



A Global Forum

Montek Singh Ahluwalia

in conversation with
Ann Bernstein



In November 2020, CDE initiated a series of events to celebrate 25 years since its launch in August 1995. The series focuses on global conversations on democracy, business, markets, and development.

Michiel le Roux, founder of Capitec Bank and the Millennium Trust, spoke about the important role that CDE has played in shaping South Africa's democracy. "I am an old friend and supporter of CDE. We talk too little about economic growth and reform in South Africa, and CDE tries to fill that gap."

Our second conversation is with Montek Singh Ahluwalia. He was Deputy Chairman of the National Planning Commission of India (a position with cabinet rank) from 2004 until 2014, and one of the central protagonists of reforming India's economy. Ahluwalia received a Rhodes scholarship to attend Oxford University, after which he worked at the World Bank as an economist. In 1979, he returned home to India, where he began his remarkable career as a civil servant, which he details in his recent book, *Backstage: The Story Behind India's High Growth Years*.

Ann Bernstein: In the 1970s, many people thought that India was destined to maintain its so-called 'Hindu rate of growth' of 3.5 percent per annum. This might sound a highly desirable growth rate for South Africans today, but it was far too low for India's expanding population and its desperate need to become a more prosperous society. Yet government, armed with a clear diagnosis of what ailed the Indian economy and a firm commitment to implement reform, produced a remarkable acceleration of growth: India's GDP grew at over 7 percent per annum in real terms from 1993-2012 and poverty declined from 37 percent in 2004 to 22 percent in 2012. Montek Singh Ahluwalia, along with Finance Minister and then Prime Minister Manmohan Singh, spearheaded the changes that transformed India. And you accomplished this in a democracy that was diverse, fractious, loud, and opinionated. How did you manage it?

Montek Singh Ahluwalia: Like most developing countries, our initial development strategy was based on the notion that the state had to play the dominant role in developing the country. This worked well initially but it also led to the evolution of an exceptionally detailed and complex system of control which severely hampered private sector activity. It was based on an excessive preference for the public sector, with high protectionist walls that compromised efficiency, and it discouraged foreign direct investment.

The dysfunctionality of the policy began to be realised in the 1980s and some steps were taken to make some corrections but these were essentially incremental. Even so, they did improve the rate of growth. The real reforms involving systemic change were introduced only in 1991.

We had a very severe balance of payments crisis in 1990 and there was a change of government in 1991. The Finance Minister Dr Manmohan Singh put into place a number of systemic changes. These changes were also gradual and it took time for the effect to materialise. Their full effect became evident only in the 2000s when India recorded over 7 percent annual growth in GDP. This meant a huge increase in growth of per capita income. It increased from growing at 1 percent to 5.5 percent per year. That made a big difference to poverty, inequality, and structural change.

Ann Bernstein: In *Backstage*, you write, "Achieving high growth is not a chance development – it requires deliberate policy steps taken by people with conviction and belief in the need for change." We are trying to reform in South Africa. What are the key lessons you take from your long involvement in the Indian reform process? In particular, how important was leadership in getting growth going?

Montek Singh Ahluwalia: Political leadership plays a very important role. There is a tendency for civil servants and technocrats to believe that all one needs is a competent civil service and good technocratic inputs, but I don't think these are substitutes for political leadership.

The crux of political leadership is to identify the important things that need to change and then to explain to people that (a) this is necessary if you want to achieve the growth rates you need, and (b) also explain that if some people are going to get hurt – and you can't avoid some people in certain occupations being hurt – then their pain can be ameliorated or they can be offered some sort of social safety net. In a democracy, any vision

of growth has to be inclusive, increasing the prosperity of all. This cannot be sold to the public by civil servants. It can only be put across by political leaders, using the political idiom most likely to appeal to different groups. It is a mistake to assume that if high growth is achieved it will automatically lead to prosperity for all. When we aim at say 8 percent growth for the economy as a whole, it does not mean that every person will have 8 percent growth in their income. That won't happen, if only because 8 percent growth means structural change, and structural change means some groups will benefit more than others. Indeed, some forms of doing business will slowly disappear, but hopefully they will be replaced by other more productive businesses that will hire more people overall.

Politicians have to persuade the public to accept the changes and try to build a large enough consensus for change. I say "large enough" because I don't think that you can ever get change in which everybody agrees with what is being done. But it is possible to develop support for change in which enough people come on board. A small retailer pushed out of business by modern retailing will be unhappy but if his children get better quality jobs in modern retailing, the family as a whole is better off. Political leadership is needed to put this across to make change acceptable.

