Chinese Dreams

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A government with a definitive mandate is in place. A show of decisiveness is visible: concentration of policy powers in the PMO; quick appointments of key bureaucrats; a call to ministers and senior bureaucrats to draw up 100-day action plans; and much else. But it is not yet clear what would be done to revive growth while reining in inflation. According to the provisional estimates of GDP released recently by the Central Statistical Organisation, growth in 2013-14 was, at 4.7 per cent, not very much higher than the 4.5 per cent of 2012-13. Point-on-point consumer price inflation was at a higher 8.6 per cent in April relative to 8.3 per cent in March.

As compared with this state of affairs, expectations of the new government, ostensibly elected to power to reverse so-called policy-paralysis, the tardy implementation of every announced action and, of course, the corruption that characterised UPA II, are great. These expectations are not just of growth revival. Rather to many it is of a China-type transformation of the Indian economy, taken with 9-10 per cent growth for a couple of decades or more, so that India (like China) can make the transition to middle- and then developed-country status in course of time.

There are alternate versions of this Chinese dream. One is, of course the belief, bolstered by India's brief flirtation with 9 per cent growth during the 2004-08 period, that India is fundamentally a 9 per cent economy, and failure to realise that potential is only the result of politically induced policy paralysis and of corruption. So if the country gets itself a decisive, clear-headed and incorrupt government with an appropriate mandate, then high growth would be an automatic outcome. The Modi-led NDA government is seen as such a regime, the small irritation of a lack of a majority in the Rajya Sabha notwithstanding.

What is the Chinese parallel here? It is the presumed similarity in leadership style between Deng Xiaoping, who led successful "reform-driven" growth in China, and Modi, who it is claimed has won himself the credentials to replicate that story based on his record in Gujarat. There are aspects of both the Deng and Modi story that should be ignored to internalise this dream. We must forget, for example, that the regime that Deng launched with his 1962 quote that "It doesn't matter if a cat is black or white, so long as it catches mice," while immensely successful in growth terms, reeks of corruption that the Chinese government and Communist Party itself admits is a major problem. We must also ignore for now the debate on how much difference Modi and his governments *per se* made to development in Gujarat. These are minor matters. The main point is that a decisive, and possibly authoritarian, leader is what gave China what it has, and will give India its own version of that experience in the years to come.

A typical example of this version of the dream is a speech made by non-resident Indian economist Arvind Subramanian, of the Peterson Institute for International Economics in Washington D.C., in which he reportedly declared that Prime

Minister Narendra Modi could well become the Deng Xiaoping of India. He gave a number reasons for that expectation: Modi represents a decisive break from dynastic rule like Deng Xiaoping represented a break from the madness of Mao Zedong ideology (though the analogy here is not clear); Modi is characterised by decisiveness, pragmatism and the obsession to get things done like the Chinese reformist leader; and both Modi and Deng ostensibly have a long-term horizon for their countries. That is presumably enough to deliver three decades or more of growth at a scorching pace.

Subramanian's is not an isolated instance of speculation that Modi would do a China in India. Well before the election results were out, David Pilling of *The Financial Times* (March 19, 2014) argued that Narendra Modi was "a prime ministerial candidate with Chinese characteristics". This was not only because "Mr Modi, whose leadership style brooks little opposition, has a reputation for getting things done," but also because "like Deng Xiaoping, who departed from Communist ideology with his pragmatic entreaty to "let some people get rich first", Mr Modi is more about making the economic pie bigger than slicing it up fairly." So privileging growth over distribution is what is required for China-style success. The only element of doubt was whether Modi would be allowed to do to India what he did in Gujarat, given the fact that India is a large and fractious country, with significant power devolved to the states. Pilling possibly does not believe Modi when the latter says he simultaneously delivered both growth and redistribution in Gujarat.

The problem with these arguments is that they fail to identify the source of the stimulus for this high growth Modi is expected to deliver in India. If we turn to the 2004-08 period, it is clear that growth was substantially the result of a credit financed consumption and automobile boom and credit financed housing and infrastructural investments. Public sector banks, which in the past refrained from large scale lending against poor or no collateral, were among the leaders in the field. Part of the reason why growth has slumped since is that a significant share of those loans has gone or is going bad and non-performing assets in the banking system are rising sharply. This adversely affects the willingness and the capability of the banking system to sustain the credit splurge. So looking to the typical debt-financed, domestic-demand led boom that has come to characterise many developed and emerging markets does not seem an option for the new government, at least till it finds a way of cleaning out the balance sheets of the banks.

What then is to spur the high growth expected in the Modi era? Here too the dream is to chase China. While agreeing that the Modi would push "reforms" in a host of areas, by implementing what the Congress had promised but not fully delivered because of its "policy paralysis", noted *Financial Times* columnist Martin Wolf has this to say: "This would be to the good, but probably not enough to bring about the needed acceleration of growth and jobs generation. Vital further reforms would be in employment regulation, education and infrastructure, with a view to making India a base for labour-intensive manufacturing. With Chinese wages rising, this is a plausible ambition." So for growth to occur, India must use the opportunity that wage competitiveness offers to displace China as a global, low-cost manufacturing hub, by inducing flexibility in labour markets, improving skills and strengthening infrastructure.

This Chinese dream may also fail. There are many factors other than the availability of a cheap labour force that underlay China's manufacturing export success. To start with, China had a much larger industrial base when its manufacturing export surge began. India, despite the promise held out by its industrial status at independence and the thrust of government policy at that time, fell short of most developing countries in terms of the extent of its industrialisation. Further, China's export-led growth was facilitated by huge public sector infrastructural investments. India falls woefully short on this front. The argument is that this is because of stalled projects held back because of unwarranted obstacles in areas such as land acquisition and/or environmental clearances. A decisive Modi-led government is expected to address that, and uncage the Indian export tigers.

But clearances are not the only problem in infrastructure. Finance also is. India under the UPA decided that the deficit on its central budget precluded public investments in infrastructure, and sought instead to kick-start infrastructural investments through the public-private partnership route. Investments were to be financed with private resources or with credit from the financial institutions. While credit went out, returns were inadequate to service that debt, leading to defaults and large scale debt restructuring. As a result the credit pipe soon froze.

So the NDA government is likely to be under pressure to do two things. First, restore the credit flow to finance projects that now get their clearances. This could increase the vulnerability of an already fragile banking system. Second, allow infrastructural projects flexibility in pricing, so that they can cover costs, meet their debt service commitments and earn handsome returns. A consequence would be an acceleration of inflation, especially since many infrastructural services are in the nature of universal intermediates that enter into the costs of production of a large number of commodities. Besides being unacceptable in itself, such inflation would also undermine export competitiveness.

So becoming China is not an easy task. Which is why, implicit in the arguments of advocates of the Chinese dream is the need to reduce welfare expenditures, referred to as populist subsidies (such as on food) and expenditures (such as on a limited employment guarantee scheme). The resources released, it is claimed, can be better used to finance public investment in infrastructure. That would mean that a population hit by slow growth and inflation would be deprived of even the limited welfare support it receives from the state. This could make the pursuit of the Chinese dream by some, a nightmare for the majority.

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