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Re-Engineering Ideas in Developmental Growth

The understanding and application of Economics as a discipline is somewhat facing an existential crisis at the moment. For far too long, our understanding of a value free economics, by value based practitioners has been shaped in form of a collection of models designed to empirically analyse the causal relationships of economic problems affecting a humanoid world. In the history of modern economics, particularly since the early 20th century, the injection of mathematics and statistics in the methodology of economic problem solving, allowed the practitioners of economics to distinguish themselves as preachers and soothsayers over and beyond being social scientists.

While mathematical modelling definitely improved the scientific validation of economic relationships through an erudite methodology, the economists in this process somewhere went beyond the more rudimentary, pertinent building blocks to economic thinking; with a conscious disregard towards the development of social, political institutions for developing economies as a precursor to sustainable productivity enhancement and income generation.

Most economists for the mathematical modelling process to have universal applicability started *assuming* a static nature of institutional arrangements, an individual based behaviour aspects (via rationality); including dynamic aspects like space and time. A closer study of the history of modern economic thought informs us how critically were all

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these aspects (especially institutional aspects like the role of the government vs. the individual) were attached amongst classical liberal thinkers like David Hume, Adam Smith, David Ricardo etc. in studying the governing dynamics of British economy back in the 18th, 19th century.

The rapid increase in methodological sophistication (recently defined as *mathiness* by Paul Romer in a recent paper), particularly since the 1980s (with the inclusion of financial modelling into economics) was centred on identifying tangible variables in targeting for income led growth across economies, which further shifted the discipline of economics more towards the scientific end of studying economic problems (for both the individual and a collective society).

My objective here is to not vilify all economists but highlight a degree of neglect shown by economists (particularly those working as policymakers, technocrats across developing economies like India, China, Brazil etc.), in failing to acknowledge and highlight the importance of going beyond growth metrics in an economy's journey to development. There is nothing reductionist about the practice of economic modelling till we confuse *a given model* with *the model* in identifying a developing economy's path to greater economic prosperity. Economic analysis and modelling, if skilfully crafted by its practitioners, can be very useful in identifying areas of potential gains and thereby helping to create new constituencies for change in resolving most developmental challenges for economies.

Below I discuss **a)** the Indian case, highlighting some of the accounting problems faced by the economy today in realistically depicting economic growth; **b)** the limitations to overall growth accounting methods and **c)** propose a theoretical alternative with an enhanced acknowledgment and adoption of social choice theories as a useful, complementary paradigm for studying what I call as developmental growth.