Ann Bernstein: The first reforms you undertook in the 1980s and 1990s were largely about stopping government from interfering in unhelpful ways. What do you say to critics who claim that India did the easy reforms, getting bureaucrats out of the economy, which had a huge impact, but failed to back that up with the harder, second-generation reforms, the sort of reforms that require institution-building to sustain India's high-growth momentum?

Montek Singh Ahluwalia: That is substantially correct. When we first started the reforms, we focussed on stopping the government from doing dysfunctional things. This is what I would call 'stroke of the pen' reforms. For example, the private sector used to need a licence before it could undertake investment and it was easy to abolish that.

But when you unleash the private sector, new constraints come up. These also require reform, but these reforms are more difficult because they require deeper institutional change. For example, if there is a burst of growth, it will generate a demand for more skilled labour. That requires building an effective education and skills development system, which will take a decade before you see any effect. You also need to build in mechanisms to ensure that competition is maintained in the market. For that, you need institutions that will ensure that dominant players don't misuse market power. You also need an efficient legal system for dispute resolution. I think we were slow in doing even the first-generation reforms – we should have done them much faster. Our progress in the second-generation reforms was also much slower.

Ann Bernstein: In your book you talk about three different reform paths. Can you tell us a bit more about these and which one India pursued?

Montek Singh Ahluwalia: I make the distinction between big bang reforms, gradualist reforms, and reform by stealth. The big bang approach to reform is when you make a list of all the things that are needed, and you somehow try to get it done within two or three years. This was attempted in Latin America in the 1980s and was not very successful.

The approach that India adopted was 'gradualist reform'. In this approach, you identify the biggest constraints on the economy today and what the policy reforms are that will give you the biggest 'bang for your buck' at that moment. Then you say, "Let's get those done." And as you proceed with these reforms you should try to anticipate what the next set of required reforms will have to be – the so-called 'second-generation reforms'. Part of this process must be building a sufficient public consensus in favour of the next set of reforms. This is tough because these reforms involve deeper institutional changes and also take a much longer time to yield benefits. They are often more politically sensitive. For example, freeing the business sector may stimulate investment, but business then typically also wants labour reforms, which run into opposition from the unions.

The third approach, reform by stealth, is relevant when the gradualist approach, if fully articulated, takes on too many vested interests. In this situation, reform by stealth amounts to indicating you are going to do something but without an actual timetable for doing it. You reconcile yourself to doing whatever is possible as and when it becomes politically feasible. That is not gradualist reform. It is better described as 'opportunistic reform'. There is a sense of the direction in which you want to move but the pace at which you are going to move at is not clearly laid out.

I should add that we were able to do many things in 1991 because we were in the middle of a crisis, so it was easy to whip up a consensus that we must respond to the crisis. It was also easier because the crisis occurred on somebody else's watch. However, once you begin to make good progress and growth improves, there is an understandable temptation to sit back and forget to anticipate the problems that are going to arise, which will make it very difficult to be as successful as before.

I think our reforms suffered from this complacency. It requires a lot of political commitment and clarity of vision on the part of the leadership to keep talking the language of reform and to be clear that this next reform is necessary, when things are going reasonably well.

Ann Bernstein: Professor Lant Pritchett of Oxford University has talked about India being a 'flailing state'. What do you think he meant by that? Is his description a fair one?

Montek Singh Ahluwalia: Pritchett is one of the most perceptive observers of the Indian scene and I think what he had in mind with this metaphor is a state whose limbs are not adequately being controlled by its mind. The government knows people want clean drinking water, better education, improved health, etc., and it wants to do something, but it responds in an ineffective way. It is unable to deliver what is needed because of a lack of state capacity. I think this is indeed an important problem.

Ann Bernstein: You talk in your book about the importance of bringing the private sector in, for public-private partnerships in infrastructure development. This requires the state to reorient itself. The difficulty is that you need government officials who understand the needs of the private sector and the strengths well established businesses can bring to the table, but you also have to ensure government won't be taken to the cleaners by unscrupulous firms. How did India navigate this issue?

