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ON A SHORT FUSE

**RACISM ROW**  
BEING AFRICAN IN INDIA

**RUCHIR SHARMA**  
HOW INDIA CAN RISE

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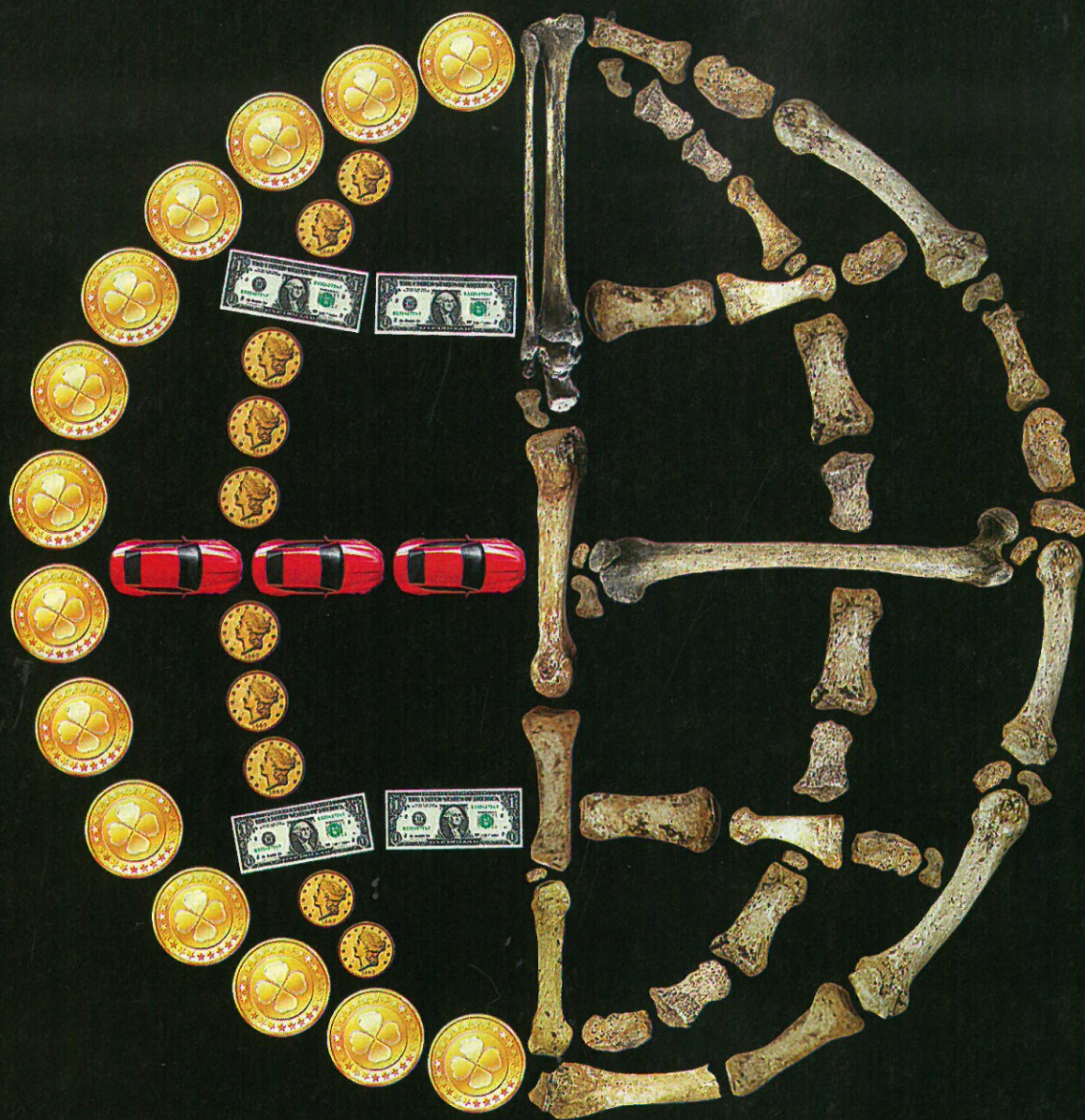
**AKHILESH YADAV**

## DO OR DIE

HOW THE UP CHIEF MINISTER IS  
BATTLING FOR SURVIVAL AGAINST  
STIFF OPPOSITION AHEAD OF THE  
2017 ASSEMBLY ELECTIONS

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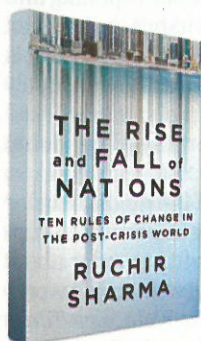