The Missing Indian Idea of Developmental Growth

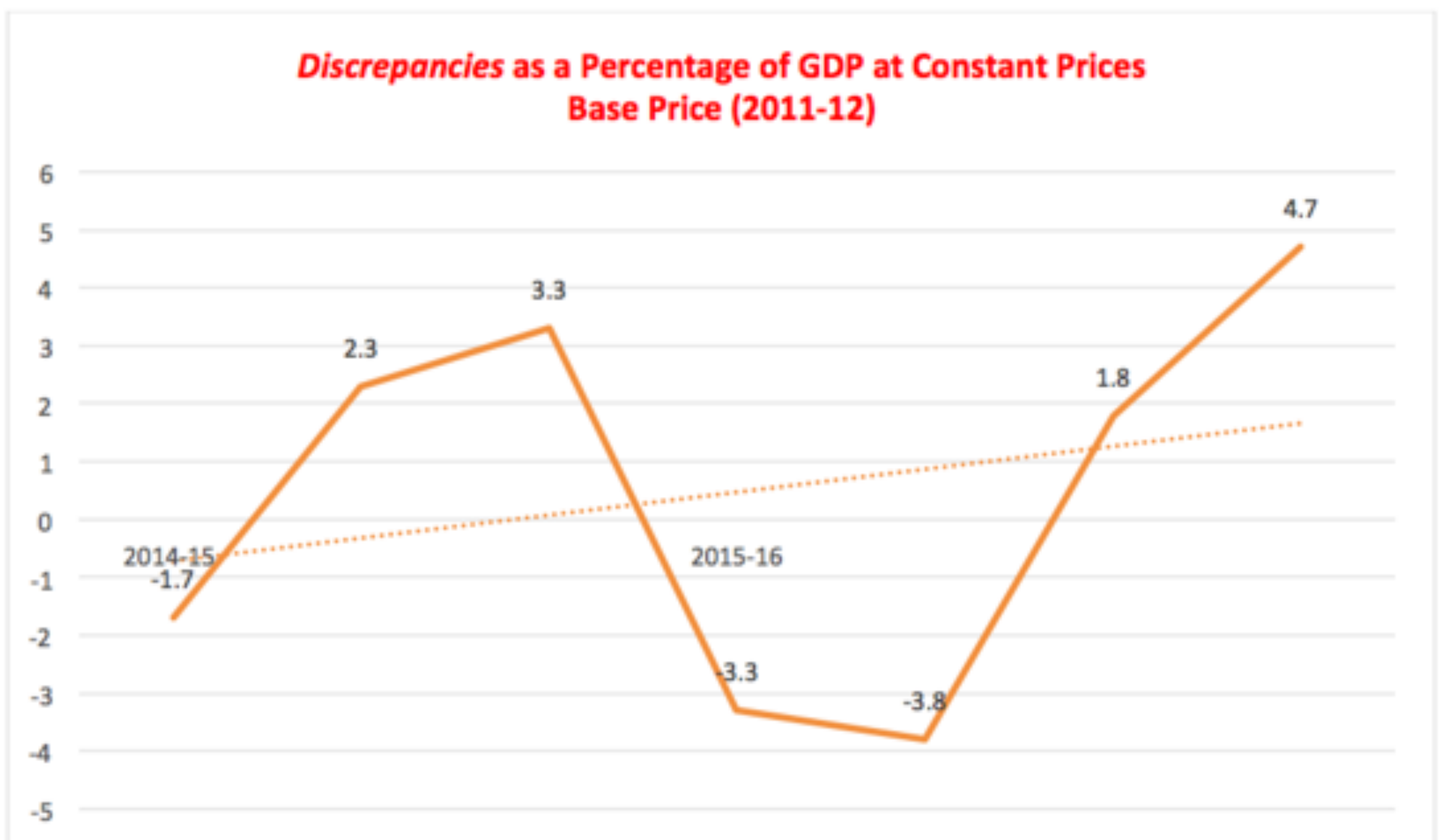
India's Gross domestic product (GDP) growth at constant prices jumped from 7.2% in the December 2015 quarter to 7.9% in the March 2016 quarter. While both foreign and national media are taking this as a great leap forward, it would be pertinent to take the data and methods on India's growth story with a pinch of salt.

What is interesting to observe in the release of June (2016) data on India's growth rate, is how instead of aggregate production per se the amount on 'discrepancies' in

India's growth accounting has drastically increased. So, what are these 'discrepancies'? GDP can be calculated using different methods, such as the net value-added (output), income and expenditure approaches, which often generate GDP values with slight differences. The difference in value, account for the discrepancies in accounting growth— that is, it represents the correction value computed to adjust the differences in GDP values. The higher this amount gets, the more difficult it becomes to realistically believe the data collected and accounted for.

The 'discrepancies' should thus, be minimum to realistically believe the growth measurement across all the methods; for India's case, at constant prices, the discrepancies amount were Rs.1.43 trillion in the March 2016 quarter, while in the March 2015 quarter they amounted to Rs.29,933 crore. If we look at the figure below the growth in "discrepancies" year-on-year was of the order of Rs.1.13 trillion (i.e. a percentage increase to 4.8% growth from -1.9%).

