

# A WELL-REGULATED MARKET ECONOMY BACKED BY EFFECTIVE STATE IS IMPERATIVE

Relevant for: Indian Economy | Topic: Issues relating to Mobilization of resources incl. Savings, Borrowings & External Resources

This survey has focused on the issue of State, in terms of quality of regulation and welfarism

The Indian State has been rewired in recent years. The early thinking after independence was that the government would be the main vehicle of rapid industrialization. It would also build public goods as well as provide food security to the poorest through ration shops. Much has changed since then. The State has moved away from being a producer to a regulator since the 1991 reforms. Investment is now led by the private sector. And the nature of the welfare state has also changed as average incomes have gone up in a country that the World Bank defines as a lower middle-income one. How well is it doing on both these fronts?

The broad shifts are implicit in some of the analytical chapters of the new [Economic Survey](#) that was released by the finance ministry on Friday. The first issue is the nature of regulations. Do they choke enterprise? Economists in the finance ministry have argued that the Indian economy suffers from too much regulation. They frame it in the language of modern institutional economics, and especially the issue of incomplete contracts, for which the duo of Oliver Hart and Bengt Holmstrom won the economics Nobel in 2016. A regulation that is written to take every possible future situation into account—or a contract that seeks to be complete—will inevitably be impracticably heavy.

How contracts are designed defines incentives in various situations in the real world. Some elements of bureaucratic discretion are inevitable if regulations have to be kept simple. The Economic Survey argues that such discretionary decisions should be as transparent as possible. However, they do not pay enough attention to the related issue of bureaucratic incentives. The trio of watchdogs — CBI, CVC and CAG — have made it too risky for a civil servant to take quick decisions. Many have ended up in trouble for no fault of their own. The efficacy of the Indian regulatory state is not just dependent on the quality of regulations but also on the ability of bureaucrats to make quick decisions.

The ability of the Indian State to regulate a modern economy is a problem at one end of the social contract. A problem at the other end is the welfare system aimed at the poor. The Economic Survey brings back the issue of basic needs in the debate. The welfare system in the 1970s was mostly about the very basics, such as food. The Perspective Planning Division of the erstwhile Planning Commission, under the leadership of Pitambar Pant, began work way back in 1961 on how to design a minimum income scheme for the poorest fifth of the population. Much of the thinking was based on the need back then to ensure that people have enough to eat.

India has progressed since then. The Economic Survey identifies a new set of basic needs—housing, water, sanitation, electricity and clean cooking fuel. These have an almost perfect fit with some of the marquee schemes of the government led by Prime Minister Narendra Modi. These basic needs are neither classic public goods nor minimal essentials such as food. They are the building blocks of what former chief economic adviser Arvind Subramanian has evocatively described as the New Welfarism, or “the subsidized public provision of essential goods and services, normally provided by the private sector, such as bank accounts, cooking gas, toilets, electricity, housing, and more recently water, and also plain cash”. Much of this is held together by the trinity of Jan Dhan accounts, Aadhaar and mobile phones.

One of the focus areas of the previous Economic Survey released a year ago was the opportunities for wealth creation through open markets backed by social trust. This year, the focus has been on the closely linked issue of the State, both in terms of the quality of economic regulation as well as the welfare system that is aimed not only at the very poor but the members of what has been called the aspirational neo-middle class, which also happens to be an important voting bloc.

The issue of state capacity is as important as that of entrepreneurial capacity. A well-regulated market economy is the best way to spread opportunity. It needs to be backed by an effective state that is not blindly interventionist. The new Economic Survey does well to touch on these grand themes of Indian political economy.

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