global markets work, he emphasizes the opportunities that can be and have indeed been exploited by many poor countries to succeed.

Second, he argues that specific policies that nurture growth and development are important, but what is more important is how the policies are made and implemented by those in power. The essential constraint, in his view, lies in these processes, which reflect the bargain among elites.

Third, he strongly de-emphasizes path dependence and suggests that “the choices made by today’s political and economic elite matter a great deal.” While history matters, the agency of people matters a lot more right now. Progress has been achieved in unlikely places because their elites made the right choices.

Fourth, while he agrees with those like Douglass North, who highlight the importance of so-called “good institutions” for long-term growth and development, he suggests that countries can harness seemingly weak institutions to achieve better outcomes in the near term.

The book is an important contribution to the literature on the politics of development. Dercon avoids the common mistake of focusing too much on reforms of formal institutions and policies, and instead allows one to consider the invisible and informal settlement that underpins the political economy. While Dercon’s theory seems too top-down, the reality in many societies is that there are top-down restrictions that make growth and development difficult. And development bargains may indeed be required to shift away from such a situation.
We can see much resonance with Dercon’s arguments in India’s development journey. The foresight about a better economic future was generated in the 1970s and 1980s by various thinkers who advocated for reforms. A crisis created an opportunity that was grabbed by a few leaders, supported by a team of technocrats. India embraced a more open and market-oriented economy, but this was a gamble. Various leaders who participated in coalition governments played a role in creating and sustaining the development bargain, often cutting deals to move things forward. As the benefits became clear over the years, more elites were convinced of the merits of the approach. However, it seems that the bargain was disrupted in the 2010s, and it is not clear whether a new bargain has taken its place.

The development bargains seem to be inherently fragile, especially in democracies. By definition, elite bargains are unseen and must be inferred. Their implicit nature makes them uncomfortable for democracies, which do not like opacity and do not want to admit that elites exist. Since the pursuit of development is a gamble, things may go wrong, and when they do, there is a strong political incentive for those with lesser share in power to use this failure to mobilize against the incumbents. They have an incentive to “oppose, expose and depose.” Further, because of the opacity of the bargain, it becomes easy to blame the whole system, feeding myriad forms of populism. What’s more, the unsavory aspects of the bargain may be closely tied to the developmental aspects. For instance, some rent-seeking may go hand in hand with developmental pursuits, and stopping the former may also stop the latter. No wonder countries find it difficult to sustain episodes of rapid growth.
It was considered unusual when India’s economy slowed down between 2016–2017 and 2019–2020.\textsuperscript{14} Decades of high growth, punctuated only by brief downturns, have created great expectations. Since countries like China, Japan, South Korea, and others defied regression to the mean for a long time, perhaps it was assumed that India would also do the same.\textsuperscript{15}

When did high growth become the norm in India? India’s GDP per capita was stagnant between 1900 and 1950. Growth then accelerated but remained low to moderate for many years. The economy then transitioned to a high growth regime. There is much debate about when this transition was achieved. The answers range from the mid-1970s to the early-1990s.

This essay gives a brief overview of this debate. Growth transitions are outcomes of complex, multi-causal processes that involve changes in political economy, technology, institutions, and/or policies domestically and globally. This lends plausibility to multiple, often conflicting and ideologically colored, explanatory narratives about economic growth, each privileging certain causal pathways while neglecting others. Rigorous identification of moments of transition could help us in understanding which changes mattered.

Some of the studies filter the transitions through criteria that may pertain to the scale of acceleration, threshold for growth rate in the post-transition period, and a minimum time period for the growth regime after each transition.

Baldev Raj Nayar (2006) advocates for 1975–1976 as the transition year, because the economy grew at 9 percent in that year and the average growth rate between 1975–1976 and 1978–1979 was 5.8 percent—much higher than that during the preceding years.\textsuperscript{16} The GDP declined in 1979–1980 on account of shocks like the increase in oil prices and deficient...
rainfall. In addition to thresholds for the scale of acceleration and the post-acceleration growth rate, the argument implies a minimum four-year period for the growth regime. A longer minimum period does not yield 1975–976 as the transition year. With such a short period, the finding can be easily affected by shocks and cyclical changes.

Growth had decelerated sharply in the four-year period between 1971–1972 and 1974–1975, from 5.7 percent average GDP growth in the preceding four years to 1.4 percent during this period. This was, inter alia, due to deficient rainfall in 1972–1973 and 1974–1975. It was, by far, the worst four-year period since 1950. The GDP per capita in 1974–1975 was less than what it had been in 1969–1970. Economic growth is non-linear. Acceleration is easier after a period of deceleration. Between 1975–76 and 1978–79, helped by normal rains, the economy was recovering from crisis. Another issue with this filter is that it also qualifies 1967–1968 as a transition year. In 1967–1968, GDP growth was 7.8 percent, and average growth between 1967–1968 and 1970–1971 was 5.7 percent—three percentage points higher than that in the preceding four years.17

This highlights the importance of choosing the right filter. Other studies have defined and applied the filters more rigorously. Looking for growth accelerations, Hausmann et al (2005) consider at least two percentage points increase in per capita income across growth regimes, at least 3.5 percent growth in the post-acceleration regime, and a minimum eight-year period for the growth regime.18 They identify 1982 as the transition year for India. Interestingly, the growth in that year was low. Since the objective is to identify a transition to a multi-year growth regime, the transition year itself need not have a high growth rate, as long as growth acceleration and the average growth during the post-transition period are above the respective thresholds.

Aizenman and Spiegel (2007) also apply a filter, but with a narrower focus.19 They look for growth take-offs—which are transitions from stagnations, defined as five-year periods with average real per capita GDP growth below 1 percent—to periods of robust growth, defined as real per capita GDP growth exceeding 3 percent over a minimum of five years, within ten years of the stagnation period. For India, they identify 1980 as the start of take-off from the stagnation period ending in 1974. A five-year minimum period for the growth regime runs the risk of being affected by shocks and cyclical changes, but their filter is, in any case, meant to identify robust recoveries, following periods of stagnation, and not any growth acceleration. Please note that we have referred to an earlier version of this paper, as the journal publication version did not specifically list the countries that experienced take-offs.20

Some of the studies conduct statistical tests with the time series data to identify structural breaks that were followed by a statistically significant change in growth rates. Wallack (2003) identified the transition year (highest F-statistic) as 1980 based on GDP data, and 1987 based on GNP data.21 Rodrick and Subramanian (2004) used the procedure described in Bai and Perron (1998) to compute the breaks for the growth rate of four series: per capita GDP computed at constant dollars and at PPP prices, GDP per worker, and total factor productivity. They identify 1979 as the transition year. Using a modified version of this procedure, Kerekes (2007) identified 1993 as the year of up-break for India.24
Kar et al (2013) try to overcome the limitations of the filter-based and statistical methods by combining their strengths. Their method involves using the procedure from Bai and Perron (1998) to estimate the best potential breaks, and then applying a filter to confirm the genuine breaks. Their filter recognizes the non-linearity in growth. For the first break, since it is not known whether it follows an acceleration or deceleration, any change of more than two percentage points in GDP per capita growth is counted as a genuine break. After that, the threshold depends on the previous history. If an acceleration follows a previous deceleration, or if a deceleration follows a previous acceleration, to qualify as a genuine break, the growth difference has to be three percentage points. If an acceleration follows a previous acceleration, or a deceleration follows a previous deceleration, then a change of only 1 percentage point qualifies. Their filter includes a minimum period of eight years for a growth regime. Using data from 1951 to 2010, they identify 1993 as the year of transition to high growth, and 2002 as marking a transition to even higher growth.