Illustrations by ANIRBAN GHOSH

# WHY SOME NATIONS GROW AND OTHERS DON'T

IN AN ENGAGING NEW BOOK, **RUCHIR SHARMA** ANALYSES  
THE RISE AND FALL OF ECONOMIES IN A GLOBAL WORLD

| By Manish Sabharwal |



**The Rise and Fall of Nations: Ten Rules of Change in the Post-Crisis World**

Ruchir Sharma  
Penguin UK  
Pages 464  
Price Rs 799

The most interesting question of all times is why countries are poor. Within a month of landing for graduate school in the US many years ago I was asking myself, "These Americans aren't smarter than us, why are they richer than us?" But the more important question is what countries can do about poverty. Investment veteran Ruchir Sharma's new book, *The Rise and Fall of Nations: Ten Rules of Change in the Post-Crisis World*, is a wonderful attempt to answer this question by asking 10 questions. This book is important for India because in 2022 we achieve 75 years of independence and milestone anniversaries are a good time to reflect on strategy. More tactically, we have completed two years of an NDA government that was elected to break with the past. This book is well written, interesting and worth

your time. That said, let's use Ruchir's questions to do a long and short review of India's economic destiny:

**PEOPLE MATTER—is that talent pool actually growing?**

Demographics matter. In the long view, the fixed costs of democracy worked out for India because Sanjay Gandhi's Emergency family planning coercion did not lead to a China-like one-child policy. But it does mean that 10 lakh youngsters will join the labour force every month. An embedded point about women's labour force participation only being slightly above Saudi Arabia seems to be a more difficult and mysterious problem. This chapter has interesting stuff about immigration issues in developed countries (Australia is now 30 per cent foreign-born while Japan is 2 per cent) but from India's perspective our diaspora of 30 million is transforming from painful brain drain to delightful brain circulation.

**THE CIRCLE OF LIFE—is the nation ready to back a reformer?**

This point backs the literary view of history (leadership matters) over the social science view (broad and deep forces of history). In the long view, this has already paid off for India; one of the important reasons for the very different destinies of India and Pakistan, born on the same night, was Jawaharlal Nehru. In the short run, the chapter suggests the need for radical civil service reform but many of the worries seem less relevant to a genuine democracy whose politicians are being forced to respond to the 100 million new voters of the last national election and the 100 million new ones in 2019.

**GOOD BILLIONAIRES, BAD BILLIONAIRES—is inequality threatening growth?**

This point is largely about crony capitalism. In the long

view, ours peaked under the licence raj when viewed through market cap but we did see a spike in 2004-14. *The Economist* suggests that Indian crony wealth is down from 18 per cent to 3 per cent of the GDP over the last two years, driven by the commodity price meltdown and corruption crackdown. Ruchir identifies some long-term side-effects of inequality for developed countries but my sense is that India should focus on raising mean household incomes rather than reducing standard deviation. But, as Maya Angelou said, the universe is not made of atoms but stories, and the most toxic impact of bad billionaires is on the narrative of what it takes to be successful.

**PERILS OF THE STATE—is the government spending and meddling too much?**

This question is about the size and role of the state. In the long view, regulatory cholesterol crippled the Indian private sector after Independence, but reforms from 1991 on have been substantial (though incomplete). That said, we don't live in an economy but a society and we need a stronger state that creates public goods and effectively redistributes. The new government's focus on decentralisation, ease of doing business, and subsidy reform could be game changers.

**THE GEOGRAPHIC SWEET SPOT—is the nation making the most of its location?**

This question is probably the one I am most uncertain about. China became the workshop for the world without changing address. And even if it matters, what can India do if we are a good house in a bad neighbourhood? But his point about new cities is important; India has only 50 cities with more



Photograph by MANJARI SHARMA

than a million people (relative to China's 385) and shoving more people into these is killing productivity.

**FACTORIES FIRST—is investment rising or falling as a share of the economy?**

This question is about manufacturing and shamefully only 11 per cent of our labour force works in manufacturing (same as post-industrial US). We don't have the same manufacturing opportunity China did in 1978 because manufacturing has changed, free trade faces protectionist pressures, global growth is muted, and infrastructure is more difficult to build for a democracy. But the Make in India programme is an important policy intervention, indifferent to exports and domestic consumption.

