

SHIVA'S INDIA

MEMO FROM
MUMBAI AND DELHI,
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BRIEFING

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Contents

| | |
|--|---|
| Shiva the destroyer? | 1 |
| Shiva the benefactor? | 4 |
| Nilakantha: Attitudes towards globalisation | 5 |
| India and the UK..... | 6 |
| Annex: Individuals and organisations consulted | 8 |

An IPPR delegation led by Lord Mandelson visited Mumbai and Delhi, 16–22 November 2011. Will Straw, IPPR associate director for globalisation and climate change, reports on the experiences and findings of the visit.

Resembling the Hindu deity Shiva, India's economy is currently in a state of great ambiguity and paradox.

Until recently, double-digit growth had been the implicit goal of policymakers. In February, Citigroup projected that India would overtake China by 2050 to become the world's largest economy.¹ Since then, the gloss has come off, with one government source telling us that 2011 was India's 'annus horribilis'.

From 8.8 per cent in the first quarter of 2010, growth has slipped back to 5.6 per cent in the third quarter of 2011, according to Goldman Sachs. It is inflation, not growth, that is now in double figures, and the Reserve Bank of India has tightened monetary policy, with 14 successive rate rises bringing the benchmark interest rate to 7.5 per cent.

Although household and bank balance sheets are in rude health, there are twin deficits on trade and government spending. India has long suffered a trade deficit but this widened in October to \$19.6 billion – the highest since April 1994, according to Bloomberg – with a slowdown in European demand and higher oil prices largely to blame. Regardless, the deficit is putting pressure on the rupee, which has fallen to an all-time low against the US dollar. The fiscal deficit, although coming down, is likely to breach the country's 4.6 per cent target this year, with Goldman Sachs predicting that it will turn out at 5.8 per cent. Nonetheless, sovereign default is not a significant risk, since India's stock of debt is almost all held domestically and is actually falling as a percentage of GDP due to the high rate of inflation.

Shiva the destroyer?

Against this backdrop, we heard two views of India's prospects. The first, primarily articulated by business leaders and journalists, sees more doom and gloom ahead. The principal problem is the paralysis at the heart of government, which shows no sign of letting up. The corruption scandal, which has dominated Indian politics for the last year, has led to a breakdown in policymaking by central government. Despite, in all likelihood, the next general election still being at least two years away, ministers and senior officials would rather put off decisions than be held responsible. In a recent interview, chief economic advisor Kaushik Basu said 'while we must go after corruption, we have to make sure it does not descend into a witch-hunt'.²

1 Buitter W and Rahbari E (2011) 'Global Growth Generators: Moving beyond 'Emerging Markets' and 'BRIC'', Citi. <http://www.nber.org/~wbuitter/3G.pdf>

2 Bamzai S (2011) 'Capital is going abroad to escape bureaucracy', *India Today*, 12 November 2011. <http://indiatoday.intoday.in/story/kaushik-basu-interview-indian-policy/1/159604.html>

Some insiders even went so far as to blame government structures and processes. We were told that the 2005 Right to Information Act – normally praised for its role increasing transparency in decision-making – was exacerbating the paralysis. Another said that the growing role and influence of regional parties, governing at state level, had begun to frustrate the governing Congress' policy agenda.

A second set of concerns centres on the make-up of India's economy and the potential for a looming jobs crisis. Fifty-seven per cent of India's 450 million workforce are employed in the agricultural sector, yet it contributes just 15 per cent of GDP. The sector is crying out for productivity gains but, as in other parts of the world, this will almost certainly mean job losses. Industry has contributed a fairly static 25 to 28 per cent of GDP for years, but it only provides 13 per cent of jobs. Growth has tended to come in capital-intensive products higher up the value chain. While good for India's overall productivity, this also suggests that new jobs may be in short supply. Indeed, officials at the World Bank told us that the latest data suggests a future characterised by jobless growth, with no sign that labour-intensive manufacturing is taking off. The government has recently published a 'National Manufacturing Policy', laying out an ambition to create 100 million jobs in the next 10 years. But even government insiders conceded that implementation would be a major problem.