*Here are three questions for you, dear reader:*

1. If we accept 1993 and 2002 as the years of transition to growth regimes with higher growth rates, what does this tell us about the causes of growth acceleration in terms of changes in political economy, technology, institutions, and policies?

2. Based on your analysis of the drivers of India’s economic growth, do you think the pre-pandemic slowdown marked India’s economy transition to a lower growth regime, or was it just a transitory phenomenon?

3. How does the controversy around India’s GDP data affect our ability to identify transitions in the growth regime?
As India marks seventy-five years of independence, it is worth reflecting on this famous quote from a paper by Robert Lucas: “Is there some action a government of India could take that would lead the Indian economy to grow like Indonesia’s or Egypt’s? If so, what, exactly? If not, what is it about the ‘nature of India’ that makes it so? The consequences for human welfare involved in questions like these are simply staggering: Once one starts to think about them, it is hard to think about anything else.”

Lucas was right to worry about India when he published this paper in 1988. In the colonial era, there was no growth in India’s GDP per capita (GPC). While India did achieve a growth acceleration post independence, in the forty years between 1947 and 1987, India’s GPC at constant prices increased by only 0.8 times, at a rate of 1.6 percent per annum. Although growth had accelerated to a moderate rate in the 1980s, India had not yet begun a high growth episode, as discussed in a previous issue of this newsletter. Lucas contrasted India with Indonesia and Egypt because in the two decades just before he published this paper, their GPC had grown at 4.2 percent and 3.9 percent, respectively, while India’s had grown at only 1.7 percent. But just a few years after Lucas posed this question, India’s growth accelerated. Over the following three decades, India’s GPC quadrupled, growing at an average of 4.4 percent.
Lucas took India itself as the unit of analysis, implying that something needed to change at the national level to help the economy grow rapidly. The nation-state remains the most important unit of analysis for economic growth and development. Actions and features of individuals, families, communities, firms, and sub-national governments matter, but the more important differences exist across, rather than within, countries. For instance, most women in a developed country are financially far better off than most men in a poor country. Many families in higher income group in a low-income or lower-middle-income country are at par with or worse off than many families in lower income group in rich countries. In 2021, CMIE’s household survey found that a household at the ninetieth percentile in India earned about Rs. 41,500 per month or Rs. 5 lakh per annum, which is about $21,500 in purchasing power parity terms. In the U.S., this is the income of a household at the fifteenth percentile.\textsuperscript{31} Similarly, the GPC of the poorest state in most rich countries is much higher than that in the richest state in most poor countries.

Lucas also implied that a comparative perspective across nations is fruitful. A nation should not be satisfied by improving on its own past performance. It should also look around. As nations have their own paths, comparisons are somewhat unfair, but they can help us see the possibilities.

First, consider our two big neighbors—Pakistan and China. Back in 1950, Pakistan’s GPC was about 4 percent higher than India’s. In the 1950s, India’s economy grew at a low rate, but Pakistan’s economy stagnated. So, by 1960, India’s GPC was about 17 percent higher than Pakistan’s. In the 1960s and 1970s, India’s growth slowed down even further, while Pakistan’s accelerated. By 1980, Pakistan’s GPC was about 24 percent higher than India’s. Both economies had similar growth performance in the 1980s. In the 1990s, India’s growth performance was better than Pakistan’s but not by a lot. In the 2000s, India’s economic growth accelerated further. Only in 2010, India’s GPC crossed Pakistan’s. In the 2010s, this trend continued, and by 2018, India’s GPC was 24 percent higher than Pakistan’s. The comparison with China is more one-sided. In 1950, India’s GPC was 24 percent higher than China’s. But China’s growth has outpaced India’s in each decade since then. Since 1970, China’s GPC has been higher than India’s. In 2018, China’s GPC was about double that of India.

Second, consider three regions—East Asia, Latin America, and Sub-Saharan Africa.

- In 1950, the GPC of East Asia was only 14 percent higher than India’s. But by 2000, it was triple of India’s GPC. The growth in many countries in the region regressed to the mean, but still, region’s GPC was about 2.4 times that of India in 2018.

- In 1950, Latin America’s GPC was already about four times that of India. Many economies in the region grew rapidly while India’s economy languished, and by 1980, the region’s GPC was about six times that of India. But as India’s growth picked up, many Latin American economies slowed down, and in 2018, the region’s GPC was double that of India.
The GPC of sub-Saharan Africa was 34 percent higher than India’s in 1950. The region grew more rapidly than India during the 1950s and 1960s, and by 1970, its GPC was 41 percent more than India’s. However, the region then stagnated for three decades. By 2000, the region’s GPC was 72 percent of India’s. Since then, the region has achieved some growth, but not as much as India. In 2018, the region’s GPC was about half of India’s.

Third, we make comparisons with developed countries to understand how the frontier is shifting and how far we are from it. Consider the United States and Western Europe. In 1950, India’s GPC was about 6.5 percent of that of the United States. By 1980, this had fallen to only 5 percent. Then the trend reversed. By 2018, India’s GPC was 12.3 percent of that of the United States. In 1950, much of Western Europe was still recovering from the catastrophic 1940s. Still, India’s GPC was only 13.6 percent of Western Europe’s. As the region did well in post-war recovery, India’s GPC fell to only 7.1 percent of the region’s GPC in 1980. It then rose to 17.1 percent in 2018. So, India’s GPC is still only one-eighth of that of the United States’ and one-sixth of Western Europe’s. Another way of seeing this is that India’s GPC is what Western Europe’s was in the 1930s and the United States’ was in the 1890s.

Fourth, we track India’s standing in the world. The table below gives the rankings for India and ten other countries based on GPC. In 1950, India was at the twenty-first percentile - 115 out of 145 countries for which data is available. Its relative position remained about the same in the 1950s but worsened in the 1960s and 1970s. In 1980, it was at the fifteenth percentile. Things improved, and in 2018 India was at the thirty-second percentile. This improvement is good, but being in the bottom third is nothing to feel complacent about. There is a long way to go, but India’s experience shows that we can achieve and sustain rapid growth.
Table 1: Ranking of select countries based on real GDP per capita

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<td>167</td>
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<td>88</td>
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<tr>
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<tr>
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<td>3</td>
<td>1</td>
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Source: Author’s analysis based on Maddison Project Database 2020

Lucas’s question about something about the “nature” of a country that may prevent it from growing rapidly was already being answered when he raised it and has since been answered more clearly. The list of countries that have achieved some measure of economic success has grown. It is a remarkable possibility, but the experience of countries that have succeeded shows that any country can prosper. Countries with very different geographical, demographical, historical, political, cultural, and natural resource settings have been able to do well. From Malaysia to South Korea, Botswana to China, the sheer diversity of countries that have succeeded gives one hope. Further, a country catching up on productivity can grow much faster than a country pushing the productivity frontier. It took South Korea three decades or one generation—1966 to 1996—to go from a GPC of two thousand dollars to that of twenty thousand dollars (in 2011 prices). The same journey took Denmark 150 years—from 1820 to 1970. The flip side of this hope is the anguish about so many countries not doing better. More than half of the people in this world live in low income or lower-middle-income countries.

