Don't Believe the India Hype

by Razeen Sally

INDIANS ARE GOING to the polls to elect a new government. The Congress party is standing on the record of the government it has led since 2004. But elections are taking place when the Indian economy has taken a sharp turn for the worse, in a climate of global economic crisis. This exposes the pathetic, do-nothing, zero-reform record of Prime Minister Manmohan Singh and his government. More generally, it lays bare India's huge reform gaps and its brittle, decaying institutions. Finally, it deflates the "India Hype" peddled by smooth-talking, upper-caste politicians, ambassadors, businessmen, management consultants and indeed some academics.

A word about India Hype. One aspect of it is the thesis that India is forging a separate successful path to development, in contrast to the traditional comparative-advantage-based development of China and the other East Asian Tigers. At its extreme, this argument holds that India's growth engines are its high-end services, and now manufacturing sectors with their globalizing, world-beating companies.

This is a fundamental misdiagnosis. The vaunted successes in information technology-based services and in manufacturing niches are welcome. But they are a high-wage, capital- or skill-intensive drop in India's low-wage, unskilled, labor-abundant ocean. India's growth should be focused in the labor-intensive sectors, but it isn't.

Agriculture is stagnant, hobbled not just by very high external protection but also by crazy subsidies captured by comparatively rich farmers and middlemen, absence of property rights, terrible rural irrigation and infrastructure, and draconian domestic restrictions that fragment the internal market. Nontradable services sectors—where potential employment generation is huge—are also crippled by domestic restrictions. Backbone services sectors (such as banking, insurance and retail) suffer from external protection as well.

Last, and crucially, India's glaring development gap is in manufacturing, for all sorts of Union and state-level policies—on

Mr. Sally is director of the European Centre for International Political Economy in Brussels and on the faculty of the London School of Economics.

labor markets, infrastructure, power generation, subsidies, the public sector, repressed agriculture and services sectors, uncertain property rights, and remaining zones of protection against imports and inward investment—conspire to prevent labor-intensive industrial production. India needs its Industrial Revolution if it is to grow out of poverty. That means putting the impoverished in the countryside into (initially) low-wage work in mass manufacturing. That is what China and other parts of East Asia have done. But not India.

India Hype extends to "Chindia," the notion that India plays in the same league as China as an emerging superpower. This is pure myth. China plays in a league of its own; India, Brazil and Russia play in a far inferior league. China's economy is thrice the size of India's; its goods exports are 10 times bigger; it is even ahead of India in the world services trade; it spends about 10% of GDP on infrastructure compared to about 5% in India; and its carbon emissions—a sure indicator of industrialization—are about four times higher.

Now turn to the Congress-led government. There have been practically no market reforms since it took office in 2004, save for the opening of domestic civil aviation. Nothing has moved on privatization, the reduction of government equity in banks and insurance companies, pensions, competition regulation and the administration of subsidies. Industrial tariffs have come down (as they were doing gradually pre-2004), but otherwise external protection has not been reduced. Indeed, export restrictions were slapped on in response to food inflation in 2008. India remains the most protectionist large emerging market.

Worse, there has been reform backsliding and reversal. Fiscal restraint, put in place by the Fiscal Responsibility and Budget Management Act of 2003, has been thrown to the winds. Now, with an economic downturn, the consolidated government deficit is projected to rise above 10%. This is going to make private capital scarcer and more expensive. Funding for much-needed infrastructure projects will suffer. Administered pricing for petroleum products was reintroduced in 2008. Off-budget expenditure has increased significantly, especially through gimmicky, populist measures to support agriculture and rural employment, and to subsidize the state-owned energy sector when oil prices soared.

The government's response to the present global economic crisis was to introduce further market-distorting restrictions, including higher tariffs, antidumping duties and assorted nontariff barriers to imports. And it is even more resistant to opening up the financial sector to competition. The result will be to entrench the power of inefficient state-owned banks and insurers, and cramp incentives to save and invest in the private sector. Finally, the Congress Party entered the general-election campaign with pledges to expand its hugely wasteful rural employment guarantee program and increase food subsidies.

This is an abysmal record. The government has squandered the boom years, left the country vulnerable to malign global economic conditions, and compromised prospects for a healthy recovery. But Mr. Singh and his "dream team" have been given an easy ride: they have escaped blame, especially in the eyes of the international commentariat. The conventional excuse is that their hands are tied by Sonia Gandhi and her Congress coterie, and by messy coalition politics.

This explanation just does not wash. Mr. Singh has impeccable academic credentials and is by all accounts incorruptible. He deserves credit for his performance as finance minister in the early and mid 1990s—though at least as much credit should go to the then Prime Minister Narasimha Rao, who had to take the tough decisions. But Mr. Singh has proved a hopeless decision maker as prime minister.

He has lacked the political instinct and moral courage to take tough decisions, hiding behind the fig leaf of Mrs. Gandhi and the troublesome left-wing parties that propped up the government. The latter withdrew their support in mid-2008, and the government won a vote of no-confidence, yet—not surprisingly—market reforms did not materialize. Sadly, Mr. Singh proves the rule that academics should generally be "on tap" but not "on top."

The whole reform program depends crucially on the prime minister himself. Mr. Rao and A.B. Vajpayee proved their mettle, despite heavy political constraints. Mr. Singh has failed; he should bear much of the blame. That blame must also be shared with the other sweet-talking, weathervane-members of his dream team. The Congress party does not deserve to be re-elected, and the dream team does not deserve to continue in office.

The question is whether an alternative Bharatiya Janata Party-led government would do any better. Yes, if it has a decisive leader with a core of able reformers. No, if its leader follows the dictates of short-term opportunism and inevitably messy coalition politics. The danger is that the election will create an even more fractured political landscape, with an even weaker, more unwieldy governing coalition. The nightmare scenario is of a new Union government held hostage by surging caste-based parties in north India and their corrupt leaders. That would scotch further major market reforms and deepen India's institutional malaise.

Hence the failure of the Congress-led government should be put into a larger institutional context. The Indian state, led by a neanderthal and venal political-bureaucratic elite, remains unreformed. It comprises a bloated, corrupt, tyrannical and grossly incompetent army of 20 million bureaucrats and their minions. It works for the benefit of the well-off with political connections, but it is still a crushing burden on the one billion-plus Indians outside the charmed circle of the upper and upper-middle classes.

India optimists aver that "stealth reforms" have and will continue to take place outside the state, crowding it in and reducing its ability to do harm. This view is dangerously complacent. To begin with, state institutions—the political class, political parties, parliaments, the bureaucracy, the judiciary –have gotten worse at both Union and state levels.

Arun Shourie, the leading market reformer in the last BJP-led government and one of India's leading intellectuals, argues that modern India has two races going on. One is a backward race of a state "hollowed out by termites"; the other a forward race of market reforms, modernization and globalization. The backward race is led by India's unreconstructed political class. The forward race is led by urban professionals in the private sector. Mr. Shourie says that these two races are fundamentally incompatible. Either the backward race will be arrested by the reconstruction of the state, or it will drag the forward race backward. He notes one silver lining: policies, governance and economic performance have been improving in a minority of Indian states, roughly in an arc from the south to the west. These are the states where the forward race is fastest. They set positive examples for other states to emulate.

India Hype-peddlers neatly sweep the country's institutional rot under the carpet. However, India cannot be expected to grow and prosper far and fast, not just now but for decades ahead, with such shaky foundations. The upshot is that much-needed market reforms cannot continue to skirt around the reform of the state itself. Politically, that is the hardest nut to crack.