Much has been written about India's booming service sector and the economy's apparent leapfrogging of the industrial stage of development. But, once again, concerns were raised about the sector's capacity to create jobs. While contributing 57 per cent of GDP, the sector provides just 30 per cent of the workforce. Information technology, for example, has only created 2.5 million jobs (although it is associated with 10 million ancillary jobs).

Against this backdrop, India's population is rapidly expanding. According to the sceptics, the so-called 'demographic dividend' could actually turn into a demon. Standard Chartered estimate that India will add about 240 million people to its working-age population over the next two decades, as its population expands to 1.5 billion by 2030. This means that the country requires 13 to 15 million new jobs every year to ensure that the dividend is realised.³

Regardless of whether jobs can be found, this population growth will place huge strain on India's energy, water and food security. India is heavily dependent on foreign imports of both oil and coal – at great expense to taxpayers due to government subsidies. We were told that water was likely to become a bigger problem even than energy, while Standard Chartered suggests that India is likely to become an importer of most food items over the next 20 years, leading to an associated fall in food affordability.⁴

Finally, there are concerns that India's development has not kept pace with its growth. There is little doubt that development in India has improved in recent years: projections by the United Nations⁵ show that the number of people in India living below the \$1.25 per day poverty line will fall from 51 per cent in 1990 to 22 per cent by 2015, while a paper from the Brookings Institution⁶ suggests that it may fall to 7 per cent. Progress against a whole series of other targets has been positive.

3 Lyons G et al (2011) 'India in the Super-Cycle', Standard Chartered. <http://www.standardchartered.com/media-centre/press-releases/2011/documents/20112505/India%20Super-Cycle.pdf>

4 ibid

5 United Nations (2011) *The Millennium Development Goals Report 2011*, New York. http://www.un.org/millenniumgoals/11_MDG%20Report_EN.pdf

6 Chandy L and Gertz G (2011) *Poverty in Numbers: The Changing State of Global Poverty from 2005 to 2015*, policy brief 2011-01, Washington: Brookings Institution. http://www.brookings.edu/~media/Files/rc/papers/2011/01_global_poverty_chandy/01_global_poverty_chandy.pdf

Nevertheless, India is falling behind its South Asian neighbours on a range of key development indicators, according to Amartya Sen and Jean Dreze.⁷ Compared to Bangladesh, Bhutan, Nepal, Pakistan and Sri Lanka, India has dropped from third in 1990 to sixth in 2009 on life expectancy, from second to fifth on infant mortality, and from second to fourth on female literacy. Healthcare is seen as a particularly worry, with one economist telling us that there was 'no credible plan' to deal with the issue.

The stated goal of the Indian government is to provide 'inclusive growth', yet it appears that inequality is on the rise. India now has the world's third-greatest concentration of billionaires, with 69 individuals holding wealth equivalent to approximately 25 per cent of Indian GDP. That said, on a statistical basis there is something of a dispute. While India's reported Gini coefficient is below that of the US and China, UC Berkeley economist Pranab Bardhan suggests that when collected on an income – rather than consumption – basis, it rises ahead of both countries.⁸ Meanwhile, Surjit Bhalla contests that when adjusted for inter-regional price differences, inequality has broadly stayed constant throughout the 30-year period since 1983.⁹ He did tell us, however, that there had been an uptick in recent years.

Shiva the benefactor?

A more optimistic view of India's future was presented to us by a series of politicians and bankers. Montek Singh Ahluwalia, deputy chair of the powerful Planning Commission, told us that the mood in the country was not as bleak as some would imply. He blamed much of the current malaise on the depressed global economy and explained that although growth

of 9.0 per cent might not be achieved, the 'business as usual' scenario was still an impressive 7.0 to 7.5 per cent. This view was endorsed, incidentally, by all the bank-based economists with whom we spoke.

