Resurgent India or Déjà vu?
A new political dispensation and visionary leader has recently come to power in India. This has generated enormous optimism nationally, and even internationally, about an Indian resurgence? What are the challenges that must be surmounted to achieve this?

Towards the turn of the twentieth century, as India was struggling to free itself of colonial rule, the Nobel laureate Rabindranath Tagore’s invoked this vision of a resurgent, independent India:

Where the mind is without fear, and the head is held high,
Where knowledge is free,
Where the world has not been broken up into fragments
By narrow domestic walls,
Where the clear stream of reason has not lost its way
Into the dreary desert sand of dead habit,
Into that heaven of freedom, my Father, let my country awake.

A century later, at the turn of the twenty-first century, The Economist of September 4, 1999 was still despairing of this resurgence. “For a country encompassing a fifth of humanity, and a nuclear bomb, India does not count for much in the world. Its trade accounts for a scant 0.7% of the world total; it gets about one-tenth the foreign direct investment that China attracts. It houses the majority of the world’s poor and illiterate. Its infrastructure is a joke by world standards, and its politicians and bureaucrats are seen more as parasites than public servants. It has no permanent seat on the UN Security Council. When pundits talk about the geo-strategic chessboard of the future, India has figured more often as a bishop or a knight than as a queen. On this view, India is the world’s biggest under-achiever.”
This was 15 years ago, close on the heels of the great optimism emanating from the great Indian story of the big bang reforms of 1991-92. This optimism seemed to be running out of steam.

Shortly after *The Economist* editorial of September 1999 India became the second fastest growing major economy in the world. Foreign investments surged. A stylized version of the short-view of the ‘India story’ made in investment seminars and road shows went something like this: India was a big and fast growing economy with a young demographic profile. It had an abundance of cheap labour with huge scope for large productivity shifts. Its entrepreneurs were in the forefront of the IT Revolution and in leadership positions in TNCs. It was the second fastest growing major economy, poised to soon overtake China’s growth rate. The only hurdles in the way of economic take-off were right policies and structural reforms in areas such as labour, land, agricultural marketing, fiscal, tax, financial, physical and social infrastructure, governance, etc.

But the opening decade of the twenty first century was also a period of unprecedented global growth, and a rising tide lifts all boats. India, along with China, were nevertheless the two major economies that weathered the early blows of the global financial crisis of 2008 reasonably well. China’s resilience was attributed to its huge stimulus. India’s was attributed to its greater reliance on robust domestic demand as its engine of growth. India seemed to have, at last, taken off.

Then, beginning Q2, 2011, the Indian economy went into a downward spiral of almost 12 successive quarters of falling growth, including several quarters of below 5% growth. There was smart uptick to 5.7% in the Q2, which however fell back to 5.3% in Q3. Several near term indicators, such as industrial production, agriculture, exports and the real estate sector remain depressed. Uncertainty surrounding US monetary policy threatens the recovery. Inflation and the current account deficit have no doubt declined impressively, but this is consistent with both low demand and sound macro-economic management. It is still unclear whether the near term decline in growth is cyclical, or whether trend growth itself has been impaired through declining productivity. Certainly, the slight decline in savings and investment is not commensurate with the large decline in growth.

There is however now a new optimism and renewed energy in the air with a new political dispensation and visionary leader in power. There has for some time been a broad consensus on what needs to be done on policy and structural reform centred on three critical economic policy arrows, and the new government seems intent on firing these. The first arrow is agriculture, where India has an inherent comparative advantage, and where there are major market failures that have made consumer price inflation endemic at a time other parts of the world are battling deflation. The second arrow comprises the clutch of reforms that can facilitate labour intensive manufacturing to make the new government’s ‘Make in India’ campaign a reality. The third arrow is thorough going fiscal restructuring to release taxpayer resources for a major thrust in physical and social infrastructure investment to improve the productivity of physical and human productivity necessary to sustain a high growth trajectory over an extended period. These three arrows need to be fired from a bow called good governance reassures investors and inspire business confidence

But is it possible that India could once again miss the bus? Re-reading the Economist of September 4, 1999 can fill the reader a sense of deja vu. Is India still the world’s biggest under-achiever?

The vast potential of India is undeniable, and is often traced back to the time before the Industrial Revolution when India and China were the biggest and most prosperous economies in the world. There were good reasons for this dominance. The Indo-Gangetic floodplain, along with those of the Nile in Egypt, the Yellow river in China, and the Tigris-Euphrates in Mesopotamia, were the most fertile and productive in the world, and consequently the original cradles of human civilization.

The Indo-Gangetic plain supported population densities rivalling industrial counties in nineteenth century England, as census officials
discovered to their astonishment. Seed-yield ratios for major cereals were about 2-3 times those in late medieval Europe. There were two crops year after year without fallowing compared to 2 every three years under the three-field system in Europe.

Such productivity spawned a sophisticated division of labour. Unsurprisingly India stood at the centre of the two dominant ancient trade routes, namely the overland Silk Road, and the Indian Ocean trade. Its strong, native entrepreneurial and artisan classes were amongst the most successful. It was the biggest exporter of cotton textiles on the eve of the Industrial Revolution. But it had long run trade surpluses through its long history, the source of its famed gold and riches that repeatedly tempted foreign predators. India was the ‘jewel’ in the crown of the British Empire.

Following unprecedented and rapid productivity shifts of the Industrial Revolution, China and India fell far behind western economies. This led, almost inevitably, to imperial domination. The causes of this great divergence are still hotly debated. It is nevertheless clear that despite their bigger economic size right up to the early eighteenth century, both countries had started falling behind in labour productivity much earlier, possibly between 1000 - 1500 AD. This shift in the relative factor advantage towards human capital and away from human labour may explain why the Industrial Revolution occurred in Europe rather than in the much wealthier Asia.