**PRICE OF ONIONS—is inflation high or low?**

This question is about the stable macroeconomic outlook. The last government's obsession with big government converted a high-growth, low-inflation economy into a low-growth, high-inflation economy. But helped by lower oil prices and fiscal discipline, inflation (Ruchir's "cancer that kills growth") for India is heading in the right direction.

**CHEAP IS GOOD—does the country feel cheap or does it feel expensive?**

This is largely about whether the currency is over- or undervalued but this almost always is obvious only in retrospect and short-term capital flows may not be representative. But the important points are not being able to devalue your way to prosperity, watching local capital flows and having a competent chief of an independent central bank.

**KISS OF DEBT—is debt growing faster or slower than the economy?**

This question is about credit bubbles and over-leverage. In the long view, India's calibrated capital account opening and no foreign currency sovereign debt issuance have been prudent. The nationalised bank crony capitalism lending is creating problems but is also forcing action on bankruptcy legislation, reconfiguring state ownership of banks.

**HYPE FACTOR—how is the country portrayed by global opinion-makers?**

This is about the lag and optimism bias of the media. Ruchir suggests this arises from investors focusing on the future while the media focuses on the present, but I wonder about the self-fulfilling upsides of hype. Anyway, we needn't worry since *The Wall Street Journal*, *FT* and *The New York Times* find it hard to find good things to write about India. And the BRIC classification was nutty; India's economic complexity has little in common with commodity-driven economies that married a pregnant bride and took credit for what happened. This book is a wonderful way to travel the world, understand the issues countries should care about. The takeaways for India: a) there is nothing wrong with our brand of not being hot or cold but consistently warm, b) GDP growth may be an imperfect target but it is the best predictor of human development indicator improvement, c) let's act rather than blame the past for our poverty and acknowledge our gifts and wounds. As Ghalib said, "*Dhool chehre pe thi aur umar bhar Ghalib aina saaf karta raha.*" If Ruchir's 10 questions were an exam, India would get a mixed grade for the last 70 years. But after the last two years, there's hope that we'll rise to be among the top of the global class.

*(The writer is chairman, TeamLease Services)*

## EXCERPTS

### THE INDIA STORY

# THE WORLD'S NEW SWEET SPOT

**T**he place to look for the next winners is always among the recent laggards, according to the hype rule. In recent decades, few countries have fallen farther off the global media radar than those in South Asia. The exception is India, which has been flattered by spasms of hype for many years, most recently when Prime Minister Narendra Modi took power in May 2014 and promised major economic reform. However, India's smaller neighbours remained out of the picture. Pakistan, Bangladesh and Sri Lanka made international news, respectively, for issues like terror, sweatshops and old war crimes. These storylines obscure the economic reality, which is that

Bangladesh, Sri Lanka, and Pakistan are contributing to the quiet rise of South Asia.

Together, the nations of South Asia are growing at an average annual pace of close to 6 per cent, very good by the standards of the AC (after the '08 crash) era, even for these low-income countries. Leaders in the region are pushing reform, credit growth is under control, and working-age population growth is strong, particularly in Pakistan and Bangladesh. Unlike most emerging regions, falling commodity prices help South Asia, where all the economies are commodity importers. Low oil prices are keeping inflation rates in check even as economic growth accelerates—the ideal combination. In 2015, South Asia had the highest concentration of accelerating economies in the world.

The whole region is emerging as a geographic sweet spot. Since 2008, many emerging economies have been hurt by rising wages and have seen their share of global exports decline, but Bangladesh, Pakistan and Sri Lanka are benefiting tremendously as manufacturers look for cheaper wages outside of China. Bangladesh is now the second-leading exporter, after China, of readymade clothes to the

United States and Germany.

And as China and Japan manoeuvre for influence in the Indian Ocean, they are investing billions in new ports in these nations, all of which offer prime locations near the major East-West trade routes, an essential element of a geographic sweet spot. After Beijing recently announced plans to build a \$46 billion "economic corridor" connecting ports on the southern coast of Pakistan to western China, Japan beat out China for rights to build Bangladesh's first deep-water port at Matarbari.