In any case, a number of reforms are taking place. Subramanian Ramadorai, vice chairman of Tata Consultancy Services and a cabinet-ranking advisor on skills, explained his strategy to us. Revenue from the universal services obligation fund will ensure that 250,000 villages are fitted with 1 megabit broadband over the next two to four years. This new network will then provide a platform across the country for educational services. Meanwhile, the National Skill Development Council is providing new vocational qualifications to boost the skills-base needed to increase manufacturing activity and also examining



Lord Mandelson catches up with his old friend Montek Singh Ahluwalia, deputy chair of the Planning Commission

7 Dreze J and Sen A (2011) 'Putting Growth In Its Place,' Outlook India website, 14 November 2011. <http://www.outlookindia.com/article.aspx?278843>

8 Bardhan P (2009) 'How unequal a country is India?' *Business Standard*, 5 September 2009. <http://www.business-standard.com/india/news/pranab-bardhan-how-unequalcountry-is-india/369106/>

9 Bhalla S (2011) 'Inclusion and Growth in India: Some facts, some conclusions', LSE Asia Research Centre working paper no 39, London: London School of Economics and Political Science. <http://eprints.lse.ac.uk/38366/1/ARCWP39-Bhalla.pdf>



Lord Mandelson meets Kapil Sibal, India's respected minister for human resource development, who was recently tasked with overseeing the country's communications and IT sectors

the role of lifelong learning. Minister for human resource development Kapil Sibal reinforced these points.

Government sources also emphasised the importance of 'frugal innovation', where Indian entrepreneurs develop lower-cost versions of existing products to meet Indians' low-budget constraints by comparison to the developed world. The \$2,000 Tata Nano automobile, \$35 Aakash tablet, and \$69 ChotuKool refrigerator are all examples of products that are being developed on this basis. The hope is that India can become a nation of *product* innovators where other emerging economies, particularly in Asia, have tended to focus on *process* innovation. The gains are potentially huge, since the total market for these cheaper goods in the developing world is far larger than the market for higher-cost goods in the developed world.

In relation to development, the National Rural Employment Guarantee Scheme (NREGS) was identified as a success by a number of people we met. The policy acts as an effective minimum wage by providing a legal guarantee for 100 days of employment in every year to adult members of any rural household. That said, assessing the policy has been tricky, since there have been no effective measurements. Officials at the World Bank suggested that, although there were some examples of the cash not being used properly ('leakages'), it was working best where civil society was energised. Elsewhere, the scheme has been criticised for distorting rural labour markets.

The government was also praised for its approach to urbanisation. The urban population makes up only 30 per cent of India's total population, compared to 46 per cent in China. In order to avoid the 'megacities' phenomenon of countries like China and Brazil (not to mention the UK), India is building another 100 cities to add to the 600 already in existence. Many of these – like the new business centre of Gurgaon – will fall on the Delhi–Mumbai industrial corridor. Officials did, however, criticise governance structures for being poorly designed with regard to urbanisation. Important functions like land reform fall under the jurisdiction of lieutenant governors rather than chief ministers, while both positions sit at the level of the state rather than the city, which makes them unresponsive to urban demands.

Nilakantha: Attitudes towards globalisation

Hindu mythology holds that Shiva had a blue throat (for which he is also known as *Nilakantha*) due to drinking – and surviving – a powerful poison (*Halahala*) concocted from the world's oceans. As well as investigating the state of the Indian economy, we focused many of our conversations on India's attitude towards globalisation. There was a near universal view that remaining open to trade was critical to India's development, with a greater focus on exports needed. There was more concern, however, about

capital account liberalisation, particularly following the global financial crisis and ongoing sovereign debt crises in Europe. India believes that it weathered the global crisis better than many countries in the west in part because of its capital controls.

Following the collapse of the Doha talks, we were told that India was going ‘aggressively’ down the bilateral trade agreement track. Following the signing of new deals with Japan and Malaysia this year, the main focus has been on the ‘ambitious’ free trade agreement currently being negotiated with the European Union. While we were in the country, Indian cabinet approval was reached on foreign direct investment (FDI) in multi-brand retail.

This has been a contentious issue, but will allow global brands like Walmart and Tesco to enter the Indian market. However, requirements to source 30 per cent of produce locally

from small and medium-sized farmers may impact on the desirability of the market and potentially undermine the use of more effective supply chains to bring down food prices. Encouraging noises were also made to us about opening up the legal services and insurance sectors to foreign investors, albeit with no detail about when and how this would be achieved. India’s growing balance of payments problems are focusing minds on the need for more FDI.

