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Do the Bold Reforms Signal End of Policy Paralysis in India?

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Five major economic policies within 24 hours are not expected from a government saddled with charges of indecision, inaction and corruption for several months. But this is exactly what the UPA (United Progressive Alliance) Government in India has done.

The last week ended with the UPA Government announcing a slew of economic reform measures. Not surprisingly, the stock market reacted with glee with the benchmark stock indices –Sensex and Nifty - surging by more than three percentage points within two trading sessions. The Indian industry, tired of pleading with the government for faster action, finally got a cause to cheer. And the global business community, which had practically given up on India, also endorsed the moves, with the US India Business Council (USIBC) declaring enthusiastically the bold reforms would cheer up investors from all over the world eyeing India[2].

The first decision signalling the government's intent to move ahead was correcting retail prices of domestic petroleum products. Slashing subsidies on diesel and LPG (liquefied petroleum gas) is expected to improve the rather dismal fiscal situation, at least partially, in the short run. At a time when the economy is experiencing a deceleration and corporate and

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[2] 'Big Bang Reforms, Says America Inc', www.financialexpress.com/news/big-bang-reforms-says-america-inc/1002985/0 (Accessed on 15 September 2012).

excise collections are anticipated to be low due to subdued economic activity, fiscal disciplining must be ensured through expenditure management. Cutting petroleum subsidies was therefore a step in the right direction. The expected howls of protest from the public, opposition and the coalition allies were reverberating across the country when the Cabinet announced a series of other radical measures. The first of these was the much discussed and debated step to allow majority foreign equity in domestic multi-brand retail operations. At the same time, the restriction on single-brand foreign retailers to procure at least 30 per cent of their requirements from domestic small and medium enterprises was amended. The decisions in retail were followed by the decisions to increase permissible ceiling of foreign equity in domestic aviation services to 49 per cent, allow similar foreign equity levels in power trading exchanges and permit four major state-owned enterprises to sell their shares[3].

None of the decisions are politically popular moves. Indeed, they can create considerable damage to the UPA Government. Mamata Banerjee – Chief Minister of West Bengal and leader of the Trinamool Congress (TMC) – one of the main allies of the government, has given an ultimatum of 72 hours for rolling back the decisions on petroleum price hike and foreign equity in retail[4]. Another major coalition partner, the DMK (Dravida Munnetra Kazhagam) has also demanded rollback. The Samajwadi Party (SP), a third ally and potential long-term partner of the Congress, has expressed its unhappiness in no uncertain terms.

All these adverse reactions were expected. And this is where the government's announcements have taken most by surprise. Why did the UPA Government do what it has done despite being fully aware of the repercussions?

Several factors could have precipitated the decisions. The first is the poor economic outlook. Two successive quarterly GDP growth rates of 5.3 per cent and 5.5 per cent confirm the prolongation of a slowdown in the economy. An almost flat growth of 0.1 per cent in industrial output for July 2012 highlights the stagnation in manufacturing and infrastructure. As the only economy in the BRICS (Brazil, Russia, India, China, South Africa) group of emerging market economies facing the possibility of a major downgrade in credit rating, the cost of inaction was becoming increasingly onerous for India. It was evident that without a 'big push' economic revival over the next few quarters would not be possible. The low growth rate is a reasonably good excuse for the government to take tough measures. This would be one of the main grounds on which the government would try to placate coalition partners.

The second factor which could have provoked the government into action is the almost complete erosion of the goodwill that it enjoyed. The recent 'Coalgate' scandal over the allocation of mining rights of coal fields and the shadow that it has cast on the Prime Minister

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[3] The four enterprises are Hindustan Copper Ltd (HCL), National Aluminium Co. (NALCO), Mines and Minerals Trading Corporation (MMTC) and Oil India Ltd (OIL).

[4] 'Mamata Banerjee sets 72 hour deadline to withdraw decision on FDI, diesel price hike', www.ndtv.com/article/india/mamata-banerjee-sets-72-hour-deadline-to-withdraw-fdi-diesel-hike-267557 (Accessed on 15 September 2012).

himself was probably the proverbial last straw on the camel's back for the beleaguered government. The despair and helplessness with the state of affairs even among the senior ministers was reflected in the recent candid admission of 'policy paralysis' by Praful Patel, the Minister for Heavy Industries[5].

Realising that an economic turnaround can deflect attention from the scandals and scams surfacing almost every day and salvage some precious goodwill, the government appears to have decided to act. With about a year and a half to go for the next general elections, the urgency of ending policy paralysis by taking firm decisions might have finally dawned on the government. Corruption will continue to dominate public and political discussions as the elections draw near and there is little possibility of the government erasing its taints completely. But a robust economic story can bring down the overall public discontent with governance and give the UPA the opportunity of building a positive electoral agenda over the next year.

The government has also displayed greater political maturity in handling a sensitive policy matter like foreign investment in retail. The minimum investment cap for proposals involving 51 per cent foreign equity in multi-brand retail has been pegged at US$100 million with 50 per cent of the investment to be in back-end processes and procurement systems in rural areas. The policy is meant to attract large investors with 'deep pockets' who can not only invest at least US$100 million, but also have the expertise of building back-ends of the supply chains. By introducing the slant towards rural procurement and back-end processes, the government can take credit for moving on the right track for removing intermediaries and tackling supply-side inflation. In this sense, the policy has considerable political virtue, which, the Congress would wish to capitalise. The even greater political maturity, however, is in leaving the eventual decision of inviting foreign multi-brand retailers to individual state governments within the purviews of their shops and establishment regulations. With eight states and two union territories willing to invite foreign retailers[6], the UPA Government can claim a fair bit of support for the move and can hope to politically isolate opposition on the issue.

The attention would now be on Mamata Banerjee and her next steps. Having been steadfast in her opposition to foreign investment in retail and increase in petroleum product prices, it will be difficult for her to do a volte face. She will need to take a step that marks her unhappiness with the decisions and yet is not politically suicidal. Given that popular discontent against her is gathering momentum in her own state at least within the urban electorate, she might need to think hard before taking the extreme step of withdrawing support to the ruling government and creating political chaos.

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5 'Govt suffers from policy paralysis', http://indiatoday.intoday.in/story/govt-suffers-from-policy-paralysis-praful-patel/1/217301.htm (Accessed on 15 February, 2012).

6 'Reforms get a major push, Cabinet opens up multi-brand FDI for retail', www.samachar.com/Reforms-get-a-major-push-Cabinet-opens-up-multibrand-retail-for-FDI-mjpeTRbfhad.html (Accessed on 15 September 2012).

Though the UPA Government has finally taken the tough economic decisions, the next few days will show whether it has enough courage to sustain the decisions. On more than one occasion during the last two years, the government has taken decisions only to withdraw them under pressure from allies. If something similar happens this time too, then not only will the government be stripped off whatever credibility it has, but policy paralysis will be there to stay for the foreseeable future.

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