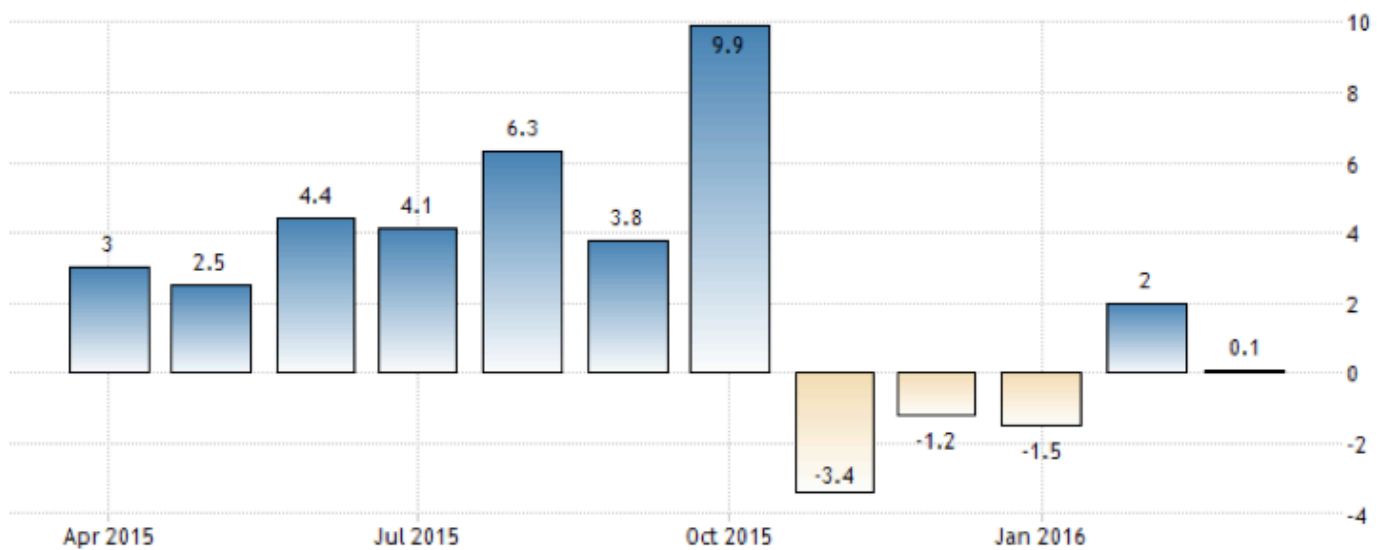
Figure 1: Discrepancies as a percentage of GDP at Constant Prices



Source: Ministry of Statistics and Programme Implementation

The reason thus, for rapid rise in India's current GDP growth rate this quarter (particularly from the expenditure method side) can be explained by this rise in 'discrepancies', rather than by actual productivity increasing trends. **And this makes perfect sense, as we look closely into the recent trends of macroeconomic aggregates like the IIP (Index of Industrial Production), GDP from Manufacturing (Figure 2) controlling for the disproportionate change made in the** base year prices **that have flummoxed most observers of the Indian economy.**

Figure 2: Index of Industrial Production



Source: Trading Economics (Ministry of Statistics and Programme Implementation)

In India's own economic growth policymaking approach, we observe an over reliance on the theoretical concepts of neo-liberal economics, a framework which saw its emergence in the US and Europe during the late 1950s. India's current push for driving Foreign Direct Investment as a source of physical capital to increase production for economic growth via its Make in India program can also be seen as a neo-liberal policy prescriptive method that excludes the scope and importance of pushing for domestic investment and human capital in its model.

The issue with India's path to economic development has been with the implementation of Track II reforms where in spite of a higher, sustained economic growth levels from early 2000s, the level of public spending on education and healthcare has remained drastically low (less than 3% and 2% of the GDP respectively till now). This has resulted in the accumulation of economic wealth in limited geographical city centres where economic prosperity is enjoyed by the few who directly accrue the benefits, leaving those from lower classes of income as *the others*, ultimately becoming entirely dependent on the government. Upward income mobility within these lower income classes remains addressed owing to a lack of access to good quality education, primary healthcare and productive employable opportunities for livelihood.

