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India: Direction uncertain

By James Lamont

Concern is mounting that the world's largest democracy is reverting to the sluggishness last seen under the 'licence Raj'

Facing both ways: Manmohan Singh and Sonia Gandhi last December. The prime minister has had his reform plans hobbled by the more leftist instincts of the Congress party chief

As India's central bankers in Mumbai prepare this week to lower borrowing costs for the first time since 2008, they are praying for at least a glimmer of economic reform in New Delhi in return.

Senior officials at the Reserve Bank of India want parliament's current budget session to pass higher energy costs on to consumers in order to pare down a subsidies bill estimated by the Paris-based OECD to be as much as 9 per cent of gross domestic product. Even the most meagre fiscal consolidation, they say, would give reason for optimism that the left-leaning Congress party-led government, with two years still to run until parliamentary elections, has some will remaining to put the economy on a high-growth trajectory to rival China.

However, many critics claim that in the world's largest democracy the clock is in fact turning back to a statist model reminiscent of that seen in the 1970s. Forty years ago, an inward-looking economy tangled up in red tape was stuck with the sluggish "Hindu rate of growth" of about 4 per cent. A reversal would diminish the clout of a nation regarded by western and regional partners as a counterbalance to the growing power of Beijing.

Taking tough decisions is not a hallmark of the administration led by the 79-year-old prime minister, Manmohan Singh. The country badly needs the fiscal austerity of a George Osborne, the UK chancellor of the exchequer, quips one senior central banker, while the UK needs a big spender like Pranab Mukherjee, India's veteran finance minister.

Dimming investor confidence contrasts sharply with the euphoria that greeted the election of Mr Singh for a second term in 2009. The rejoicing was so enthusiastic that the Bombay Stock Exchange's circuit breakers were triggered to keep share prices from rising too quickly. The prevailing belief was that Mr Singh, a former finance minister and central bank governor, would enact the changes needed to propel the economy to double-digit growth. Tax reforms, lower caps on foreign investment and deepening financial markets were just some of the ways to do it.

Mr Singh's reputation had been made by pushing through the 1991 financial reforms that transformed a shuttered economy and brushed aside the "licence Raj" of restrictive business regulations. These have helped per capita income to double in the past 20 years and unfettered industries including pharmaceuticals, outsourcing and telecoms to become world-beaters. Having presided over a five-year period of unprecedented growth of 9 per cent, his party won a clear mandate in 2009. India was feted as a rising power.

Yet political analysts overlooked the more leftist instincts of Sonia Gandhi, president of the Congress party and widow of slain former prime minister Rajiv. She models her own economic outlook on that of former prime minister Indira, her autocratic mother-in-law. They also underestimated how little authority Mr Singh would have as part of a diarchy with Mrs Gandhi. Few then imagined he would preside over a rapid fall in growth to 6.1 per cent in two and a half years, a slew of corruption scandals and embarrassing policy reversals.

India's captains of industry are now dispirited. They have been steadily lowering their expectations at home and looking for options to invest overseas. Even the long-in-the-works tax reform championed by the likes of Adi Godrej, chairman of Indian consumer goods group Godrej – to standardise multifarious goods and services levies around the country – is today in the realm of outlandish ambition.

Many senior commentators say they misjudged Mr Singh and what he could do. Bangalore-based historian Ramachandra Guha says there has been "a sharp disconnect" between outside perceptions of the prime minister and his popularity at home.

Shankar Acharya of the Indian Council for Research on International Economic Relations warns that the country could be stuck with relatively disappointing annual rises in real GDP for the next five years and is losing touch with its higher growth trajectory. "Look at us now," he says. "Economic growth has fallen to below 7 per cent. Industrial growth has collapsed. The aggregate investment rate has dropped to 34 per cent of GDP and is headed south, with many large projects stymied ... The fiscal deficit and subsidies are, frankly, out of control."

A subdued Mr Singh and his ministers blame the "compulsions of coalition politics" and stubborn allies in the regions for policy inactivity. They say the eurozone crisis has held back growth: the rise in exports, heavily dependent on sales to Europe, slowed to 19.5 per cent for the year to March, down from 37.6 per cent in 2010-11.

This reasoning does not wash with critics who detect a chaotic retreat from reform economics by the champions of 1991. They admit they were blinded by Mr Singh's reputation as a reformer and the miracle of Indian growth. "We should have all seen it coming. There was every signal that this political formulation was incapable – and even unwilling to pursue any more reform," reflects Shekhar Gupta, editor of The Indian Express, an English-language daily. "In nearly eight years so far, the [Congress-led government] has completely changed the reformist mood to a dark, negative povertarian discourse of the 1970s."

For example, reforms such as liberalisation of the small-scale and notoriously protected retail sector were launched last year only to be withdrawn in response to political outcry from allies within Mr Singh's own coalition. Simultaneously the government has relied increasingly heavily on big welfare programmes to address the needs of the rural poor in order to win over voters in a nation where most people live in the countryside.

This year, after an effort to claw back investor confidence and halt slides in the rupee and benchmark stock indices, matters have taken a turn for the worse. The finance ministry has picked a bruising fight with the UK's Vodafone, India's largest foreign investor, over a disputed capital gains tax bill. In the March budget were notes introducing a retrospective tax designed in part to elicit $2.9bn from Vodafone, following a supreme court ruling in the telecoms group's favour.

Investor dismay about this saga, the harm done to the country's profile and the constitutional ramifications have made the finance ministry queasy. Local analysts say the department has given the revenue services discretionary powers that it could come to regret. One foreign investor, who asked not to be named, says the unpredictability introduced into the tax regime puts India on a par with the Democratic Republic of Congo.

