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India's Changing Priorities

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Abstract

The paper examines India's latest budget and official economic pronouncements to identify the government's recognition of the strengths and weaknesses of the Indian economy and the resolve to address these issues. It argues that this pragmatism is driven by the realisation that India's significance might be diminishing in some critical segments of the global arena.

Introduction

Analysts and media commentators are just starting to unravel certain fundamental features of the latest Indian budget presented in Parliament on 26 February 2010. The initial comments were about the reliability of the numbers, whether there was too little or enough on reforms, and whether the growth versus inflation balance had been maintained.

As analysts are discovering,[2] there are several distinct features to this document. At one level, it is clear that India has weathered the crisis rather better than several of the European and even Latin American countries, and that a steady growth in the range of 7.0 per cent to 9.0 per cent is almost a given for the next few years. It is also clear this would be driven largely by domestic demand and not necessarily by exports and trade. There is considerable pent up demand in the country that has enabled industrial production to grow at over 8.0 per cent (year-on-year) and the services sector, including information technology and telecommunications, continues its robust growth. The flagship National Rural Employment Guarantee Programme (NREGP), initially criticised as a waste of public funds, is working rather well, with citizen oversight committees ensuring that 'leakages' are minimised. The huge demand for work under this programme demonstrates the high levels of rural poverty and the safety net in terms of livelihood that this programme has been able to provide. The money available through these programmes, as well as the higher minimum support price for

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[2] See, for example, Martin Wolf's analyses in *Financial Times* on 3 and 4 March 2010 respectively.

agriculture, has generated sufficient liquidity in the rural and semi-urban areas to ensure that consumption demand is robust.

Yet it is not all good news, a fact that the government's statements in recent weeks have recognised. The large public outlays on subsidies and welfare programmes are straining public finances. For the first time ever, the government came out with a statement that its responsibility was for providing an enabling environment for growth with a primary concern for the welfare of the people. The budget allocated 37.0 per cent of all plan outlays for the social sector. As a statement of political philosophy, it is unique, for the Congress Party has been long considered to be left of centre, and prone to supporting nationalised industries and financial institutions as the vehicle for growth. The Finance Minister confirmed in a television interview on 26 February 2010[3] that he and his party felt that the development responsibilities should increasingly be shouldered by the private sector and that he felt that India had reached a level of development where the private sector could be entrusted to shoulder these responsibilities. The budget announced that foreign direct investment (FDI) rules would be made easier; that there would be more licenses for private sector banks and also that the long overdue changes to permit FDI in retail would be pushed through. The priority for the Delhi-Mumbai Industrial Corridor was announced as well the fast freight corridor between Mumbai, Delhi and Kolkata. In subsequent interviews, the Finance Minister clarified that he expected substantial investments in infrastructure to happen through Public Private Partnerships.

Critics have been quick to argue that this is less a change of policy than making a virtue of necessity. On the one hand, the high levels of poverty dictate that there should be emphasis on social sector programmes which ensure livelihoods for the poor, leaving little money in the public exchequer to pay for growth, the responsibility for which is, therefore, passed on to the private sector. Of course, the constraint would be capital, for the equity as well as the bond markets may not be in a position to absorb the huge demands likely to made by public borrowings as well as capital formation requirements - a constraint that is recognised by the government as it announces more banks, a better financial architecture, and easing of FDI norms. The trick is to convince external investors in infrastructure projects that long-term risks are worth taking and would yield adequate rewards - again a problem of state-level contractual obligations that the Prime Minister and Finance Minister recognise as a constraint.

A second constraint is that of capacity. India is a supply constrained economy and private capital investment has always lagged behind demand growth: a policy of scarcity has often resulted in supernormal profits for the producers. These supply constraints are spilling over to several sectors now. There is nearly 50,000 MW of power plants under construction but the core equipment manufacturers of turbines, boilers and electrical machinery have long order books on hand that is likely to delay all the projects. This is true of capital engineering goods as well as machinery and equipment. A recent tender by the National Thermal Power Corporation for seven super critical boilers-cum-generation equipment did not give rise to an adequate response as suppliers are already full up with orders. Capacity constraints are likely to slow down growth, again a fact that the Prime Minister's Economic Advisory Council has recognised.

[3] TV interview with NDTV, 27 February 2010

Third, and most important, are the inflationary pressures in the economy. The drought of last year affected agricultural production; the government is also claiming that its fiscal expansion measures have led to greater food grains consumption among the poor. It is certainly true that prices of food articles have increased during the last one year substantially, straining middle class budgets. Though the government claims that food prices would be back to normal once the winter crop is harvested, it is more likely that India is going to witness an era of high food prices. Per capita availability of food grains is stagnant and increasing urbanisation is putting a pressure on agricultural production. As the economy grows, there is likelihood of pressures on commodity prices as well, including coal, gas and metals, and this would work its way into the prices of goods and services. The government has as yet no answer for this and the initiatives in agriculture are too small and too little.

An important development in the past few months has been the recognition by the government of the strengths and weaknesses of the economy, and the stated resolve to do something about it. Fiscal deficit is being addressed through expenditure contraction rather than taxation to ensure that growth parameters are not disturbed; there is a realisation that poor governance is at the root of most of the bottlenecks and also that management of the domestic economy requires a balance between social sector expenditures and investment. There is a promise to focus more on education, health and infrastructure, and most important, on delivery. In the past, of course, promises have always been more than actual realisation but it is perhaps the first time that a ruling government has laid bare its strengths and weaknesses in the public domain.

At the bottom of all this soul searching is perhaps the growing realisation that in the global arena, India is possibly losing its role. The London Conference on Afghanistan in January 2010 clearly marginalised the role of India, and as the United States (US) military increases its alliances with the Pakistan military against the Taliban (now called 'insurgents' rather than 'terrorists' by the US), India is disadvantaged in the dialogue. The increasing frequency of the US-China consultations on economic as well as political issues indicates that India is not a great player in these strategic initiatives and that the euphoria of 2007 is not relevant any more. The opposition has accused the Prime Minister of acquiescing to the US wishes, an argument that has been put forth by other commentators as well. In climate change negotiations or in trade discussions, India is not leading from the front but it is just an important member of a group. There is little that India can contribute to the debate on international financial regulation or on the long term stability of markets, institutions and instruments, a fact that the large Indian contingent realised during the recent Davos discussions. Foreign policy strategists are quickly looking for alternatives, and the focus on Russia, Saudi Arabia and Southeast Asia are attempts to retain foreign policy relevance in a fast changing world. There is also concern that internal security and external terrorist threats are real and need to be dealt with expeditiously and effectively, and perhaps these need new strategies and ideas. The important impression from New Delhi is that the government and policy makers are clearly aware of these developments and have taken these into consideration during their statements and actions. The decision to focus on stable growth, getting the economy in order, correct imbalances, and create an environment for the economy to grow and provide for an opportunity for all citizens, not only makes good economic sense at this time but it is also an excellent political strategy for a government that is likely to be burdened with a third term in office in 2014.

The interesting part of the story is that these shifts in emphasis and in thinking appear to have happened imperceptibly over the last few months. Soon after the elections in May 2009, the government was captive to huge public expectations about reforms and delivery - the hundred-day agenda with which they started was quietly buried. In its stead has come a very pragmatic, carefully considered strategy that focuses more on the internal dynamics and recognises the limitations of its foreign policy initiatives. It remains to be seen whether this pragmatic thinking can be converted into effective action.

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