Lucas’s question emphasized the role of the government in improving growth. This seems puzzling, since growth is generated mainly by the markets. But this is a recognition that something needed to change in the way the government in India acted vis-à-vis the rest of the economy. The comparisons discussed above show that nations are economically consequential political units, because the political and governance systems have a considerable bearing on economic outcomes. Depending on what they do, political and governance institutions can enable or impede the working of well-functioning markets. But all governments are not the same.
Lucas chose Indonesia and Egypt as role models because at that time, their economies were growing well. But they also had authoritarian governments—under Suharto and Mubarak, respectively. They happened to be among the small subset of authoritarian regimes that have delivered rapid economic growth. From the 1990s, India has delivered rapid growth while preserving the democratic character of its polity. In fact, national politics in India in the 1990s and 2000s was marked by coalition rule. Most states also had highly competitive politics. India’s rapid growth happened in a complex political economy characterized by fractious democratic politics, vertical and horizontal distribution of power in the governance system, a permanent civil service, raucous civil society and media, uppity unelected institutions, industrialists who gained from dirigisme, and so on. A broad conception of development would include some political freedoms, and India did not need to give up this aspect of development while achieving rapid growth. While claims about the necessity of single-party governments and strong leaders for economic growth refuse to go away, they are not rooted in India’s experience.

Essays like this typically deploy a variety of indicators, but we have focused only on one—GDP per capita. Although economic growth is not sufficient, it is necessary for India. As we look back, India’s achievement on this count has been modest. For about three decades following independence, India’s relative standing on GDP per capita declined. What has happened since is worthy of some celebration, but there is much work to be done. Lucas was right about the staggering welfare consequences of economic growth and the remarkable hold that this thought has once we focus on it. Looking at the economic insecurities with which a vast majority of Indians live, it is indeed hard to think about anything else.
About a decade ago, corruption became by far the most prominent issue in India’s political economy. That anticorruption uproar can be linked, through complex pathways, to many consequences—from changes in the party system (for example, the emergence of a prominent political party—the Aam Aadmi Party, and the decline of a major party—the Indian National Congress), to consequential decisions affecting the economy (for example, 2016’s demonetization of high-value currency notes).

One of these consequences is the significant rise in cases under the Prevention of Corruption Act (PCA), 1988—the primary law against corruption by public servants in India. The number of cases under this law increased sharply in the 2010s. One legal database reports that between 1990 and 1999, there were 800 cases under this law, 2,096 in the next decade, and 6,978 between 2010–2019. So the number of cases per year went from around eighty in the 1990s to 210 in the 2000s to 700 in the 2010s.

Interpretation of this remarkable rise in cases is fraught with difficulties. This increase could be because the government has become more aggressive in prosecuting corruption. It could also be because it has become easier to identify and report corruption (perhaps due to the Right to Information Act in 2005 and then the Whistleblowers Protection Act in 2014), or because the actual incidence of corruption has increased.

The PCA law states the legal norms, but the specific decisions that governments take to prosecute or to forbear, reveal the law’s real truth. The PCA law states that no court can initiate criminal proceedings under it without prior government approval. The government has some discretion in the application of this law.
This essay seeks to raise certain questions regarding anti-corruption efforts and economic growth in India’s context.

What is corruption? Corruption by public officials means pursuing their own interests while violating the rules that are supposed to govern their decisions. Sometimes this involves benefiting one’s family and friends, but the more common form of corruption involves people who are not relatives or friends. This kind of corruption is, as Robert Klitgaard writes, “where a market enters where society says it shouldn’t.” Corruption turns certain decisions into illicit transactions, which, as per societal rules, ought to be taken on the basis of some other criteria.

Corruption mostly relates to two types of state power—allocating benefits and imposing obligations. Corruption can lead to a misappropriation of benefits or an allocation to beneficiaries not selected based on the rules. In the case of obligations, (for example, taxes or regulations), corruption may lead to their misapplication. This can take the shape of forbearance in their application, wrongful application at the behest of competitors, and so on.

While most corruption is growth-damaging, in a recent book on China, Yuen Yuen Ang argues that what she calls “access money” (elite public servants giving special deals and lucrative rights to businesses in exchange for bribes) can stimulate growth, albeit with distortions, systemic risks, and inequality. She argues that another form of corruption - “speed money” (frontline functionaries taking bribes in exchange for quicker approvals) - has more ambiguous effects because it solves a problem but at a cost to businesses. Corruption that only involves theft, without solving any problem in return, is uniformly growth-damaging.

While all corruption involves deviations from the rules, all deviations from rules may not be corrupt. A public servant may make deals with developmental motives, without taking something in return. Sometimes, deals involving special benefits and/or pragmatic imposition of obligations are required to attract investments and promote business activities.

The systemic context creates incentives for such deals. In India, there are vast inconsistencies between the economic performance that the society seems to demand and the legal and administrative systems governing business activities. While governments are expected to deliver economic growth, business-related laws in India—many of them remnants of India’s socialist past—include many unreasonable obligations for investors and firms. They include thousands of imprisonment clauses, even for something like delayed filing of a compliance report. Some impose obligations that impede working of important markets. For instance, the law on interstate migration of labor makes hiring laborers from other states much more expensive than hiring locally. Inter-state flow of factors of production—labour, capital, entrepreneurs—has helped India’s growth. Such laws coupled with relatively weak state capacity create a situation wherein deals serve as adaptive responses to promote growth.
There is evidence to suggest that, at least in some sectors, deals rather than rules drive state-capital relations in India (as they do in most developing countries). But until recently, the PCA law did not make much distinction between corrupt deals and developmental deals. It had a provision [Section 13(1)(d)(iii)] that made it criminal for a public servant to “obtain for any person any valuable thing or pecuniary advantage without any public interest”, even if the public servant did not receive or expect any benefit in return. This criminalized developmental deals (subject to the vague “public interest” test). While this provision was rarely applied, there was an increase in its application in the 2010s—about 70 percent of all cases referring to this section are from 2010 onwards.

After much protest from civil servants, an amendment in 2018 repealed this provision, but not before public servants went to jail in certain high-profile cases even when they were not accused of earning wrongful gains. This may have made others revise their assumptions about the protection they would have while making decisions. Things get complicated because some deals do not yield their intended results, leading to accusations that they were not developmental. An example of this was the coal block allocation case.

Deals can vary in the extent to which they incorporate the public concerns (for example, safety, health, environmental protection, workers’ rights) implied in the rules. Deals with developmental objectives may seek to address some of the major public concerns. Some indirect evidence from about a decade ago suggests that, in comparison to most developing countries, deals given to businesses in India may have involved a more pragmatic balance between imposition of legal obligations and enabling business activity, rather than a complete neglect of legal obligations.

Coming back to anti-corruption efforts, India has embarked upon a multi-pronged strategy to detect corruption—from the right to information law, to the whistleblowers protection law, to the Lokpal law, to widespread deployment of digital technologies - and to punish the perpetrators—by increasing prosecution under the anti-corruption law. India has also tried unusual methods such as the cancellation of currency notes to both detect and to punish corruption.

It is, however, more important to address the systemic reasons that partly incentivize deviations from the rules: building administrative capacity, limiting the powers of the state by reforming the laws, and more. It is not that India can suddenly become a rules-based political economy, but it can move in that direction. Since 2015, the present government has undertaken a massive exercise of repealing old laws to improve ease of doing business. However, most of these repealed laws were amendment laws. Since an amendment stands even after the amendment law is repealed, this exercise has had little effectual consequence.