Investment in Sri Lanka and Bangladesh is now at or near 30 per cent of GDP, right in the stable zone for promoting strong growth without inflation, and a significant portion of that investment is going into factories. Pakistan has a weaker record for both investment and manufacturing, which represents just 12 per cent of GDP, but the mood has transformed amid signs that the fragile Pakistani state appears to be getting its act together and tamping down extremist violence. Since the 2014 Taliban massacre of more than a hundred schoolchildren in Peshawar, one no longer hears ordinary Pakistanis distinguish between "good" and "bad" members of the Taliban rebellion. Public revulsion seems to have inspired its army to crack down, and the number of terrorism-related fatalities fell to 10 a day in 2015, down from 30 a day in 2009.

**75**

Percentage of loans that the state banking system controls

On a 2014 trip, the risks of travel inside Pakistan were so high our security detail confined my team to its Karachi hotel. A year later, they were allowed to wander the country, accompanied by guards who did not bother to arm or dress for combat. One bodyguard showed up in blue suede shoes, reflecting the brighter national mood. To locals, the big news is how the coup-prone military has matured, focusing on security and leaving the task of managing the

economy to Nawaz Sharif's civilian government.

Since coming to power in 2012, Sharif has overseen a decline in the inflation rate to less than 3 per cent, a fall in the government budget deficit from 8 per cent to 5 per cent of GDP, and the current account deficit, from 8 per cent to less than 1 per cent of GDP, well into the safe zone.

Critics attribute those deficit reductions to falling oil prices and credit any progress under Sharif to the fact that his reform program faces quarterly review by the IMF, as a condition of a 2013 emergency loan. The legitimate concern is that the reforms will end when IMF oversight does, but for now it seems the Pakistan government will engage with the IMF for a few more years.

The new burst of Pakistani optimism is inspired less by Sharif than by the decline in violence and the infusion of Chinese money, which could go a long way to address the investment shortfall in a small economy. China's \$46 billion

**INDIA IS AS MUCH A  
CONTINENT AS A  
COUNTRY, WITH 29  
STATES THAT ARE AS  
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REAL ECONOMIC  
ACTION IS IN THE  
HANDS OF THE STATE  
CHIEF MINISTERS**



“economic corridor” plan is scheduled to build new roads, railways and power plants across the country within just 20 years. Pakistan may not be able to complete so many projects that fast, but spending even half that sum could double the current rate of foreign investment...

Though the change in mood is less dramatic, Bangladesh is heading in a similar direction. With exports and investment strong, it is running a current account surplus. Population trends are even better. Through 2020, very few countries in the world are expected to see working age population grow at or near 2 per cent a year—the pace set in most miracle economies in the past. Two of them are in South Asia: Pakistan and Bangladesh.

South Asia has been dogged by political instability since

the independence movements of the 1940s, and the economic risks of authoritarian rule still loom over the countries... On average, authoritarian governments are no more or less likely than democracies to produce long runs of strong growth, but they produce much less steady growth and tend to experience volatile swings from very strong to very weak growth. This risk faded last year in Sri Lanka after voters rejected President Mahinda Rajapaksa's bid for a fourth term. Relieved local business executives, who did not dare criticise Rajapaksa when he was in power, say his defeat lifts the “Mugabe risk”—the threat that Sri Lanka would end up with a disastrous dictator like Robert Mugabe, whose 35-year reign in Zimbabwe has seen wild boom-and-bust cycles that have left the nation in ruins.

## THE SERVICE ESCALATOR

# FACTORIES FIRST, NOT TAXI CABS & HAIRCUTS

**D**uring its boom years, before the global financial crisis, India was growing in large part on the strength of investment in technology service industries, not manufacturing. This gave birth to a cottage industry of Indian economists trying to prove, in optimistic hindsight, that this approach would work as a development strategy. In a globalising world, they argued, more and more services could be delivered over the Internet. One might still need a local beautician for a perm, or a landscaper to cut the lawn, but the Net would make it possible to replace any number of local service agents, from the lawyer to the insurance broker, from the radiologist to the techie to fix your internet connection.

Instead of growing richer by exporting ever more advanced manufactured products, India could grow rich by exporting the services demanded in this new information age. These arguments began to gain traction early in the 2010s in new research on the “service escalator”. A World Bank 2014 working paper made the case that the old growth escalator in manufacturing was already giving way to a new one in service industries, which can range from taxi rides, haircuts and restaurant meals to medical care.