At the same time, anti-reformists took the scalp of one of the most competent railway ministers India has had for some time. Dinesh Trivedi was forced to resign in March after raising cross-subsidised passenger fares for the first time in a decade, being denounced by his own party for passing an "anti-poor" budget. Indian Railways is the world's largest employer, a totemic institution that has its own budget presented in parliament days before the federal one.

Another alarming sign of a breakdown in governance is strain between the upper levels of the government and a million-plus army that – uniquely among south Asian nations – has kept its generals in check since independence from Britain in 1947. A bitter row between the defence ministry and the army chief over his retirement date and reports of unauthorised troop movements close to the capital in January suggest the breakdown may be more profound than many imagine.

Pratap Bhanu Mehta, the head of the Centre for Policy Research, a Delhi think-tank, is scathing about the sclerotic political leadership. His comments are particularly biting because he was once a mentor of Rahul Gandhi, the 41-year-old scion of the Nehru-Gandhi dynasty, who Mrs Gandhi is trying to install as a future leader. This month, Mr Mehta published an open letter to Mrs Gandhi berating her for emasculating the prime minister's office and presiding over a rotting party with sycophantic medieval instincts.

"One cannot remember a time in the last decade, when there was so much arbitrariness and uncertainty ... Economic policies are exhibiting a degree of ... whimsicality unprecedented since the 1970s. Indian investors are voting with their feet," he wrote. "The reforms unleashed in the early 1990s deserve credit for these [economic] changes. But now the Congress is throttling the dynamism of Indian society. It is putting India's growth story ... at risk."

He and others, including Delhi-based economist Surjit Bhalla, worry that the leadership is out of step with the youthful, entrepreneurial population. "The government is behaving as if it has not recognised that India has changed," says Mr Bhalla.

Others are more sanguine, preferring to take a longer-term view. Jean Drèze, an economist formerly on Mrs Gandhi's National Advisory Committee, an influential party policy-making body, says it will be hard to divert India from a 30-year "runaway growth" path. "You must not get mesmerised by short-term constraints," he says. "Even with the slowdown we are still growing pretty fast."

Nonetheless, the RBI faces pressure from industrialists to cut benchmark lending rates from about 8.5 per cent to help return growth to 9 per cent. However, the central bank is reluctant to do so while inflation remains stubbornly high at 7 per cent.

Robert Zoellick, the outgoing president of the World Bank who visited the country last month, notes that any student of India will recognise that even 7 per cent growth is a remarkable achievement. He says small gains to create a national market in agriculture or unify the transport network will have a big effect. "It's a nice commentary that we are saying that 7 per cent growth in India is too little," he says. "Since 1991 they've made pretty good progress in this democracy. If I'm an investor in the future, I'm going to think ... India is going to be a serious growth story for years to come. Mr Zoellick warns, however, that under future coalitions decision-making will grow harder.

This prospect, after a heavy electoral defeat for Congress last month in Uttar Pradesh, India's most populous state, is what preoccupies many in the ruling party. Ashwani Kumar, minister of state for parliamentary affairs and planning, says "every day in India" is approached in the spirit of an electoral contest. The nation's politicians play for votes rather than uphold a long-term vision. "In this conflict-driven politics, winning elections becomes both a compulsion and an obsession whereby the future is often sacrificed to the present," he warns. "We do not have solutions to every difficulty and instead have a difficulty in every solution."

That can be taken as shorthand for: the halcyon days are over.

The opposition: Leaders who shine outside the national limelight

When Time put Narendra Modi, the chief minister of Gujarat state, on the front cover of its Asia edition last month, the US news magazine ignited debate in India about the premiership after general elections in 2014. The headline read: “Modi means business”.

The economic performance of Mr Modi’s state, particularly in infrastructure, has attracted public endorsements by local industrialists and increasing attention internationally.

Mr Modi, a Bharatiya Janata party leader firmly on the Hindu right – and blighted by the anti-Muslim riots that took place on his watch in 2002 – has regularly beaten Rahul Gandhi, the scion of the Nehru-Gandhi dynasty, in opinion polls on who should be the next prime minister.

In one recent poll, published by India Today, a local weekly, 24 per cent of those surveyed said Mr Modi should be the next occupant of New Delhi’s 7 Racecourse Road; Mr Gandhi trailed with 17 per cent.

Another opposition contender for the national leadership is Nitish Kumar, the chief minister of Bihar and leader of the Janata Dal United party. This month he met George Osborne in Delhi as the UK chancellor of the exchequer tried to gain a feel for what might come after Manmohan Singh’s time in office.

Mr Kumar’s appeal lies in the stability and economic turnround he has brought to what has long been India’s poorest state. A former railway minister, he has taken steps to unify a caste-ridden state by taking a decisively secular stance and won over Muslim voters.

“Narendra Modi and Nitish Kumar are held up as models of administrative competence,” says Nick Paulson-Ellis, country head of Espirito Santo, a Mumbai-based investment bank. But he cautions that running a state government and managing a rainbow coalition in New Delhi are two very different propositions at a time when India is becoming a more complex country to govern.

In spite of government missteps over the past three years, the BJP-led opposition coalition has failed to capitalise on that weakness and the lack of an alternative to Mr Singh.

But one of the BJP’s own biggest problems is clear leadership. The 84-year-old L.K. Advani is still centre stage alongside parliamentary leaders Sushma Swaraj and Arun Jaitley. Few consider Nitin Gadkari, the party president, as the man to take the party into a national election.

Yet Mr Modi has largely stayed in the wings, keeping to Gujarat and avoiding national debate. Mr Kumar is meanwhile seen as a likely candidate only if all the BJP leaders cannot agree on their own nominee.