GS-III: Institutions weakened, economy crippled.

News

The credibility of the RBI, the CSO and the NITI AAYOG has taken a beating in recent times due to political interference. Why are the ambitions of economic development practitioners and reformers so often disappointed?

Institutions weakened:

The slowdown in GDP growth rate has been dissected digressed and disowned by analysts, commentators and policymakers. However the diagnosis is far from complete and the growth engine is running out of fuel.

Both the demand and supply side factors have been central in all the analyses but the crucial role of institutions in shaping the outcomes of both the factors in this episode of slowdown has been neglected.

A market centred economic model necessitates creating and sustaining credible institutions that further the efficiency of market mechanism.

The credibility of three such important institutions – the RBI, the Central Statistical Organisation and NITI AAYOG has taken a beating in recent times.

Major Factors Affecting India’s Growth:

Consumption:

Private consumption, which contributes nearly 55-60% to India’s GDP, has been slowing down.

While the reduced income growth of households has reduced urban consumption, drought/near-drought conditions in three of the past five years coupled with the collapse of food prices have taken a heavy toll on rural consumption.

Savings:

Savings by household sector – which are used to extend loans for investment -- have gone down from 35% (FY12) to 17.2% (FY18).

Households, including MSMEs, make 23.6% of the total savings in the GDP.

Investment:

Gross Fixed Capital Formation (GFCF), a metric to gauge investment in the economy, too has declined from 34.3 per cent in 2011 to 28.8 per cent in 2018, government data show. Similarly, in the private sector, it has declined from 26.9% in 2011 to 21.4% in 2018.

NBFC crisis triggered by IL&FS default led to a liquidity crunch in the economy.

RBI’s Annual report highlighted that there are still structural issues in land, labour, agricultural
marketing and the like that need to be addressed.

Erosion in RBI's autonomy:

The RBI which was clamouring for more autonomy, has been systematically brought under the ambit of the central government. A three pronged strategy resulted in this first the RBI was bypassed on matters relating to currency, secondly its role as regulator of the banking sector was questioned when banks flattered and finally its reserve were siphoned. The net result has been that the RBI has been reduced into an institutions which presides over a limited space of monetary policy that is inflation targeting.

Way Forward:

It is useful to focus on understanding and reforming the forces that keep bad institutions in place, especially political institutions and the distribution of political power. This requires the understanding the complex relationship between political institutions and the political equilibrium. The use of high quality academic information which the present establishment lacks, is valuable both to think about these issues and generate better policy advice.