One of the other possible explanation for the short sightedness in a developing state like India's economic approach, can be associated with the existing nature of the political system itself. A democratic system warrants political parties to achieve quick results and implement policies with short-term implications that allow them to score points in the next election cycle; while ignoring the long term economic costs of such policies that are usually attached with short-term benefits. The ad hoc policy decision on the nationalisation of all large banks in India in 1969 can be cited as one such policy that resulted in long term economic costs.

The returns associated with social investments in skill development, primary education and healthcare facilities are long term (in the form of human capital development) and are part of a macro strategy for improving productivity of workers and for enhancing aggregate effective demand in the economy. In this effect, the evidence on sustained economic development, in the recent past, is skewed more towards state led, authoritative political regimes; with classical examples being, South Korea, Singapore, Mainland China etc.

Limitations of Growth Accounting Methods

Despite its extensive use within the industrial countries, methods used in growth accounting including the computation of GDP as the main *proximate* determinant for measuring economic growth, have done surprisingly little to resolve some of the most fundamental issues under debate in the development literature. In a recent article, I attempted to discuss some of the issues that countries like India need to be wary off in over obsessing with growth numbers as ultimate means for real developmental growth.

For example, one of the main rationales used in the methods of growth accounting is to explain the difference between the contributions of increasing capital per worker and the total factor productivity (TFP). Yet, there is enough empirical research that points at a widely divergent view (refer to Bosworth and Collins) on the issue that oscillates between the claims that a) the process of capital accumulation is fundamental to a country's economic growth as against b) the notion that capital accumulation is largely unimportant in real developmental growth.

Therefore, for the scope of my discussion here, there are three larger critiques (highlighted below) on the current methods employed in growth accounting techniques that policymakers in developing economies like India need to acknowledge and correct for:

a) Total factor productivity (TFP) is merely a residual factor that accounts for increase in the level of production in an economy but doesn't necessary explain the causes to technical changes in production levels; there are many more determinants that allow and need to be accounted for changing production levels (say, increased technological innovation, changes in government policies, institutional changes etc.)

b) As Collins & Bosworth (2003) argue with evidence in their essay on The Empirics of Growth, growth accounts in countries can be very easily be constructed or let's say be manipulated to yield estimates of TFP that are independent of the functional form and the deeper determinants of the production process. A disproportionate change in base year prices can inflate growth numbers very easily. There is therefore, a strong need to either stop focusing on production numbers alone in designing policies for encouraging capital investment or alternatively, availability of data on factor shares of income need to be made for robust.

c) Finally, growth metrics on quantifying production or output levels cannot enable us to fundamentally understand the *causes* of growth or study its impact on the development of people in a country. I have previously argued on how critical it is to widen the discourse on understanding economic growth and its benefits by focusing more on the *deeper* determinants to developmental growth (institutional development, individual & collective property rights,

degree of socio-economic integration etc.) than *proximate* determinants (capital accumulation through physical and human capital deepening) alone.

A Theoretical Framework for Gauging Developmental Growth: Social Choice Theories & Collective Action

In welfare economics, utilitarianism for a long time emerged as the *official theory* of studying the overall welfare of given societies in an economy (with contributions from Jeremy Bentham, John Stuart Mill, Pigou etc.). Our policy framework needs to be assessed in light of a question raised by the title of a famous essay by Richard Easterlin, *"Will raising the income of all increase the happiness of all?"* Putting happiness as a self-evident fact at the center of a utilitarian, totalistic approach is a prescription offered by many economists including Amratya Sen himself (refer to his works on Happiness, Well Being & Human Capabilities reflected in the book on *Collective Choice and Social Welfare*).