It is also important that anti-corruption efforts do not weaken the incentives of civil servants, who tend to be risk-averse, to find creative solutions to developmental problems. If such efforts are not well-targeted, the incentive to craft growth strategies involving developmental deals may get weakened.
Incentives of India’s permanent civil service are crucial in shaping the country’s development. While the civil servants work under political leaders in government, the latter heavily rely on the former to consider alternative courses of action, choose a particular course, and get things done. Even though the anti-corruption law has been amended to decriminalise developmental deals, it is questionable whether enough has been done to restore confidence. It is worth highlighting that due to judicial delays, the journey from accusation to acquittal is usually quite long in India.\(^5\)

In all this, the key is how political judgement takes into account the facts about India’s state and economy. While the judgement of governments at state level matters a great deal, the onus for leading with sound judgement lies primarily with the union government, because it has significant powers for economic regulation, resource allocation, and enforcement against economic offences and corruption.\(^6\) Further, with the rise of a dominant party at national level, this onus has shifted even more. Deals are decisions to make exceptions, and with political centralization, the power to make exceptions also tends to get centralized.

In the last one decade, India’s political economy, especially the order of state-capital relations, has undergone major changes.\(^7\) The anti-corruption mobilization a decade ago seems to have triggered some of the changes. The consequences of this need to be examined properly.

*Considering all this, here are four questions for you, dear reader:*

1. Have the deals in India’s political economy been mainly corrupt, developmental, or both?

2. Are the PCA cases targeting mainly growth-enhancing or growth-damaging decisions?

3. How has the incentive of civil servants to create developmental deals changed in the last one decade?

4. Have the anti-corruption efforts centralized the dealmaking powers in India’s political economy, thereby privileging a few firms, especially in sectors where dealmaking is important?
We, in India, routinely read or hear about raids conducted by income tax authorities on high-profile individuals or businesses. These raids often lead to attachment of property and the alleged discovery of undisclosed incomes. While the raids make for sensational headlines, it is important to consider the big picture on the relations between the state and taxpayers.

In her speech presenting the budget for 2019–20, Finance Minister Nirmala Sitharaman invoked the Tamil Sangam era poet Pisiranthaiyar’s allegory for government-taxpayer relations, “a few mounds of rice from paddy, that is harvested from a small piece of land, would suffice for an elephant. But what if the elephant itself enters the field and starts eating? What it eats would be far lesser than what it would trample over.”

Arguably for more than a decade, the elephant has been rampaging in the field because its appetite remains unfulfilled. Some of these years have been times of poor harvest. What’s more, hardly any of the crops the elephant takes after entering the field actually make it to its stomach.

An imaginative mind might see the shape of an agitated elephant in the following graph, which plots direct tax collection under dispute, at the end of a year, as a percentage of the gross direct tax collection during that year. The year-on-year change reflects the net change during the year, as some disputes get resolved, while others get instituted.
At the beginning of the previous decade, the disputes started rising rapidly, moderating slightly in 2016–17 and 2017–18, probably due to the amnesty schemes, which also suggested a thaw in state-capital relations. But in 2018–19 and 2019–20, the elephant raised its trunk in hunger and anger. To make matters worse, in 2020–21, low revenue receipts, a rise in disputes, and the slow resolution of disputes pushed the stock of direct tax collection under dispute to a level higher than the flow of direct tax revenues in the year. The spike in the early 2010s was mostly on account of disputes in personal income tax, but the recent spike is due to a rise in disputes in both corporate tax and personal income tax.

Disputes are not necessarily indicative of problems in tax administration. Rapidly changing economic activities lead to differences in how tax laws are interpreted. For instance, an increase in the presence of multinational corporations has created disputes around base erosion and profit shifting. Disputes could also rise due to changes in tax laws that take time to settle. What makes this rise in disputes a troubling indicator for tax administration is that the administration is usually unsuccessful in winning these disputes when they reach the courts.

The average percentage of cases resolved in favor of the tax administration—that is, cases in which the administration was successful in more than fifty percent of the issues contested—in the jurisdictions that reported for OECD’s biannual report on tax administration, was 66 percent in 2015, and more than 70 percent in 2016 and 2017. In India, this was in 11.5 percent in 2015, 12.1 percent in 2016, and 13.5 percent in 2017. This data was not reported for India in the latest edition, which covers the years 2018 and 2019.
While the poor success rate could partly be explained by a failure to fight these disputes properly, the sheer rarity of success suggests that the tax administration is making many unreasonable demands from the taxpayers. It is worth considering why this may be happening, and what could be done to address this problem.

Four aspects of the context could help in understanding the rise in disputes and the low success rate.

First, the rise in disputes corresponds with periods of crisis or slowdown in the economy. Early in the 2010s, the direct tax disputes increased while the economy was registering a fledgling, stimulus-driven recovery from the global financial crisis. The recent rise in disputes also corresponds with a growth slowdown. The economic problems may have translated into low tax collection. Perhaps the tax authorities, under pressure to deliver the revenue targets, made unreasonable demands; these demands later turn into disputes, leading to many demands being overturned. Even as the economy slowed between 2016–17 and 2019–20 and collection of indirect taxes was falling, direct tax receipts were rising, though they fell mildly in 2019–20, on account of a cut in corporate tax rates.

Second, the rise in disputes also corresponds with diluting checks and balances in the law that constrains the actions of revenue authorities. In 2017, major changes were made to the income tax law to weaken the checks on tax authorities. These include not requiring tax authorities to disclose the reasons for conducting or expanding searches and seizures, even to the appellate tribunal; empowering the officer conducting the search and seizure to attach property for a period of up to six months, with the prior approval of senior officers; reducing the seniority level of the officer who can call for information for any inquiry or proceeding; and so on.

Third, the fiscal context may also accentuate the pressure for making unreasonable tax demands. The government has large, committed expenditures but has, in most years since the global financial crisis of 2008–09, achieved weak performance in collecting indirect taxes, non-tax revenues (for example, dividends and spectrum auction), and non-debt capital receipts (primarily, disinvestment receipts). In recent years, a large increase in states’ share of union government’s tax collection motivated the latter to pursue a variety of tactics for increasing revenues. There also seems to be an unwillingness to increase indirect taxes, except through duties on petroleum products, depending on the crude oil prices. It is also administratively easier to make additional demands for direct taxes than for other forms of revenue receipts.

Finally, the rhetoric of political leadership in the last few years suggests that political leaders believe there is large scale tax evasion going on. The motivation for such rhetoric is complex, and this is not the place to analyze it. However, the rhetoric might have translated into political pressure on the tax administration to appear to be going after tax evasion. In 2019, additional assessments raised from audits corresponded to 41 percent of tax collections, while the average for the fifty countries included in an OECD report was just 5.5 percent.
More than half of the corporate income tax collection, and about 28 percent of personal income tax, corresponded to additional assessments raised from audits.

The economic survey of 2015–16 found that India’s direct tax collection is consistent with other countries at this level of income. India’s personal income tax collection is much higher than the average for countries at its per capita income. So, the expectation from direct taxes might be built on false assumptions. This may be leading to unreasonable expectations from the tax administration, which delivers in the short run but later loses in disputes. So, the high contribution of additional assessments and the low success rate in disputes might be two sides of the same coin.

In a conversation on taxation, a former finance minister of India told me that from his perspective, tax buoyancy was a function of how many meetings he held at regional offices of tax authorities and how sternly he expressed himself in those meetings. In other words, he saw buoyancy as a function of political pressure on the administration. He also saw the perils of putting too much pressure.

The allegory of the elephant and farmer needs to be modified to include a mahout riding the elephant. When and how to exercise the power of the elephant to enter the field is a matter of the mahout’s practical wisdom in understanding what is in the elephant’s (and the mahout’s) long-term interest.

If the state goes too easy, rational actors may take advantage of it, but if it becomes too draconian, it could have a chilling effect on economic activity. Powers of tax authorities are the sword of Damocles dangling on all individuals and enterprises. They can disrupt businesses and harm personal reputations, and eventually they can also hurt the government’s ability to mobilize resources.