Montek Singh Ahluwalia: Public-private partnerships in infrastructure was one of the big changes made in the course of the reforms. Before the reforms, most of the infrastructure was built by the public sector. Telecommunications was reserved for the public sector, as was power generation and many others. Since the government did not have the resources necessary to make massive investments in infrastructure it was felt the private sector could be brought in. We took the view that the government would still have to build the infrastructure for the poorer and more backward areas, but private actors could take the load off the government in many areas of infrastructure development where user charges would cover costs and allow a profit.

It led to many important successes. Take the case of ports. Initially all major ports were under the control of the central government but minor ports were controlled by state governments. State governments allowed the minor ports to be privatised and some of them became larger than the major ports. We had to start calling these minor ports 'non-major' ports. There were also major successes in bringing in the private sector into telecommunications and airports.

But bringing in the private sector also presented problems. The government had to put together tightly defined contracts that would ensure that private sector firms will also take care of consumer interests. This presented its own problems. Private participants complained that such contracts, running over say thirty years, had to be flexible enough to allow for unforeseeable circumstances that always arise. Government officials were typically unwilling to make changes that were seen as favouring the private party. Private participants typically felt that the government viewed any change in contract terms in a highly adversarial manner and the 'partnership' component of public-private partnerships quickly disappeared. These are genuine problems, and we need to find ways of addressing them

Ann Bernstein: You say that government should focus on education and health, but Amartya Sen, the famous development economist, and his colleagues have written that India has been outperformed by Bangladesh, its much poorer neighbour, on these two social issues. What is your response to this?

Montek Singh Ahluwalia: It is true that on some indicators, not all of them, but particularly child nutrition and primary education, Bangladesh has done better than India as a whole. This is primarily because Bangladesh has done a lot better than the northern Indian states, which account for the bulk of the population and lag behind the southern states. Bangladesh is not necessarily doing better than the Indian south, where per capita income is higher and state capacity is better.

However, let me add that Bangladesh deserves full credit for what it has achieved, and to that extent, we also need to look at our own failings and learn from Bangladesh and others. We haven't done as well as we should have in the northern states.

I should add that these are areas in the control of the state government so the central government has relatively limited role. However, the good news is that even in these states change is taking place and the situation is improving steadily.

Ann Bernstein: Why do you think education is so hard to fix? South Africa struggles with this – we are one of the worst performers on comparative tables like PIRLS and TIMSS, like India. It is such a difficult and yet vital issue if we are really going to get inclusive growth. How do you see this?

Montek Singh Ahluwalia: I'm not an expert on education, but one thing that I've heard many experts say is that education is very hard to push for first-generation learners. A lot of what a child learns is reinforced by the family atmosphere at home. So, if a child is getting a decent education in school but comes from a home where the parents are illiterate, the child is not going to be able to catch up with classmates coming from literate households. Typically, if they start lagging, they simply lose out over time, because we don't have the quality of teachers who are actually able to address these issues.

Many things are at work: state capacity, incentives for teachers, inherent problems with first generation learners, education levels of parents and especially of mothers. Some of this is changing over time. However, lots of children are now entering the system who have literate mothers. So, what we are going through is a two-decade lag in education improvement. The real benefits of what is being done will only emerge in the next generation. Many observers comment that the government should spend more on education and I think that is correct. We are not spending enough public money on education. But merely spending more will not solve the problem. It is easy to hire a lot of new teachers but not easy to ensure that they will deliver quality teaching.

Linked to the issue of teacher quality is the incentive structure. In most Indian states, the education structure is dominated by teacher unions that tend to be resistant to change. They primarily concern themselves with protecting the interests of teachers as government employees. One of the critical changes that many educationists advocate is making teachers responsible to the local community, but this is resisted by unions, because they want teachers to be viewed as civil servants, and not subject to what they would call 'local village politicians'.

Lots of people also say that because we have a caste system, which has traditionally excluded a large number of people from education, we have not been motivated to expand education as East Asia did.

Ann Bernstein: One of the big issues in developing countries with lots of poverty is whether to prioritise growth or redistribution. Can you give us a sense of what the debate was on this issue in India at the time you were implementing these reforms? How did you think about the priorities and choices that the Indian government had to make?

Montek Singh Ahluwalia: We consistently took the view that at India's level of per-capita income, redistribution independent of growth doesn't make any sense at all. We had to have a policy that promotes growth, and the reforms aimed at raising the rate of growth to between 7 and 8 percent. However, we did not assume that high growth would automatically ensure a wide spread of benefits. We adopted a number of policies that were aimed at making growth more inclusive.

