Indian social democracy: The resource perspective

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Part I

The role of the State
India has experienced three transitions

- From socialism to capitalism
- From autarky to openness
- From an agriculture-dominated economy to a modern economy.
What is the role of the State?

A fair consensus today about 8 functions:

1. Law and order
2. Defence
3. Elementary education
4. Public goods connected with health
5. Policy frameworks for reducing transactions costs
6. Environment
7. Macroeconomic risk reduction
8. Income transfers to the poor.
Or a more expansive role?

- Risk insurance for the population at large?
- Population-scale redistribution?
Part II

Living within our means
The fiscal danger zone

- Debt/GDP ratio must decline in normal years
- We don’t know what is a dangerous debt/GDP ratio, but many defaults have taken place below 60 per cent.
- In India, high GDP growth helps debt dynamics greatly.
Payoffs from fiscal prudence

- Good for stability
- And good for growth.
Debt capacity as a reserve for extreme conditions

- Once or twice a century, a nation faces grand challenges
- At a time like this, a massive ‘spare capacity’ for borrowing is required.
- It is best to not live on the edge in ordinary times.
India does not, as yet, have decades of experience with fiscal prudence.

The first task is to achieve this, to reduce the debt/GDP ratio every year through primary surpluses.

A premature escalation of expenditures would be unwise.
Part III

How can resources be obtained?
What tax/GDP ratio is feasible?

- Few countries have crossed a tax/GDP ratio of 20% until the per capita GDP exceeded $9000.
- (This is the sum for all levels of government).
- So there is a lot to do in Indian tax policy and administration. But it is about efficiency, not about raising the tax/GDP ratio greatly.
The channel of influence

- Reform of tax policy and tax administration
- Will increase GDP
- Will yield greater expenditure in absolute terms.
Part IV

Intelligent design of government programs
Trust is important for social democracy

- Low trust capital: more free riding
- Low trust capital: Bureaucrats can’t be trusted
- Low trust capital: Low tax/GDP ratio.
Is India fertile ground for social democracy?

Agree that most people can be trusted:

<table>
<thead>
<tr>
<th>Country</th>
<th>Overall</th>
<th>University grads</th>
</tr>
</thead>
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<tr>
<td>China</td>
<td>52.3</td>
<td>70.1</td>
</tr>
<tr>
<td>Germany</td>
<td>36.8</td>
<td>48.8</td>
</tr>
<tr>
<td>India</td>
<td>23.3</td>
<td>21.4</td>
</tr>
</tbody>
</table>
The power of cash transfers

- To put the poorest 20% of India well above the poverty line
- Requires cash transfers of 2% of GDP.
- Modern computer technology: innovations in payments, Unique ID Numbers.
Part V

Diminishing economic risk
Low-complexity paths to reducing risk

A government that gets involved in risk of individuals: A very difficult matter.

But government can more easily do macroeconomic risk reduction.

Fiscal, financial and monetary institutions: Yield reduced fluctuations of GDP.

Without running into the microeconomic consequences of risk insurance by the State.
Part VI

Conclusion
From $1100 to $8800 per capita, the gains for India’s poor can come from growth and not from redistribution.

For the next 30 years, aim for a tax/GDP and expenditure/GDP ratio of roughly 20 per cent.

Stabilise the business cycle through fiscal, financial and monetary institutions.

The decision about whether to build big population-wide welfare programs should be made in 2040.
Thank you.