In recent years, the government has been trying to reduce the disputes. Its efforts have mostly been in the form of dispute settlement schemes that involve payment of taxes and, depending on the type of case, penalty by the taxpayer. Even when the appeal is filed by the department, the taxpayer must pay some taxes, albeit lower than the original claim. It seems that only those who expect to lose the case, or those for whom the cost of litigation does not justify continuing the dispute, would have the incentive to settle. Reports suggest that the latest scheme has addressed about five percent of direct tax collection under dispute.

In an important move signaling the political feasibility of other such moves, the government recently changed its stand on the retrospective tax cases. Perhaps things will get better going forward.
Here are three questions for you, dear reader:

1. Is the government’s revenue mobilization strategy and its approach to administration of direct tax consistent with India’s investment and growth ambitions?

2. Going forward, how can the tax administration’s incentives be structured so that unnecessary disputes do not arise?

3. How can mechanisms such as advance ruling be used more actively to avoid future disputes?
In recent years, the union government has revealed a fiscal strategy for growth that seems to comprise of three elements: protectionism through tariff hikes, production-linked incentives, and capital expenditure to create infrastructure. In this essay, I consider two elements of this strategy—protectionism and production-linked incentives. India’s pivot toward protectionism began in 2017, and the 2022–23 union budget moved the country further in that direction by phasing out of the concessional rates in most capital goods and projects imports and announcing that more than 350 exemption entries would be phased out. Since 2020, the government has also announced several production-linked financial incentive schemes. These began with pharmaceutical ingredients, electronics manufacturing, and medical devices and have expanded to include telecom and networking products, food products, certain household appliances, textile products, drones, and more.

As this year’s budget will be released a week from now, it is worth considering whether these two policy pivots are sensible given what we know about India’s economy. One way of doing this is to compare with other countries on the relevant metrics. International indices can be useful for understanding where a country stands, thereby informing policy choices. This is not to suggest that the organizations that prepare these indices are infallible. In a previous issue of this newsletter, we pointed out how India’s improved measurement of trade facilitation may have forced OECD to revise its scores retrospectively. So, experts from any country should, with evidence, challenge the validity, reliability, or objectivity of a measure. Such discussions should, however, proceed from a premise that there is value in well-prepared comparative indices.
Arguably, one such index is the Economic Complexity Outlook Index (COI) developed by Ricardo Hausmann, Cesar Hidalgo, and their colleagues. They study economic development in terms of productive capabilities (know-how) that go into making products. The more complex products usually require a wider combination of capabilities. These products also tend to be more valuable and provide better quality employment opportunities. In this respect, economic development can be seen as the transformation of a country’s economy towards the production and export of more complex products.

COI measures how well a country is positioned to grow through diversification into more complex products, by quantifying how close the products it makes are to the products that it does not make, weighted by how complex those products are. A high score on this index reflects that there are many nearby complex products that require capabilities similar to those reflected by a country’s existing production. Hausmann, Hidalgo, and their co-authors suggest that a higher ranked country on the index should be able to more easily sort out the problems associated with coordinating the development of new industries and the accumulation of required productive capabilities because the industries that are closer to a country’s existing capabilities tend to have fewer coordination failures to resolve and hence provide an easier path to the accumulation of capabilities.

If we look back at the COI rankings at three points in time—the years 2000, 2010, and 2020—India has ranked number one in each of these years. In contrast, China’s ranking on this index has gone through many changes—from the second rank in 2000 to the seventh in 2010 to rank forty-three in 2020. India not only ranks number one on this index, it also scores much higher (India’s score is 2.96) than the country that ranks second (Turkey with a score of 2.4). What are the implications of this for India’s growth?

First, while the index shows that Indian economy’s existing capabilities are well-suited to support rapid growth in the next decade or so, we cannot take it for granted that this potential will be realized. Back in 2015, it was projected on the basis of this work that India’s economy would grow at an average of 7.9 percent over the following eight years. In 2016–17, the economy grew at 8.3 percent, and it seemed that the actual growth would be consistent with the projection. However, India’s growth decelerated after that—to 6.8 percent in 2017–18, 6.5 percent in 2018–19, and 3.7 percent in 2019–20. The average for the four years before the pandemic—2016–17 to 2019–20—was 6.3 percent. Further, as noted in a recent issue of this newsletter, the economy is yet to properly recover from the impact of the pandemic. So, while the existing productive capabilities can support rapid growth, the political economy and the institutions would determine whether they are put to good use.

Second, looking at existing productive capabilities can help us understand where we stand relative to other countries when it comes to attracting foreign investments. Let’s consider one aspect of the emerging geoeconomics of foreign direct investments: the attempt of some firms to diversify away from China. China is a leader in many sectors, but in 2020, its share in the trade of textiles (37 percent) and electronics (28 percent) was particularly high. For firms in these sectors looking to move away from China, the natural choice would be to
look at countries with some demonstrated productive capabilities in these sectors. Moving production to such countries would be easier. If we consider, say, Vietnam between 2010 and 2020, its share in the world trade of electronics goods rose from 0.4 percent to 5.2 percent, and that in textiles rose from 2.4 percent to 5.8 percent. It is no surprise that Vietnam has attracted significant investments from those looking to diversify away from China. India’s share in electronics exports remained stagnant at around 0.5 percent all through the decade, and that in textiles fell from 3.4 percent in 2010 and 2.9 percent in 2020. This does not mean that India cannot attract investments in these sectors, but in the near future it may be harder than it is for Vietnam.

A journalist recently shared on twitter that India has taken over a large part of the Davos promenade at this year’s World Economic Forum. From the union government to certain state governments to private corporations, India has a large presence in this year’s forum. This is part of a broader effort to position India as a preferred destination for foreign investors. However, given the existing productive capabilities of India’s economy, if we do more to fix the political economy and institutional problems in Delhi and Dispur, we may not need to do so much at Davos.

Third, India’s standing on the COI can also guide the choice of a suitable strategic approach for creating growth opportunities. Countries that are at the technological frontier and are already producing existing highly complex products need to invest in developing new products and build capabilities for doing so. Germany and Japan are examples of such countries. Countries like Bangladesh and Nigeria, whose existing capabilities do not afford significant opportunities to diversify into more complex products, need to make leaps to build capabilities in strategically chosen areas that allow for diversification in the coming years, otherwise their economies may slow down. Bangladesh, for instance, relies heavily on textiles exports but has few demonstrated capabilities that can allow it to diversify into other more complex product categories. India is in neither of these categories. Its existing productive capabilities are quite close to those required to make a variety of more complex products. So, the suitable approach for India is a light-touch one, even though some states may choose to implement “parsimonious industrial policies” that identify and address specific bottlenecks to enable production of related products.

This takes us back to the question: why is India betting so much on fiscal incentives and tariff hikes to boost domestic production? In other words, why has India chosen more activist trade and industrial policies than seems necessary on the basis of its existing productive capabilities? One answer is that in some product categories, such as active pharmaceutical ingredients, India is keen to reduce dependence on countries that it does not trust. Another answer is that India may be looking to build capabilities in certain technologies that could yield diversification opportunities in the long run. Examples of this include semiconductors and related products. But such justifications can be offered only for a few sectors, and in those as well, questions can be raised about the methods through which these objectives are being pursued. They do not explain the proliferation of production-linked incentives schemes in sectors ranging from food products to textile products.
They also do not explain why tariffs have been hiked on so many goods, including many intermediate goods. If the government believes that some market failures are preventing the productive capabilities from being used for producing more complex products, it is better to identify and address the same directly and precisely.
2021–22 was one of the best years for India’s merchandise exports. At $422 billion, the year recorded by far the highest-ever merchandise exports, and as a percentage of GDP, they were the seventh-highest on record. This included $355 billion of non-petroleum exports. This performance was noteworthy because it followed many years of slow growth in exports. Between 2012–13 and 2018–19, merchandise export growth averaged just 1.5 percent and non-petroleum product exports grew only by 2 percent on an average. This seemed like a significant decline when compared with the average growth of 15.8 percent in merchandise exports between 1993–94 and 2011–12. Export performance was a major driver of growth for India during those years.

