

High-decibel policy reforms absent so far and may have to wait till assemblies like Maharashtra have been won. Focus on fixing business climate good for now, to hike capital productivity, but big reforms vital for an 8%+ growth

What makes an economy grow or, put another way, what attracts investors? Obviously big flourishes get hyped up in the media, but is this what drives investors? A good place to start answering this question, at the end of Narendra Modi's 100th day in office, is the government's decision to hike FDI levels to 49% in defence.

Most commentators, including this newspaper, have criticised the government, arguing no great money will come in since there is little difference in terms of the control the foreign partner has in a 26% versus a 49% FDI level—it is only at 51% that the foreign firm will feel comfortable in transfer of technology. Defence minister Arun Jaitley, however, rubbishes this argument and points to how, in a few weeks, the government has cleared two large orders for aircraft made in India—so, he argues, once foreign manufacturers see the market opening up, they will come in, never mind that FDI limits are not at 51% levels.

Time will tell whether Jaitley is right, but it has to be kept in mind foreign investors came in when FDI limits in insurance were at 26% and at 49% for telecom. The two industries are different from defence, but the question is whether simply 'opening up' announcements are good enough or whether investors want genuine action/orders of the type Jaitley is demonstrating.

The telecom success suggests investors look at the long-term. Indeed, despite the Vodafone tax case and even the non-renewal of the 900 MHz licences, companies remain interested in investing — were more spectrum available, the industry will immediately invest another R80,000 crore or so just to buy it.

While talking of the NDA's hits and misses (see table), some of the obvious big misses are not raising gas prices and not starting to cut LPG subsidies in the manner done for diesel—in both

cases, you get the impression the PM wants some critical state assembly elections out of the way.

On the positive side, there is a move to fix the UPA's crippling land acquisition law, though it is an open question as to how much can be done now—the best that Jaitley seems to be promising is some more exemptions to the law; what needs to be seen is if the government can come around with as neat a solution as it did in the case of the retrospective taxation law.

Not surprisingly, given the government is just 100 days old, much of its plans remain in the works, but after some missteps — on WTO, and on dithering over even field trials for GM crops—it appears to be going in the right direction. Junking Aadhaar seemed top on the government's agenda initially, but it seems back on the front-burner and is likely to be the pivot around which the Jan Dhan Yojana will revolve.

It remains to be seen as to what the finance ministry says to the Finance Commission—the states have already made their representations—but if it recommends greater devolution of funds to the states as is expected, going by Modi's campaign trail promises, this will leave less room for Central ministers to dictate terms to states. That will represent a sea change in the manner India is governed.

Another related reform is the use of Article 254 (2) of the Constitution. This is what allows the states to bypass laws where the Central one is opposed to what the states want. Labour is a good example, land acquisition is another. The question now is whether Centre will get President to give his assent to the Rajasthan law that allows firms with under 300 workers—the Central law says 100—to shut without getting government approval. Rajasthan is working on a similar law that allows for much higher compensation instead of time-consuming and laborious social impact assessment (SIA) for land acquisition for for even modest-sized projects. If that happens, the government will have opened a new window for important reforms.

Which brings us back to the question as to whether investors are impressed with big bang reforms. Certainly in many cases, a big step is required. It is difficult to see, for instance, any serious investment—as opposed to MoUs—in nuclear plants unless the liability clause in the Nuclear Liability Act is significantly watered down. Similarly, we are not going to see serious change in coal production unless, as in the oil sector, the mining sector is also opened up to commercial miners, including from overseas—right now, however, the government has no plans to open up. It is difficult, similarly, to see how banks are going to raise money — vital to lend to

industry— unless the government goes ahead with the holding company proposal. And it is difficult to see how India's farm sector can progress without a dramatic change in the current FCI system where large farmers growing rice and wheat in a handful of states corner all the benefits. That can happen only if, instead of large FCI procurement of wheat and rice, farmers are given US-Europe style per acre-subsidies irrespective of what they grow. Indeed, while the WTO food subsidy calculations are deeply flawed, India can live with them and benefit its farmers much more if it moves to cash transfers.

A Crisil table on ICOR summarises the dilemma of small steps vs big bang best. Due to various inefficiencies in the production chain—land not being available for projects, not enough coal etc—India's efficiency of capital use has plunged. So, instead of needing 4-5 units of capital to produce one unit of output on a sustained basis, India now needs 7.4 units. Which means, at India's current investment level of 35%, it will get an output growth of 4.7% — at an ICOR of 4.4, the growth would have been 8%. Put another way, with a 7.4 ICOR, India would need to have much higher investment levels than they are today to get an 8% growth; even big bang reforms can't, in the short term, get investments up to that level. India's immediate solution has to lie in getting the micro right, and that's Modi's focus. For 9-10% growth levels, India needs, however, big bang reforms on coal etc. But that's in the medium-term. If Modi wins some critical assembly elections, it increases his ability to reform, may be even scrap the onerous SIA provisions of the UPA's bad land laws.