

# A change in economic regime?

For the new dispensation, moving away from statism is highly desirable – but unlikely

ILLUSTRATION BY BINAY SINHA



At a panel discussion on “The economic agenda of the next government: is an economic regime change necessary and possible?” at the Indian School of Business in Mohali, I answered that such a change was necessary but not likely. This column elaborates on these answers.

The 1991 reforms ended the Nehruvian licence permit raj, removing major policy-induced distortions in the commodity markets, but failed to do so in the markets for labour and land. Most of these distortions go back to Indira Gandhi’s leftward turn after she won her “Garibi Hatao” election in 1971, with the nationalisation of banks and coal, the attempt to nationalise the wholesale grain trade, and the tightening of the Industrial Disputes Act for establishments employing more than 100 workers. These and other dirigiste measures still cripple the Indian economy. Rajiv Gandhi, her son, loosened the licence permit raj, but Sonia Gandhi, his widow – by promoting various “rights-based” subsidies in her decade-long reign – has saddled India with a premature European-style welfare state. My suggestion at the panel, that it would be best for India’s future economic performance if the incoming government rescinded all the economic Acts passed during the Indira and Sonia reigns, got loud cheers from the assembled students. My answer to the second question was that such a change was unlikely, since the intellectual hegemony of Nehruvian socialism was still in place, though the coming crisis of the demographic dividend turning into a demographic bomb might at last induce a change.

A little personal history might be in order to explain these answers. In 1972-73, I was working as an advisor in D P Dhar’s Planning Commission when Indira Gandhi’s left turn was evident. Like my peers, I was still largely a Nehruvian social democrat. The commission

was torn between Bagicha Minhas’ voice of economic rationality and Sukhamoy Chakravarty’s Marxist voice. Witnessing their heated debates and the absurdity that was Indian planning led to my Damascene conversion to classical liberalism.

After I returned to London, at events at the Institute of Economic Affairs (IEA), I got to know Friedrich A Hayek and other leading classical liberals such as Milton Friedman, Peter Bauer and Alan Walters. This was also the period when Margaret Thatcher was converted to classical liberalism by her mentor, Keith Joseph. Many years later, when we became friends, Joseph told me that he had been shocked in the late 1960s when he met Walters, an old friend, on the street

outside Parliament, who refused to shake hands, and instead wagged a finger exclaiming, “you are an inflationist”. This shook Joseph, then part of the statist intellectual social democratic political consensus known as Butskellism. He got a reading list of classical liberal writings from Ralph Harris at the IEA. This was his Damascene conversion. He set up a think tank with Thatcher: the Centre for Policy Studies developed the classical liberal programme, which Thatcher

implemented when she came to power in 1978. She would fling a copy of Hayek’s *The Constitution of Liberty* at her colleagues, telling them they needed to read it to restore Britain’s economic fortunes.

Her success in restoring Britain’s economy and standing in the world led to a shift in the climate of opinion; the Labour Party under Tony Blair came to embrace Thatcherism. When his successor, Gordon Brown (much like the second term of the United Progressive Alliance, or UPA), tried to use the burgeoning tax proceeds of the ensuing economic prosperity to expand entitlements, he suffered a crushing defeat.



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I wrote a book for the IEA, *The Poverty of Development Economics* (1983), in which I applied classical liberal ideas to the economics of developing countries. This was revised and updated, rebutting many of the fashionable arguments against classical liberalism, in my *Reviving the Invisible Hand* (2006). On my frequent visits to India, I found that these ideas had fallen on stony ground. Even after the 1991 economic liberalisation, after growth accelerated with the easy economic pickings from ending the licence raj, the same old social democratic mindset – reminiscent of Butskellism – prevailed. There were no think tanks in India – like the IEA, or the American Enterprise Institute, Cato Institute or the Heritage Foundation in the United States – to propagate the case for classical liberalism. With the demise of the Swatantra Party in the 1971 Indira wave, no leading politician supporting classical liberalism was left in politics. When the unreconstructed Left denounced even the limited 1991 reforms as hurting the interests of the poor, the stage was set for Sonia Gandhi to use the rising tax proceeds from growth to expand the entitlement economy.

What of the opposition by the Bharatiya Janata Party, which has just won a stunning and well-deserved election victory? Do its election slogans – “development, not doles”, “maximum governance, minimum government”, constantly reiterated by its incoming prime minister – mean that he and his party are shorn of the Nehruvian social democratic mindset? Note that during its reign, the UPA did not vote against various “rights-based” entitlements enacted at the behest of Sonia Gandhi’s *Jholawalas* in the National Advisory Council. Moreover, in the 1980s, the BJP was burning effigies of Arthur Dunkel, former head of the General Agreement on Tariffs and Trade (GATT). Though its tune changed in the 1990s, the continuing hold of “Gandhian socialism”, as Atal Bihari Vajpayee called it, is still evident in the party’s support for “*swadeshi*”, its backsliding on foreign direct investment in retail, and its purported support for public sector enterprises, instead of their privatisation, as in Thatcher’s flagship programme. Maybe this will change with a Thatcherite Damascene conversion of Mr Modi and his party.

For me, this would be signalled if Mr Modi does battle with the “insiders” of the industrial labour aristocracy, who have kept the massive number of semi-skilled workers willing to work for much lower wages, as “outsiders” in the manufacturing sector. There seems to be widespread acceptance of the industrial caste system India has created, with its segmentation through distortions of the industrial labour market. As the experience of China and of the other Asian Tigers has shown, it is impossible to jump the labour-intensive industrialisation phase and move into a post-industrial service economy. It is not top-down skill development that India needs, but removing all the colonial labour market restrictions that prevent freedom to hire and fire labour, as China – an ostensibly socialist economy – has done. This requires rescinding the colonial-era labour laws (see my *The Hindu Equilibrium*, 2005) and the 1947 Industrial Disputes Act. Without this, India’s demographic dividend will turn into a demographic nightmare, even as the millions of unemployed, semi-skilled and sex-starved youth increasingly disturb social order. Perhaps only then will India’s continuing dirigiste intellectual mind-set change.