The years 2019–20 and 2020–21 were affected by the pandemic and the policy responses to it. During 2019–20, merchandise exports shrunk by 5.2 percent, while non-petroleum product exports shrunk by 4.1 percent. In the following year, 2020–21, merchandise exports shrunk by 7.1 percent, while non-petroleum product exports shrunk by 2.5 percent. The revival of exports began in 2021, starting from the April–June quarter of that year. To avoid being misled by the base effect when gauging this revival, it is important not to use year-on-year change as a benchmark for quarters in which the corresponding quarter of the previous year was affected by the pandemic-related constraints. In India, the fourth quarter of 2019–20 (January to March 2020, especially the month of March) and the first and second quarters of 2020–21 (April to June 2020 and July to September 2020, respectively) were heavily impacted by these constraints. So, for the corresponding quarters in the following year, we should consider the growth over the corresponding quarters in the year just before the pandemic and annualize this growth. For all the quarters thereafter, the growth can be assessed on a year-on-year basis.
In the following table, we have provided the growth in non-petroleum merchandise exports by using such an approach—for the three quarters from January to September 2021, we have calculated growth over the corresponding quarters two years earlier and then annualized it. For all the other quarters, we have provided year-on-year growth.

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Growth in non-pol merchandise exports (in percentage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>October–December 2020</td>
<td>3.1</td>
</tr>
<tr>
<td>January–March 2021</td>
<td>4.0</td>
</tr>
<tr>
<td>April–June 2021</td>
<td>8.9</td>
</tr>
<tr>
<td>October–December 2021</td>
<td>13.0</td>
</tr>
<tr>
<td>January–March 2022</td>
<td>27.0</td>
</tr>
<tr>
<td>April–June 2022</td>
<td>16.4</td>
</tr>
<tr>
<td>July–September 2022</td>
<td>-0.2</td>
</tr>
<tr>
<td>October–December 2022</td>
<td>-8.2</td>
</tr>
<tr>
<td>January–March 2023</td>
<td>-5.8</td>
</tr>
</tbody>
</table>

As the table shows, the growth in merchandise exports was quite robust in most of 2021–22 and the first quarter of 2022–23. In fact, the growth rate of India’s merchandise exports between 2019–20 and 2021–22 was more than double the growth rate in world merchandise exports in this period. However, since then, merchandise exports have slowed down considerably.

How should we interpret this trend?

One way is to see the export boom as a temporary phenomenon, which occurred because of the unique situation of global trade. 2021–22 was a time of significant frictions in supply chains, and there was also possibly some pent-up demand from the previous year. While the volume index of global merchandise exports rose by 13.7 percent between 2020 and 2021, the value of merchandise exports jumped by 28.2 percent. This suggests that the prices of merchandise exports increased due to the frictions in the global markets.

Together, these factors created opportunities for those firms and countries that were able to meet the demands. Many Indian exporters across a range of sectors made good use of these opportunities. In the textile industry, for instance, manmade yarn fabrics and cotton fabrics saw significant export growth for a few quarters. Despite this, growth within these categories has slowed down considerably since mid-2022. A similar pattern can also be seen in several categories of engineering goods, such as iron and steel, ferrous and non-ferrous metals, machine tools, hand tools, cutting tools for metals, and so on.
However, this rise and fall in export growth is not a universal pattern across all product categories. On the one hand, certain categories did not enjoy an export boom at all, such as that of readymade garments. On the other hand, a few merchandise categories, such as those of major electronic goods, have reported robust export growth even in recent quarters—electronic components, electronic instruments, telecom instruments, and medical and scientific instruments have continued to register considerable growth. Interestingly, some of the engineering goods categories have also seen continued export growth in recent quarters. For instance, some of the machinery and instrument categories have reported only a moderate slowdown, albeit the total exports in these categories are small.

Some of these are the categories in which certain sub-categories have received support from production-linked incentives. Increased tariff barriers have also encouraged the manufacturing of certain products in India. Given this, a more detailed study is required to understand the net benefits of these measures, because there are both costs—such as fiscal costs and the loss of consumer surplus—as well as benefits—such as an increase in domestic value addition and employment generation—to them. For instance, while a combination of tariffs and fiscal incentives can lead to an increase in the production, and consequentially the export of mobile phones, the benefits depend on the extent to which the value chain of producing mobile phones moves to India and what new technological know-how this helps create. The overall cost of such measures must be fully accounted for—for example, given these measures, mobile phones might become more expensive, thereby reducing the consumer surplus, and fiscal resources also have opportunity costs.

It must also be noted that the growth in global merchandise exports decelerated from mid-2022 onward, especially in the October–December quarter, when merchandise exports had about the same value as that in the corresponding quarter of the previous year. So, the slowdown in India’s merchandise exports is happening at a time when world merchandise trade is also slowing down. However, the slowdown in India is more pronounced than that in the aggregate merchandise trade in the world.

At the same time, the recent slowdown does not necessarily mean that India’s export boom is over. A comparison with India’s years of export boom can also be instructive here. During the period of export boom from the early 1990s to the early 2010s, there were short periods of contraction in merchandise exports, particularly in 1998–99, 2001–02, and 2009–10. But the exports picked up again and continued to grow rapidly. So, while it remains to be seen if the recent slowdown will persist, the fact that it has continued for three consecutive quarters is a cause for worry.
India’s merchandise exports face certain headwinds. In the latest World Economic Outlook, the International Monetary Fund projects that the baseline forecast for growth will fall from 3.4 percent in 2022 to 2.8 percent in 2023, before increasing slightly to 3.0 percent in 2024. It expects advanced economies to see a more pronounced growth slowdown, from 2.7 percent in 2022 to 1.3 percent in 2023. This may dampen the demand for India’s merchandise exports. However, the impact would depend on how well India is able to adapt to raise its share in world trade.

Note: Unless a separate citation is given, the data used in this analysis can be found through the Department of Commerce’s website at the following link: https://commerce.gov.in/trade-statistics/
Last week, Micron Technology broke ground to build a semiconductor plant in Gujarat. In recent years, there have been many announcements of new manufacturing facilities, and many of them have started making goods in India. From semiconductors to smartphones, it seems that India is becoming a manufacturing hub for goods that were earlier not made here at a large scale. It would appear that the Union Government’s Make in India initiative, which was launched in September 2014 with the stated objective of promoting India as a preferred destination for global manufacturing, is succeeding.

Large-ticket, high-profile investments make it to the news, but the very fact that they attract such attention can bias our understanding of what is going on. So, we should consider such news in the context of the aggregate performance on the objective of promoting manufacturing in India.