One of these related to the sectoral composition of growth. Accelerating growth in agriculture was seen as especially important. In contrast, growth based mainly on mining, which is highly capital intensive, was likely to bypass most of the poor.

The other mechanism we employed was special programmes for the economically disenfranchised. There were a variety of these: an employment programme to help people in the rural areas get jobs, which was aimed at building rural infrastructure; credit programmes for small-scale businesses; supporting women self-help groups through the banking system, etc. We had a whole variety of these programmes – some were good and some not so good, but there were several of them.

Interestingly, our attempt to achieve high growth often attracted criticism from NGOs on the grounds that we were only promoting the private sector, which in popular parlance meant 'the fat cats'. What these critics didn't quite realise was that the 'fat cats' can't do well unless their businesses expand and when they expand they create jobs. These jobs don't go to the 'fat cats', but to ordinary people. NGOs were very supportive of our anti-poverty programmes but much less appreciative of the growth component of the strategy.

However, criticism is an essential part of a democracy and it is for the government to educate the public about the rationale of what they are doing.

Ann Bernstein: You mention that India is a democracy. It is commonplace to compare authoritarian China and democratic India, as though these are the two countries that represent the two systems. How do you see the two countries and is reform easier in a non-democratic state? How do you assess China's prospects as it takes an increasingly authoritarian path again? Are there advantages that democracy provides?

Montek Singh Ahluwalia: I don't think China's development experience justifies a general statement that autocracy is good for reform. There are many autocracies in the world and most of them have delivered very poor results. They have then tried to escape subsequent criticism through more oppression.

China is not a democracy, but it is also not a run of the mill autocracy in which power is concentrated arbitrarily in one person. China has evolved an extensive system of examining options through several layers of scrutiny, all within the Communist party. It has produced very good results and the government then relies on these good results to legitimise itself. True, it does not permit or tolerate any public dissent, which to my view is unfortunate.

India is much more diverse than China and could not adopt this approach. Ninety seven percent of the Chinese population is ethnically Han. India has innumerable differences across languages, cultures, and regions. We have to follow a political system in which public articulation of different points of view is allowed and different political parties engage in electoral competition. This may make reform more difficult to implement, but the choice of a political system cannot be guided solely by what is good for reforms. It has to be guided by what kind of society you want.

I would add that despite democratic constraints, India did manage to grow very rapidly for a number of years under coalition governments. So, it is not as if democracy is not consistent with economic progress. But yes, it is more difficult and political leaders have to find a way of managing the situation.

Ann Bernstein: It seems a truly strange phenomenon to me that castes in India now want to compete to get into the category of constitutionally defined 'other/backward castes' so that they can get the affirmative jobs that the most disadvantaged castes in India receive. I understand that it is now more than 50 percent of the population that are eligible for special quotas in public sector jobs and university places, etc. What is your view of this phenomenon? Has this all gotten out of control now, because it is a strange ambition for parts of society to strive to be 'backward'?

Montek Singh Ahluwalia: That's a tough question. Initially, affirmative action in India through reservations for education and for government jobs was for a group that was most discriminated against, what is called 'scheduled castes and tribes'. In time it got expanded to cover what was called 'other backward castes'. The demand for reservations is not unconnected with economic performance.

Economic growth accompanied by a rapid expansion of job opportunities would weaken this demand, but when jobs don't expand rapidly these demands intensify with excluded castes demanding to get the benefits of reservations. I don't see any easy resolution of these problems. One can only hope that if we can achieve sufficiently rapid growth so that economic opportunities and employment expand, and good quality education is made available to all irrespective of income or caste, the pressure for reservations to expand will ease

Montek Singh Ahluwalia in conversation with Ann Bernstein

Ann Bernstein: Sadly, we have come to the end of our time together. Thank you for spending time with us, Montek. This has been a wonderful discussion. We could have gone on for another hour! I think everyone can see why we were so excited that you agreed to talk to us. I will conclude by reminding you of the first time I came to your Delhi office. South Africa had just started its own national planning process. I asked what we could learn from your experiences that might be useful for South Africa. After thinking about it a while you asked, "How many priorities does Trevor Manuel have in his National Development Plan?" I said that I thought it was around 123 and rising. You smiled and said, "Well, I'm down to 25 for a population of 1.3 billion."

Montek Singh Ahluwalia: Thank you so much for hosting me. I really enjoyed being with you. I am a strong believer that developing countries need to know a lot more about one another. So, I hope you will have many more such interactions with other developing countries, including India.

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