The report argued that while manufacturing is in retreat as a share of the global economy and is producing fewer jobs, services are still growing, contributing more to growth in output and

**75**

Percentage of people who have ‘smart’ phones, up from 20 per cent 5 years ago



jobs for nations rich and poor. It said that the old beliefs that service jobs tend to be ill-paid and unproductive no longer apply to even poor nations such as Ethiopia, where labour productivity is rising faster in services than in other sectors—particularly as more modern services like mobile phone networks catch on. Its message was that not only Ethiopia but all of Africa could avoid the spectre of “jobless industrialisation” by creating jobs in services instead.

The next turn may now be visible in the way the process of deglobalisation is unfolding. Though global trade has slowed, and global capital flows have retreated, the flow of travellers, tourists and internet communications has continued to explode. The share of people whose mobile phone is “smart” has risen from less than 20 per cent to 75 per cent in just the last five years, which reflects what some have called the “peak stuff” trend.

One basic problem with the idea of the service escalator is that in the emerging world most of the new service jobs are still in very traditional ventures, not in creating virtual realities or high-end travel experiences. Consider the ubiquitous kerbside tire repair stalls from Lagos to Delhi, or what might be called the barbershop in a box. In small Indian villages, many entrepreneurs will cut your hair for a pittance in what looks like a large plywood coffin, tipped up on one end. It would take a bold tourist to venture inside...

The trend that got some Indian economists so excited was the arrival of modern services, which in India meant information technology (IT) services that by the late 1990s had made cities such as Bangalore and Pune internationally

**THE LEAP FROM THE FARM TO THE MODERN SERVICE SECTOR IS MUCH TOUGHER, SINCE THESE JOBS OFTEN REQUIRE MORE ADVANCED SKILLS, INCLUDING THE ABILITY TO OPERATE A COMPUTER**

famous boomtowns and home to rising corporate giants including Infosys and TCS. It was hoped that, just as Korea moved up from manufacturing textiles to manufacturing kitchen appliances, India could move up from selling simple back-office services—the roadside repairs of the IT sector—to more advanced and profitable consulting and software services. But this vision has limitations. A decade on, India's tech sector is still providing relatively simple IT services, mainly the same back-office operations it started with, and the number of new jobs it is creating is relatively small.

## INDIA BELATEDLY JOINS THE FIGHT AGAINST INFLATION

# THE PRICE OF ONIONS RAISES A STINK

India was the only big country suffering from double-digit inflation in the five years after the 2008 global financial crisis, an outbreak that says a lot about what went wrong under then prime minister Manmohan Singh. Singh took office in 2004, and over the next 10 years India's investment rate rose from about 25 per cent, to more than 35 per cent of GDP. That should have been a good sign, but it fed a false sense of confidence among the country's economic elite. Now that India was investing heavily, like China, many leading Indians figured they were also building the next high-growth, low-inflation economy.

During most of Singh's first term, inflation was very well behaved. The second term, starting in 2009, was different. Trying to prevent the economy from slowing as the global financial crisis spread, the Singh government raised public spending at an unsustainable annual pace of 18 per cent

over the next five years. Increases in investment were mainly driven by the government. Private companies were investing less and less. Between 2011 and 2013, private investment fell by 4 percentage points to 22 per cent of GDP, a drop that would amount to more than \$72 billion a year.

State bureaucrats were interfering more not only at the central bank but by issuing new rules one day only to dilute or re-write them the next. In one particularly striking case, after losing a legal battle to collect tax from British telecom giant Vodafone for its purchase of a Dutch company with a subsidiary in India, the Singh government, in its pique, pushed through a law saying that any com-

### **\$72 billion**

The annual drop in private investment in India between 2011 and 2013



**INDIA WAS HOPING TO BE THE NEXT CHINA, BUT ITS GOVERNMENT WAS BUILDING THE NEXT BRAZIL, A LOW-GROWTH, HIGH-INFLATION ECONOMY**

pany, foreign or domestic, would be liable for tax on any purchase of companies with assets on Indian soil—and that this tax would apply to any purchase going back to 1961. The resulting hullabaloo forced the government to back down, but that reversal only left potential investors more unsure about the predictability of the government's next moves.

Rather than investing in ways to help contain inflation, India was spending in ways that made its economy exceptionally vulnerable to inflation. Trying to protect people from the effects of the global downturn, it threw money at populist schemes that tend to push up both wages and prices, including an expensive scheme to guarantee at least one hundred days of paid work to every poor rural household, and another to bolster farmers' incomes by buying wheat and rice at artificially high prices. These programmes encouraged Indians to stay in their villages rather than move to factory jobs in the cities, making the economy less productive and more vulnerable to inflation.