An important indicator for this purpose is the share of manufacturing in the gross value added (GVA) by the economy. The following graph shows India’s performance on this indicator in the last twenty years—there has been no improvement on this indicator since the launch of the Make in India initiative. At 14.7 percent, the share of manufacturing in GVA in 2022–23 was the lowest since 1968–69. Even in 2019–20, the year just before the pandemic, it was only slightly better—14.72 percent.
Another way to understand progress on this objective is through the data on investments in the manufacturing sector in India. A relevant measure of this is the gross fixed capital formation in manufacturing as a percentage of the GDP. A rise in this measure would suggest that investments in manufacturing capacity have increased, which could mean that more manufacturing would happen in the subsequent years. The following graph shows performance on this measure in the last twenty years. Even if we do not consider the pandemic years, when capital investments were difficult to make, there has been no progress on this measure since the Make in India initiative was announced.
Another measure of the success of the initiative is the employment generation in manufacturing. It is possible that even if the share of manufacturing in GVA has not increased, employment in manufacturing may have if the share of labor-intensive manufacturing has grown. The Consumer Pyramids Household Survey conducted by the Centre for Monitoring Indian Economy reports data on the number of employed persons industry group-wise. This series goes back to 2016–17. As the graph below shows, according to this survey, there has been a considerable decline in the number of persons employed in manufacturing. Between 2016–17 and 2022–23, the number of persons employed in manufacturing fell by almost 1.57 crore. Part of this seems to have happened due to the pandemic, but even before that, there was a large decline.

Source: Economic Outlook Database, Centre for Monitoring Indian Economy

Since the Make in India initiative is significantly targeted at foreign investors, a partial measure of its success is the foreign direct investment (FDI) into India. FDI is often associated with transfer of knowhow and increasing the share in global value chains. Therefore, even though the FDI is a small part of the total investment in the economy, its impact can be quite significant. The following graph shows the trends of the FDI into India as a percentage of the GDP in the last twenty years. On this measure as well, there has been no increase since the Make in India initiative was launched, even though the government has often used nominal numbers to claim improvements. In the eight full financial years since the launch of the initiative, the FDI has averaged 1.76 percent of the GDP, while in the preceding eight years (2007–08 to 2014–15), it had averaged 2.14 percent of the GDP.
Finally, a key measure of manufacturing success is export success. The following graph shows the value of exports of manufactured goods as a percentage of India’s GDP for the last twenty years. On this measure as well, there has been no noticeable improvement. As discussed in a previous issue of this newsletter, India’s merchandise exports have declined for much of the last one decade, except for a few quarters in 2021 and 2022, when opportunities temporarily created in developed economies led to a spike in exports, which have since declined.  

Sources: Foreign Trade Statistics of India, Ministry of Commerce and Industry; National Accounts Statistics, National Statistical Office, Government of India
The Two Phases of Make in India

Based on these economy-wide measures, it can be argued that the aggregate picture is very different from the one that is painted by the news around big-ticket investments. Perhaps this disconnect can partly be explained by the shift in the government’s strategy for promoting India as a manufacturing hub. One can arguably delineate two phases in the strategy.

In the first phase, the focus was on promoting and facilitating investment as well as improving the ease of doing business. The former meant expanding and energizing Invest India, India’s main investment promotion agency. The latter meant creating a top-down system of monitoring wherein the relevant government departments and agencies were asked to take the steps necessary to improve their performance on different components of the World Bank’s ease of doing business index.

In the second phase, even as the attempts to promote investments and improve ease of doing business may have continued, there has been much more focus on the use of fiscal policy. Three types of fiscal policy instruments have been deployed—tariff hikes, tax cuts, and expenditure commitments. This phase began with the hikes in import tariffs on several products in late-2017. Since then, there have been many changes in import tariffs, and a wide range of goods now attract higher import duties. The government has also announced import restrictions on some product categories.

In September 2019, the government announced tax cuts for new manufacturing enterprises—those set up after October 1, 2019, were given an option of paying income tax at the rate of 15 percent as long as they did not avail any exemptions or incentives and commenced their production on or before March 31, 2023. This was later extended to March 31, 2024. For other companies, the tax rate was cut to 22 percent, again subject to the condition that they do not avail any exemptions or incentives.

Finally, from March 2020 onward, a series of production-linked incentive (PLI) schemes were announced. These schemes involved certain expenditure outlays. The incentives are to be given to those firms whose applications have been accepted and met the targets given in the scheme guidelines. Initially, the PLI schemes were focused on key starting materials, drug intermediates, active pharmaceutical ingredients, large-scale electronics, and medical devices. Later, they were extended to eleven more product categories: electronic/technology products, pharmaceutical drugs, telecom and networking products, food products, white goods (ACs and LEDs), high-efficiency solar PV modules, automobiles and auto components, advance chemistry cell batteries, manmade fiber and technical textiles, specialty steel, and drones and drone components.

These shifts in the strategy might partly explain the disconnect between the aggregate indicators and the narrative shaped by the news articles. Consider the PLI schemes. By design, they are much easier for larger firms to access. The quantitative thresholds and
targets with which the fiscal incentive is linked are much easier for larger firms to achieve. For instance, in the PLI scheme for the automobile and auto component industry, the incentive slabs are in nominal rupee terms with the fiscal incentive increasing as the additional sales value rises. The additional sales numbers are easier for the larger automobile firms to achieve. Further, administrative capacity constraints may be creating a bias toward larger firms. It is easier to process a few large-ticket applications from larger firms and to monitor their compliance than to do so with many applications from smaller firms.

In areas like semiconductor manufacturing, the combination of large subsidies and the special treatment being given to the investors in overcoming problems of factor markets and business regulations makes it easier for large firms to make big-ticket investments that make it to the news headlines. The Micron plant is estimated to require a $2.75 billion investment, of which $825 million will be put in by Micron and the remaining will come from the Union Government and the state government of Gujarat. Understandably, the government also seems to be putting in special efforts to make it easy for such firms to establish and operate these facilities. It is worth mentioning that such special deals have enabled investments in many other countries as well.

Further, protectionist tariffs on product categories such as smartphones have also led to large facilities being established in India. Since India is now a large market for these products, high tariffs can make companies establish facilities here. In essence, such policies lead to an increase in manufacturing in a country by forcing a transfer from the consumers in the country to the producers. If, over time, such policies lead to efficient, globally competitive production in the country, a case could be made that they have succeeded, although, as discussed later in this essay, this is an empirical question to be answered with rigorous analysis. In India’s automobile sector, more than three decades of protectionism and other forms of support have led to considerable manufacturing of automobiles and components in India, but India’s share in the world automobile trade remains small.

**Course Correction by Performance Measurement**

To misquote Robert Solow, we can see the success of Make in India everywhere except in the national accounts statistics, employment figures, foreign investment figures, and trade flows. This is not to suggest that it will not eventually show up in these. It can be argued that it is too early to assess the success, especially for the turn in strategy that began six years ago and for the elements such as PLI schemes and tax cuts that have been added in the last three to four years. The pursuit of structural transformation is a long process, and a variety of policy approaches should be tried to enable it. What matters is that the strategy should work.

We need to be clear about how success should be defined and measured. Here is a question: If the share of manufacturing in GVA rises significantly in the coming years, is it sufficient evidence of the success of the government’s strategy? It would indeed mean that the strategy has succeeded in promoting manufacturing in India. However, there is one more aspect that
needs to be considered—the costs of this strategy. While considering the benefits of any government intervention, we should compare them with the direct as well as indirect costs of the intervention. PLI schemes involve expenditure that could have gone to something else. Tariff hikes increase the price at which a product can be purchased. The government’s own estimate is that the tax cuts for corporations cost around INR 2.3 trillion in the first two years. The government may have increased taxes elsewhere in the economy to make up for some of this loss and/or raised borrowing from the market, thereby raising the cost of borrowing.

There are two broad, mutually complementary ways of evaluating this ambitious initiative.

First, the policies should be subject to standard cost-benefit analysis. Drawing on microeconomics, such analysis is built on a careful identification of costs and benefits of government intervention. While such analysis should consider indirect costs and benefits as well, in practical application, there are limitations in doing so. They are still useful and often used for project evaluation in India but rarely for evaluation of policies and regulations. In many other countries, policies and regulations are also subject to such analysis. If done well, such analysis can be useful in choosing the right policies, undertaking course corrections, and understanding the impact after the implementation.

