

CAPX

Demystifying India's economic transformation

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The Billionaire Raj, a new book on India's economic transformation by James Crabtree — who was, until recently, the Mumbai bureau chief for the *Financial Times* — is a curate's egg.

First for the good part.

One of the puzzles of the 1990s moves from planned economies to market-based economies in China, Russia and India was that the liberalisation of the numerous economic controls that had damaged their growth and promoted rent seeking led to even more rabid rent seeking without damaging growth.

Crabtree describes this new form of cronyism vividly, but he does not explain why, unlike the old version, it has been accompanied by high growth rates.

In 2011, just as the previous decade's growth surge was coming to an end, I wrote a paper in which I distinguished between 'monopoly rents', 'economic rents' and 'composite rents'.

The main economic difference between them is that whereas 'monopoly rents' — such as those generated by licenses and controls — are equivalent to distortionary taxes-cum-subsidies affecting the marginal decisions of consumers and producers, which damage economic efficiency, the other types of rent (like the 'economic rents' from land) are like lump-sum taxes which have only distributive effects without damaging economic efficiency and therefore growth.

Nevertheless, by the 2010s India's economic growth started to decline. This could not have been due to the scams generating economic or composite rents from land, natural resources like coal and the spread of mobile technology like 2G. Crabtree's contribution, without recognising the above analysis, is to show that these scams were associated with the financing of these investments by unsustainable debt.

In “The House of Debt”, the best chapter in the book, Crabtree shows how the banks nationalised by Indira Gandhi in the early 1960s became the main instruments financing the investments generating economic and composite rents.

Many of these turned sour – particularly when it came to financing infrastructure projects – because they were private-public partnerships (PPP) whose risks were misaligned. Private investors bore the initial risks of getting the requisite licenses. After 2010, with the populist turn in the second Congress-led coalition, a new “permit raj” based on environmentalism emerged. The result was stalled investment projects that added to the non-performing assets of the banks (NPA).

Most of the loans that soured were rolled over. But there was limited knowledge of the extent of these NPAs until the new governor of the central bank Raghuram Rajan got a private agency to dig into the data and found that the public sector banks had a debt crisis as bad as China’s. On his initiative, a new bankruptcy law has been instituted and his successor Urjit Patel is now using it vigorously to clean up these NPAs.

Crabtree also reports his various interviews with the capitalists who took advantage of the opportunities opened up by Manmohan Singh’s economic liberalization in the 1990s. But it is here that the book starts to go wrong.

Beginning with the subtitle, “A journey through India’s Gilded Age”, Crabtree seems keen to echo the writings of the US historians of the late 19th and early 20th centuries who, as L.M. Hacker has shown, could not see past their anti-capitalist bias and painted the agents of impressive industrialisation and infrastructure development as “The Robber Barons”.

These historians took their lead from Charles Beard, who in his various writings took a dim view of American capitalism not for any economic reasons but for moral ones.

Beard was the progenitor of the anti-capitalist bias in much American historical writing. He took over the agrarian prejudices of his Indiana boyhood to the capitalist processes which he did not, nor try to, understand.

As Hacker notes, these anti-capitalists do not realize that setting the “rules of the game” (like monetary, fiscal and regulatory policies) is a public function, whilst “the willingness and ability to take risks in order to engage in capital creation (with the failure as well as successes recorded)” is a private one. He concludes “here in epitome is the history of capitalism”.

In his pen portraits of India’s purported robber barons in the post-liberalization era, Crabtree falls into the same trap as these US historians and many Western social democrats. Many of these Indian entrepreneurs were new and from modest backgrounds, who took the publicly created “rules of the game” as given whilst bearing the required risks in this environment to generate the rapid growth needed to alleviate poverty.

He also resurrects the usual social democratic chestnuts to attack India’s new capitalists. They have worsened wealth inequality based on Thomas Piketty’s dubious calculations from limited and often false tax returns.

However, as Surjit Bhalla has argued, this recent Western turn from concerns with poverty alleviation — where there has been phenomenal progress — to wealth inequality is deeply flawed, because it neglects to count one of the main modern forms of wealth: human capital. Bhalla provides estimates of wealth inequality incorporating educational capital for the world and many countries including India. It overturns the current paradigm about worsening inequalities of wealth promote by the likes of Piketty.

Crabtree's panaceas are also the tired old ones of the "Progressive Era". He fails to note that these were tried after 2010 in the second term of the Congress-led coalition, and this socialist program was resoundingly defeated by Modi's slogan of "development not doles" in the 2014 election. For, as the French sociologist Louis Dumont emphasised in his *Homo Hierarchicus*, Hindu society is based on hierarchy, in which given its belief in reincarnation, promoting equality of outcomes (as opposed to opportunities) in this life, would reverse the just deserts which one had earned from actions in one's past life.

The Hindu majority has thus always formed an aspirational, and not egalitarian, society. This was the basis of Modi's victory over the Westernised Gandhis trying to implement the Western-style social democratic agenda Crabtree commends.

This highlights the most serious shortcoming of this book and those by many foreign journalists as well as their Westernised Indian acolytes: it is the lack of understanding of Indian history and in particular of its unique institution of caste.

I wrote a book, *The Hindu Equilibrium*, trying to explain the origins and role of caste in India's political economy. A brief outline of the argument might help to dispel some of the bafflement that Crabtree and others reveal about the success of democracy in India as well as its long-standing tolerance of corruption.

Indian civilization developed on the vast Indo-Gangetic plain where its polity was notable for its endemic political instability among numerous feuding monarchies, and its distinctive social system embodied in the institution of caste, which tied then scarce labour to abundant land. Given the lack of any enduring centralised state to enforce other methods of tying labour to land — like slavery or serfdom — the caste system provided a unique decentralised system.

By making war the trade of professionals, it saved the mass of the population from being inducted into the deadly disputes of its changing rulers, while the tradition of paying a certain customary share of the village output to the current overlord meant that any victor had little incentive to disturb the daily business of his newly acquired subjects. The democratic practices gradually introduced by the British fitted these ancient political habits like a glove. The ballot box has replaced the battlefield for the hurly-burly of continuing political conflict, while the populace accepts with a weary resignation that its rulers will, through various forms of rent-seeking, take a certain share of output to feather their own nest.

Crabtree had, in his chapters on India's spiraling debt and the portraits of India's new capitalists, the making of a good, concise book on the Indian financial system (as Walter and Howie have done for China in their *Red Capitalism*). Unfortunately, however, he has interwoven this with a

shallow anti-capitalist line of thinking which does not illumine the political economy of India's past, present or future.

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