

Politics is preventing India from fulfilling its vast economic potential



INDIA is a land of large numbers: a place of over a billion people, a million mutinies and a thousand different tongues. But it is not too much of a stretch to say that since independence in 1947 there have only been two kinds of Indian economy.

The first produced slothful growth, mind-bending red tape and suffocating bureaucracy. The second revved up gradually after liberalisation in the 1990s, so that by the mid-2000s India was a land of surging optimism—open and full of entrepreneurs who overcame a retreating but still cranky public sector. The country seemed destined to enjoy a long spurt of turbocharged growth, thanks to its favourable demography, fired-up firms, gradual reforms and willingness to save and invest.

But lately, like a Bollywood villain who just refuses to die, the old India has made a terrifying reappearance (see pages 27-30). The main reason is the country's desperate politics.

Back to the rickshaw rate of growth

India's acceleration in trend growth, from an average of about 6% in the late 1980s to as much as 10% (and, some hoped, beyond), may sound modest. But extrapolated over several decades it promised to transform the country and Asia. Hundreds of millions of Indians would escape poverty faster. Firms the world over licked their chops at the prospect of a vast new middle class. Strategists in the Pentagon began to see India as a superpower-in-waiting and a democratic counterweight to China.

No one doubts that India's economy will keep getting bigger. But the angle of its economic trajectory has dropped. Growth slowed to 6.1% in the past quarter. Even if, as the government hopes, it bounces back, plenty of people worry that trend growth is now unlikely to be much above 7%.

Three recent episodes illustrate the muddle at the top. First, the government announced that it was at last opening its inefficient retail industry to foreign firms—only to change its mind within days. This month, to protect industry at home, it banned the export of cotton, upsetting India's farmers and trading partners; within days, it backtracked. And last week the government moved to overrule the Supreme Court and change the tax code to tax foreign takeovers retroactively, not least Vodafone's purchase of its Indian arm. Some worry that the rule of law, one of India's great strengths, is being eroded.

No wonder business is in a sulk and investment is falling. Red tape and corruption, always present, seem to have got worse—in recent state elections so many banknotes were doled out that they help explain a liquidity problem in the banking system. Longstanding bottlenecks have not been tackled. Partly as a result, inflation is high and stubborn.

Every one of these problems involves the state, still huge and crazy after all these years. Few ever thought it could be reformed easily. But the hope was that a wily private sector would allow India to sprint to prosperity regardless. That view now looks romantic. It is not just a matter of a lack of the public services, from roads to power, that any economy needs, par-

ticularly if manufacturing is to thrive—as it must in India if the millions entering the workforce every year are to find jobs. Lately the state has found other ways to muck things up.

Its borrowing binge in the past few years (India's overall fiscal deficit is approaching a tenth of GDP) has crowded out the private sector and made it hard for the central bank to cut interest rates. New industries that had largely escaped the bureaucracy, such as mobile telecoms, now feel its clammy grip.

This dispiriting scene is in turn mainly caused by two political problems. The gradual fragmenting of voters' allegiances has made India's parliamentary arithmetic excruciatingly tight. The Congress party, which has ruled the country since 2004, depends on fickle and populist coalition partners. Congress itself is in a mess. The elderly ministers who run the country serve at the behest of Sonia Gandhi, the hereditary chief; an attempt to promote her son Rahul as the next dynast has gone badly. The government has not passed a big reform for years and seems preoccupied by holding a ragged coalition together until national elections in 2014.

The second kind of political problem has to do with limited ambition. The recent budget saw tweaks to tax rates, debt quotas and duties, all implausibly heralded as big steps. Struggling to pass reforms such as a new nationwide goods and services tax, and unwilling to tackle state monopolies and vested interests in industries like energy, even reforming politicians now settle for yanking a few rusty levers of the bureaucratic machine. Administrative improvisation is being taken as a substitute for genuine reforms that open up the economy.

India's politicians point out that growth of 6% or 7% is far faster than most other countries. But that is complacent. Just as China is said to need 8% growth in order to maintain social stability, India probably needs to grow at 6% or more to maintain financial stability. Lower growth than that would make the public debt harder to bear and scare off the foreign capital that India needs to fund its current-account deficit and pay for its imported energy. And whereas for a rich country, failing to fulfil its potential is a disappointment, for India, so full of poor people and so badly in need of jobs, it is a tragedy.

Out with the old

Eventually, fragmenting politics may become a source of hope. Some states are still forging ahead. And although local elections this year featured the usual graft and hereditary candidates, some voters discarded the old politics of grievance, caste and religion, chucked out useless politicians and voted in more promising ones. Yet at the national level it may take years for a new generation of politicians to break through today's crowd of gerontocrats. The main opposition party, the BJP, is scarcely in better shape than Congress.

For now, then, it is up to the existing lot to get India back on track. One motivation should be fear. A slower-growing India will be more financially vulnerable, poorer, full of frustrated young people and taken less seriously by the rest of the world. India's political class will not enjoy the consequences. India is a place that has fallen out of love with reform. It needs to get the magic back. •