Second, it is important to consider the macroeconomic impact in terms of how the initiative is affecting the economic growth and employment. It is possible to promote one sector in a manner that harms other, possibly more productive sectors. For instance, if taxes are cut for one sector but the shortfall is then demanded from other sectors, the latter might see a dampening of economic activity. This would show up in the aggregate GDP growth figures. So, a macroeconomic analysis is also required. Macroeconomic models that consider multiplier effects on the economy, which are usually not captured in cost-benefit analysis, can help make this assessment. While professional economists might do such analysis to publish papers at some point, to inform policies here and now, such model-driven analysis must accompany the initiative, preferably housed in research institutions operating at an arm’s length.

A problem with the Make in India initiative, as with many others in India, has been the lack of transparency about the intellectualism that went into designing them. If the rationale for a policy is published and the ongoing progress is documented in detail, others can critique and help improve it. If things are not working well in the aggregate, it might mean that course correction is required. This realization should then trigger analysis of specific elements of the strategy. This analysis can be done internally by the government or through external institutions.

Chances of businesses offering evaluative criticism about the overall strategy are slim because incumbent businesses generally stand to benefit from measures like financial incentives, tax cuts, and protectionist barriers. Since the PLI schemes were launched, firms in many sectors have clamored for more such schemes. The state-capital interactions are probably now
focused more on lobbying for such benefits and less on advocating for reforms.

Finally, it is important to remember that it is very difficult to get industrial policy right, especially in a moderate-capacity state like India. This calls for care and caution. Any strategy of industrial policy implies a particular theory of change, which is underpinned by a view on what objective is worth pursuing, a perspective on how the world works, and assumptions about how policies will be implemented. The theory can be wrong on any of these counts, but the sunk cost fallacy is quite common in such matters, especially in a context where there is a large community of narrative-shapers who are willing to claim success too easily. Therefore, only careful analysis can help the government realize the need for timely course corrections.
Achieving Economic Growth by Negotiating Property Rights in China’s Cities

Anirudh Burman | August 16, 2022

“. . . when I talked to Huo Yingdong [a Hong Kong tycoon . . .] and mentioned that we didn’t have funds for urban development. . . . He asked me, ‘If you have land, how can you not have money?’ I thought this was a strange comment. Having land was one issue; a lack of funds was another.”

- Zhao Ziyang, Chinese Premier 1980-87, as quoted in Rithmire, Meg E., Land Bargains and Chinese Capitalism

How can economies like India unlock the value of land to grow rich? In India, the answers to this question often lie at two extremes of the property rights debate. There is the argument that strong individual property rights, clear land titles, and liberalization are essential for unlocking land markets. The opposite argument is that the developmental state requires eminent domain powers to manage the spatial allocation of productive forces within the economy. Both arguments focus on creating a property rights regime exogenously that can then be used by actors within society.

Meg E. Rithmire’s book Land Bargains and Chinese Capitalism (2015) demonstrates the opposite—an account of how China grew rich by developing several property rights regimes endogenously, through a process of local negotiation and experimentation, and within the overall framework of public ownership over land. Rithmire begins her book by introducing
the idea that property rights in China were not only critical to its race to prosperity, but the rights themselves also kept evolving constantly as cities and provinces tried to grow in the late 1980s and 1990s. She studies the process through which three Chinese cities—Dalian, Harbin, and Changchun—pursued growth strategies by using land resources at their disposal.

Each city pursued a different course during a period where both the national Chinese government and local governments were dismantling socialism and building markets. Though there was a significant change in how land markets were considered at the national level (from a factor of production to a resource that could be capitalized), national laws were vague and allowed local interpretations and experimentation. At the local level, governments adopted many innovations, including land exchanges by rural land dwellers exchanging homestead land for urban citizenship, trading of land development rights between different jurisdictions, and forcible removal of peasants into high-rise, dense housing.

The three cities’ governments used property rights in the service of economic growth but did so with a close sense of the local “economic order.” The fundamental differences in approaches and outcomes, according to Rithmire, was determined by how each city adapted to (a) differences in preferential policies handed down specifically to select cities by the national government, and (b) the “differential sequencing of economic reform and opening up to global capital.”

For Dalian, the early opening up to FDI and earlier access to preferential policies allowed its local government to monopolize the allocation of property rights. The Dalian government used this power to undertake market reforms and urbanization as a strategy for economic growth: “...the city of Dalian articulated a unified vision about the role and use of land in the city’s economic strategy.” This was achieved by sequencing economic reforms smartly—first attracting foreign capital as a counterweight to struggling domestic state-owned enterprises, and then reforming the SOEs.

The city government’s monopoly over land allocations was critical for enabling this transformation. Dalian, before most other cities, was able to commodify the land resources of the city by collecting lump-sum revenues from leases, trading land in the downtown areas for land in the special development zone, relocating factories and residents by allocating land rights, and so on. Land was basically treated as a state asset to be mobilized for economic growth.

Unlike Dalian, Harbin and Changchun opened up late to foreign capital and were late in receiving preferential treatment from Beijing. The Harbin government espoused no grand strategy and managed market reforms through ad hoc negotiations with residents, SOEs, and other interest groups. Changchun, known as the Detroit of China, managed market reforms through a process of constant negotiations with the leading car manufacturer in the city and its employee-residents.
In contrast to Dalian, the city of Harbin was not able to monopolize control over land resources. Informality and de facto land claims constrained the city government’s ability to regulate land. Therefore, the city of Harbin had to use land resources to create value for “firms and individuals rather than exclusively for the state.” The city of Changchun was not able to monopolize land resources, but it did succeed in establishing significant regulatory authority over land that it could mobilize.

Common to the three cities is the endogeneity or the contextual evolution of property rights in the service of economic growth. While national laws and policies shaped the overall framework, city governments clearly had considerable leeway to experiment, create, and modify institutions, declare new development zones, offer incentives, and negotiate both with industry and residents.

For policymakers in India, the question of endogenous development versus exogenous imposition is worth considering. Rithmire’s insight points to the fact that building markets requires giving full play to local interests and political factors: “. . . [in] places undergoing rapid and uncertain economic and political transitions in which local practice is not determined by a national legal framework, the nature of the property rights regime is a question of fact.”

The Chinese city governments were able to mobilize land resources for economic growth as well as local revenues because a) national land laws permitted experimentation and flexibility, b) city governments were extremely decentralized, c) there was a clear focus on economic growth, and d) the historical fact of public ownership of land made land mobilization easier in some cases.

Rithmire’s book is thus useful for understanding how governments, given the right incentives and objectives, can mobilize land resources not just for their own revenues but also in the service of economic growth and urbanization. The Delhi government’s lieutenant-governor recently stated that the Delhi Development Authority has liabilities exceeding Rs. 10,000 crores ($1.2 billion). China’s success in the commodification of land should give Indian urban authorities some hope.
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Notes


35. Ibid.


45. *Manupatra* (see note 34).


49. *Manupatra*, (see note 34).


57. Suyash Rai, (see note 53).


62. OECD, (see note 59).


72. Shereen Bhan [@ShereenBhan], “India Has Quite Literally Taken over the #DavosPromenade 1/n #CNBCTV18DavosDiary @investindia @TCS @Wipro @Infosys @hcltech @KTRTRS Https://T.Co/GI664kbJnG,” X, January 16, 2023, https://twitter.com/ShereenBhan/status/1614881863725903872.


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