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Modi has one job: Get India's lazy tiger of an economy to roar

Indian finance minister Arun Jaitley will have two tough acts to follow when he stands in a few hours to present India's budget for 2015-16.

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Indian finance minister Arun Jaitley will have two tough acts to follow when he stands in a few hours to present India's budget for 2015-16.

The first: On Feb. 26, railway minister Suresh Prabhu did a rousing, clackety-clack rendition of the railway budget. For the first time in many years, that parallel universe of the Great Indian Railway seemed once again to regain some of its charm. Prabhu, a chartered accountant and mastermind behind electricity reforms

in 2003, outlined a five-year vision to truly turn the railways into the nation's sinews.

The second: On Feb. 27, chief economic adviser Arvind Subramanian followed with an uplifting, and yet realistic, Economic Survey for the year gone by. He broke tradition with a two-volume report, half of which, to paraphrase him, was descriptive of what happened—for the attention-deficit challenged, as he put it, and the other half forward-looking and prescriptive. “India has reached a sweet spot—rare in the history of nations—in which it could finally be launched on a double-digit medium-term growth trajectory,” Subramanian said.

Prabhu, too, broke the mould when he did not announce a single new train, the traditional, populist sop that railway ministers hold out to this or that political constituency. Prabhu, a man who knows his numbers, now leads 1.3 million

employees who run one of the world's largest transportation networks: It carries 23 million passengers every day, totaling more than the world's entire population over the course of a year. Yet, it is sourly under-funded. India has not added too much to the railways it inherited from the British in 1947. The huge bulk of the nation's freight is now transported by road, which means more congestion, pollution and cost inefficiency. Prabhu aims to change all that with help from new sources of funding, and the private sector.

Subramanian had the task of critiquing the nation's economy over the past year, and laying out a roadmap that Jaitley can populate with his own milestones.

Time to pop the champagne?

By now expectations from Jaitley's budget are sky-high. The stock market has shot up, business leaders are cheering all the good news, and only the champagne remains to be opened. Last July, when Jaitley presented a budget for eight months, he was criticised for not being bold enough, and indeed for hewing to some of the previous government's most dubious targets, chiefly that of holding the fiscal deficit at 4.1% of the gross domestic product (GDP).

Since then, of course, prime minister Narendra Modi has been blessed with much good luck. Global oil and commodity prices have plunged, India's inflation has simmered down much faster than its central bank imagined, its current account deficit has narrowed and might even swing into surplus soon, manufacturing is

starting to revive, and suddenly India looks like the only—yes, the only—economy on the planet that might grow smartly in 2015.

But don't get too carried away. Subramanian, who is an expert on China as much as he knows India and has cut his teeth at the respected Peterson International Institute and the International Monetary Fund, said the air is thick with expectations of big-bang reforms, but we need to take a step back. India is not in crisis today, he said, and it is a "frustratingly vibrant" democracy with multiple checks and balances.

In areas where Modi's government holds the levers of power, change should come faster with decisive policy shifts, but in other areas it should continue to plug away, the adviser said, in "persistent, encompassing, creative incrementalism."

Daunting problems

Incremental change is not something that impatient Indians and investors like the sound of. The realities are daunting. Wiping every tear from every eye, to quote Mahatma Gandhi, will take a lot of time. “No nation can become great when the life chances of so many of its citizens are benighted by poor nutrition, limited by poor learning opportunities, and shrivelled by gender discrimination,” the survey says.

A stone's throw away from Subramanian's press conference, Modi made fun of his Congress Party rivals in the Lok Sabha. He would never kill their Mahatma Gandhi National Rural Employment Guarantee Scheme, he said, because he wanted to tom-tom the fact that six decades after Independence, mostly under Congress rule, India's poor could only earn a meagre livelihood by digging ditches.

One way Modi and Jaitley hope to attack both poverty and corruption is by direct transfers of subsidies to the poor through what Subramanian calls the “JAM number trinity”—the Jan Dhan Yojana, or people's wealth plan, under which more than 125 million bank accounts have been opened in the names of India's poorest; then, the Aadhaar or unique identity scheme that will link benefits to unique identity numbers. The M stands for mobiles: The government wants to exploit India's huge tele-density. The corruption is huge and growing: Subramanian cited research to show that only a quarter of subsidised kerosene reaches the poor. Another quarter vanishes, and is likely used to adulterate petrol and diesel.

Create a business-friendly India

What will really get the economy's engines roaring is investment, and this is where Jaitley faces his biggest challenge: To make India more business-friendly, to make its tax regime fair and predictable, and to persuade business to expand, create new capacity, and create new jobs.

The Economic Survey notes that gross capital formation, which hit a peak of 24% six years ago, is now nearly zero. The stock of stalled projects at the end of December 2014 stood at Rs8.8 trillion, or \$149 billion, or 7% of the GDP. That is a shocking figure. Even worse is the fact that 85% of it is private sector projects. This could be because India's businessmen made too many wrong bets when the going seemed good, and the country lacks enlightened bankruptcy laws that can help to restructure failed enterprises.

On the resources side, the 14th Finance Commission, which submitted its report earlier this week, has sharply increased the proportion of central taxes that will be distributed among India's states. In a big boost for fiscal federalism, up to 62% of all taxes collected in the country will now go to the states. The states have done better at managing their money, so this should be a very good thing for the country's finances as a whole.

But more money to the states means less money with the centre, which Modi controls, to fund his dream schemes like the Swacch Bharat (Clean India) campaign. That is where Jaitley will have to perform a balancing act—not raising taxes, but increasing revenue.

A tiger economy in waiting

There is a tide in the affairs of this nation, which, taken at its flood, can lift all Indians towards two nirvanas: The poor will be protected and provided for, and most prices will be liberated to perform their true roles of allocating resources and boosting long-term growth.

Let me rephrase that: Rarely in India's history has its economy stood at such a tantalising crossroads. Six years ago, when the Congress won an emphatic second term in office, it seemed like India couldn't have asked for a better economic team at its helm. But the Manmohan Singh government frittered away several years of breathtaking growth, mainly through disastrous fiscal management and populist profligacy. By 2013, India's economy was on its knees.

Today, with brilliant economists such as Subramanian; Columbia professor Arvind Panagariya, who heads the new planning think-tank NITI Aayog; and Reserve Bank of India governor Raghuram Rajan, Modi and Jaitley really have a chance to make economic history. Here again, Subramanian counsels sobriety. India is a recovering economy, not a surging economy, and not a tiger economy just yet. You can see its stripes. Now you need to hear its roar.

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