That said, at a roundtable organised by the Confederation of Indian Industry in Mumbai, concerns were raised about the administration’s seriousness on trade. One voice said that India was often perceived to be on the wrong side of the debate in multilateral negotiations like Doha. Others warned that domestic policies were necessary to ensure that people ‘down

the line benefited from globalisation’. The failed ‘India shining’ slogan of the Bharatiya Janata Party (BJP) in the 2004 general election was highlighted as an example of how misplaced optimism by elites about the benefits of openness failed to win votes. One speaker said that domestic pressure against globalisation could mean that India would drift into economic isolation. Another participant complained about the current problems getting goods to market in a system that requires 10 days and 36 permits to get goods to Mumbai from Delhi.

India and the UK

There is little doubt that Britain stands to gain from India’s rise. The historic and linguistic ties were repeatedly raised as huge assets for the UK. Although we heard many concerns about the combination of student visa restrictions and high fees, the continued quality of UK universities means that many Indians have enjoyed, or aspire to, a British education.

Two areas where India is actively seeking help are in education services and infrastructure – British firms are already active in both these areas, but we heard further entreaties from Subramaniam Ramadorai and Delhi’s chief minister Sheila Dikshit for greater engagement.



Lord Mandelson and IPPR director Nick Pearce attend a roundtable organised by the Confederation of Indian Industry

The path to wider service sector liberalisation has been more tricky, although government officials reassured us that the question was one of pace and not of commitment. The churn effects of international competition and strong domestic lobbies complicate the politics and require patience on the part of those looking to enter new markets.

Elsewhere, British firms need to do all they can to enter Indian markets, since the country will not wait for the west. While we were in Mumbai, the inaugural Latin America India Investors Forum took place: from a value of \$2.1 billion in 2000, trade and investment between the two regions is expected to rise to \$30 billion by 2012. Exports from India to Europe are down 30 per cent this year, but they grew (from a low base) by 95 per cent to Brazil and 100 per cent to Africa. Indian prime minister Manmohan Singh has been to Brazil twice in the last year to push for Brazilian help with the modernisation of Indian agriculture. Brazil, meanwhile, seeks IT outsourcing from India. Africa is also seen as a potential market for Indian investment and trade.

'India used to be a country high in patience and low on expectation. It is now a country low on patience and high on expectation.'

Deepak Bagla, 3i

Whether such expectations can be met is largely in India's hands. While its democracy is seen by some as a constraint, particularly in comparison to the state-led capitalism of China, in another way it is a great virtue. The lack of patience in a nation where 50 per cent of the population is under 25 years of age puts huge pressure on India's government to facilitate future growth at the upper rather than lower bound. That dialectic, democratic process might also be the key to taking Indian innovation to the next level and surpassing its more powerful but stifling neighbour to the north.

Annex: Individuals and organisations consulted include:

- Deepak Bagla – partner, 3i
- Suman Bery – country director, International Growth Centre
- Surjit Bhalla – managing director, Oxus Research and Investments
- British High Commission
- Confederation of Indian Industry
- Ridham Desai – managing director, Morgan Stanley India
- Sheila Dikshit – chief minister of Delhi
- Federation of Indian Chambers of Commerce and Industry
- Gateway House
- James Fontanella-Khan – Financial Times
- Rahul Khullar – commerce secretary
- Pankaj Pachauri – managing editor, Special Projects, NDTV
- Nick Paulson-Ellis – India country head, Espirito Santo Securities
- Tushar Poddar – Global Economics, Commodities and Strategy Research, Goldman Sachs
- Kapil Sibal – minister of human resources development
- Montek Singh Ahluwalia – deputy chair, Planning Commission
- Parthasarathi Shome – director and chief executive, Indian Council for Research on International Economic Relations
- Subramaniam Ramadorai – vice chair, Tata Consultancy Services
- UK Trade and Investment, India
- World Bank, India