It would be pertinent to acknowledge the work put forth by some of the early social choice theorists whose work focused on the development of a framework for rational and democratic decisions for a group, paying attention to the preferences and interests of all its members (refer to Kenneth Arrow's work on the *impossibility theorem* in his book on *Social Choice and Individual Values*).

The Social Choice theoretical applications are particularly useful in *indigenising* self-assessing developmental process within pluralistic societies; away from the transcendental thinking of an ideal, uniform process of economic development usually projected as a *one size fits all* (similar to the neo-liberal framework or the neo-Rawlisian idea of justice as fairness).

The social choice theoretical framework is not a single theory, but a cluster of models and results concerning the aggregation of individual inputs (e.g., votes, preferences, judgments, welfare) into collective outputs (e.g., collective decisions, preferences, judgments, welfare). Information on interpersonal comparisons of well-being and relative advantages turns out to be particularly crucial in the resolution of an inclusive, long-term process of economic development.

There is a strong need for the Indian state, particularly the policymakers to acknowledge the role and importance of social choice theories that allow the emergence of a more complete symbiosis between the process of institutional reforms along with behavioural changes. As a useful example cited by Sen in his work on

economic justice, mentions Condorcet's (a French philosopher, mathematician) emphasis on the importance of women's education in medieval France as a need for institutional reforms in securing such a change; a change that is realised by a larger effort to recognise the need for women's voices in public affairs. Condorcet's views here reflect the symbiosis needed between the process of reforming institutions that are driven by the collective needs of a society; in the above case, acknowledging more participation of women over time in the public policy decision making framework.

In India and across the developing world, a fresh look in our public policy framework is required, that, at a micro level is institutionally designed combining elements from both Kautilya's views on Indian political economy (in *Arthashatra*, where he acknowledged the role of institutions in planning and directing efficient economic performance, including the imposition of restrictions and prohibitions to promote good conduct at a society level) and Ashoka's views on advancing the welfare and freedom of people in general (his optimistic views were based on the belief of making more people behave better by promoting self-awareness and persuading them to reflect more) .

At a macroeconomic level, it is critical to end the tug of war evident from the clear lacuna evident between the growth phase and the redistribution phase. The mainstream growth process that creates exclusion as well as inequalities tends to overpower the redistribution process and intensifies exclusion in the process. Both the growth phase and the redistribution phase should be complimentary to each other for the mainstream growth process to be inclusive.

If we simply talk about principles of fair, equitable, sustainable economic growth as a pre-cursor to economic development for an economy's overall well-being; it is critical in every developing economy like India to have a self-drawn map for developmental growth. The nature of such development beyond the maximisation of economic comparative advantages, warrants an institutional self-assessing process realising the collective social choice of societies in the process; one which is less transcendental in achieving what is "ideal" as against what is pertinent for a given economy.

For economists to use the methods of economics in its best scholarly capacity for a given economy, it is critical to showcase skilful craftsmanship in applying economic principles balancing social, political aspects with local economic benefits attached with integration. Any developing nation state's policies must reflect the interests of the dominant social groups which control the state than cater to the world aggregate demand as the main prerogative. Changes in the economic policies at a local level

invariably hurt some of these interests, which makes changes difficult within a gradualist framework. The important question for developing societies is how to develop a mutually supportive structure of market and non-market institutions, which is well suited to promote economic development.

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Mr. Deepanshu Mohan is an Assistant Professor of Economics and Assistant Director of the Centre on International Economic Studies at the Jindal School of International Affairs at the O.P. Jindal Global University located near New Delhi, India. Mr. Mohan is also a Visiting Professor to the Department of Economics at Carleton University, Ottawa, Canada. Trained as an economic historian from the London School of Economics (2012), his academic interest and research work lies in development economics, history of economic thought and the history of economic crises and its impact on South Asia (particularly, India).