It did not help that India was the only major country in the world where the central bank had yet to adopt an inflation target and was still under political pressure to keep interest rates low. Though India was hoping to be the next China, its government was building another Brazil, a low-growth, high-inflation economy. Between 2009 and 2013, India's key economic numbers flipped for the worse: GDP growth fell to 5 per cent, inflation doubled to 10 per cent. As Indian workers came to expect higher prices, they demanded higher wages, and the central bank began to issue open warnings about the threat of a wage-price spiral.

This is a particularly dangerous cycle. Once the spiral begins, it is likely to spin for a few years before the central bank can contain it. Fortunately for India, it got a new central bank chief in '13, Raghuram Rajan, who made clear he understood that fighting inflation was the bank's top priority.

## BAD BILLIONAIRES AND THE MEDDLING STATE

# CRONY CAPITALISM AND INCOME INEQUALITY

I first started to read the billionaire lists around 2010, inspired by a turn for the worse in India, where one scandal after another was exposing the corrupt ways of an old elite, which had wormed itself ever more deeply into Parliament, into the world of Bollywood movies, and into the commanding heights of industry. Just a few years prior, leading business tycoons were among the nation's most trusted figures, admired for building successful companies that burnished India's global image.

But the scandals started destroying that trust, exposing collusion between leading business figures and politicians. They were caught manipulating auctions for wireless spectrum, angling for ownership stakes in a new cricket league, and rigging real estate transactions, among other unsavoury deals. More and more new tycoons seemed to be rising not on merit but on political connections, and many Indians were disgusted by the brazenness of these machinations. In Mumbai, CEOs complained to me that the first

**IN INDIA, THE GOVERNMENT COLLECTS TAXES EQUAL TO JUST 3 PER CENT OF GDP, WHILE THE SIZE OF THE BLACK ECONOMY IS AROUND 30 PER CENT OF GDP. THIS IS ONE REASON INDIA SUFFERS FROM CHRONIC GOVERNMENT DEFICITS**



question now for any investment decision was about which officials had to be bribed to get the deal done.

To check the popular impression of the increasingly stagnant and dominant elite, I did a quick scan of the 2010 billionaire list and found that the top 10 Indian tycoons controlled wealth equal to 12 per cent of GDP—compared to only 1 per cent in China. Moreover, nine of India's top 10 were holdovers from 2006 compared to zero in China, and this stagnation was relatively new; on India's 2006 list, only five billionaires had been holdovers from 2001.

A cover story I wrote for *Newsweek International* in September '10 argued that the rise of crony capitalism was "India's fatal flaw", and it was greeted with great scepticism in Delhi's political circles. Top officials told me that corruption is normal when a young economy is taking off, citing the robber barons who ruled America in the 19th century. But as economic growth fell by almost half in the years that followed, the same officials came to acknowledge that an abnormally high level of corruption and inequality was one of the main factors in the slowdown.

Rising crony capitalism steers money and deals to undeserving hands, but it also sets off a chain reaction in the political system. India's courts after 2010 started to sense the popular outrage, and in a policy akin to killing a few chickens to scare the monkeys, they took strict action against some high-profile targets. The judges began denying bail to accused businessmen, holding them in jail for months before formal charges were filed; they began pressuring agents of the CBI to push forward with corruption charges and questioned their probity if they dropped a case.

By 2012, the crackdown was widening, and at parties in the lavish "farmhouses" that wealthy Indians keep as second homes on Delhi's outskirts, it sometimes seemed that every other guest was either out on bail or about to go to jail.

At this point, it was not clear which was worse: crony capitalism or the backlash. Bureaucrats grew fearful of attaching their name to any policy or even approving any permit that might look pro-business, lest they be tarred as corrupt themselves. Businessmen started avoiding deals that might require government approval, which in India is an expansive list. Investment ground to a halt, and the atmosphere of suspicion lingered for years...

Large black economies can breed social resentment, as the art of dodging taxes is often most refined among the rich. In India, the government manages to collect income taxes equal to only 3 per cent of GDP, and the size of the black economy is estimated to be around 30 per cent of GDP. This is one reason India suffers from chronic government deficits. The culture of avoiding taxes starts at the top: in a population with more than 2,50,000 millionaires, only 42,000 individuals report incomes of \$150,000 or more, as economist Tushar Poddar has pointed out. ■

**42,000**

No. of Indians among 2.5 lakh millionaires to declare an income of \$150,000 plus