India nevertheless bounced back to be at the forefront of anti-colonial movements from the late nineteenth century. When it finally attained Independence from foreign rule in 1947 it was perhaps the most advanced ‘developing country’. The foundations of a modern infrastructure of metalled all-weather roads, canals and railways had been laid; there was a strong indigenous modernizing impulse. In several respects the ‘Bengal Renaissance’ mirrored the Enlightenment that planted the intellectual seeds of the Industrial Revolution in Europe. Its burgeoning new middle class that led the Independence Movement had acquired a fluency in English, the emerging global link language that gave it a head start in a fast globalizing world. It also formed the nucleus of a burgeoning domestic demand that could facilitate India escape the middle income trap, unlike several other developing economies dependent on external engines of growth. Its vibrant native entrepreneurial class not only survived the imperialism of free trade, but by the early twentieth century it was giving the cotton textiles of Manchester a run for their money. India, along with Japan, seemed poised to lead the ‘great convergence’.

But what happened next? First Japan in the sixties and seventies, then the ‘East Asian Tigers in the seventies and eighties, then China in the eighties and nineties left India far behind. In 1980, per capita income in China and India was roughly the same – today China’s is 4-5 times higher. This is perhaps what inspired the damning verdict of The Economist. Opportunity rarely knocks twice – for India it knocked three times, and may be knocking a fourth time. How well is it positioned to seize it?

**What holds India Back: Economy and Society**

To answer this question is essential to take the long view because current indicators, policies and reforms work their way through extant institutions. The economy, as Karl Polanyi pointed out several decades ago, is embedded in society. Its functioning is determined by Institutions and the mentalities of people who man them. Institutions and mentalities change only slowly over time.

The great divergence that culminated with the Industrial Revolution in the west and subsequent imperial domination can ultimately be explained by institutions and underlying human resources. If India is to forge ahead and build on its comparative advantages it needs to bridge this continuing institutional and human gulf.

There are -- arguably -- three fundamental reasons holding India back from tapping its true potential. And why it seems to be repeatedly left behind by the tide of history. These operate at three interrelated but heuristically distinct planes, economic, social and cultural. The focus in any civil society discourse on a resurgent India is usually confined to the economic plane, but one needs to pay equal attention to all three.

**Economic Plane: Fear of Markets**
On the economic plane, the chief constraint is the failure to get the right balance between Markets and the State. There is a close fit between societies that have for years been economically free and those that have a high median per capita income. The reason for this is startlingly simple: Free markets and trade maximize efficiency and productivity growth through the time tested principle of comparative advantage. The fastest growing economies in the world today started growing rapidly only after opening up their trade and markets for land, labour, capital and products.

A fear of markets has long pervaded economic policy and civil society in India. This fear has tilted the balance between market and State sharply towards the latter. This has come in the way of greater economic efficiency and productivity growth. State power can also corrupt. The licence-control-permit Raj, crony capitalism, or what the eminent Indian economist Jagdish Bhagwati calls 'Directly Unproductive Profit Seeking' activities, was the direct outcome of this imbalance. Despite significant economic liberalization since the early nineties, India remains amongst the most protectionist, economically unfree, and challenging business environments.

The State no doubt has a critical role the State has to play in regulating markets and providing public goods. Adam Smith, the doyen of free enterprise economists, noted that participants tend to abuse the market, necessitating state intervention. But it can try to do too much and get the balance wrong. Just as there are market failures, there can also be State failures. Indeed, markets often fail because of excessive State intervention. Agricultural markets in India are a good case in point. Like all monopolies, state monopoly risks becoming inefficient in the absence of the competition inherent in the market mechanism.

But even as the State has overextended itself in regulating, controlling and indeed substituting for markets, it has not invested sufficiently in critical physical and social infrastructure, where private enterprise has a much lesser role to play. This has constrained productivity and income growth.

**Cultural Plane: Inward Orientation**

If the fear of markets has tended to limit efficiency and productivity gains, India’s predominantly inward orientation has constrained competitiveness in a rapidly integrating global economy. A country that accumulated vast wealth by running current account surpluses over several centuries is now an outlier amongst Emerging Market Economies in running structural current account deficits.

Despite the far reaching trade reform of the early nineties, India remains putatively one of the most protectionist major economies of the world. This inward orientation is difficult to fathom because of its strategic location between east and west; because of the global spread of its entrepreneurial diaspora; and because whenever India has engaged economically with the world, whether through merchandize trade in pre-modern times, or through services trade today, it has consistently been a world leader.

This insularity was arguably best articulated over a thousand years ago by a remarkable visitor, the Arab scholar Al Beruni. Al Beruni was seeking to understand why, despite the bravest warriors, and its significant contributions to science, India repeatedly succumbed to foreign invasion. This was because he got the impression that Indians did not feel the need to learn from the rest of the world, or indeed to engage with it intellectually.

"The Hindus believe that there is no country but theirs, no nation like theirs, no king like theirs, no religion like theirs, no science like theirs....They are by nature niggardly in communicating that which they know, and they take the greatest possible care to withhold it from men of another caste among their own people, still much more, of course, from any foreigner...if you tell them of any science or scholar in Khorasan and Persis, they will think you to be both an ignoramus and a liar."

Elsewhere Al Beruni described the boundaries of the physical world as perceived by Indians, and the religious sanctions against stepping out of these known boundaries. India continued to succumb long after the time of Al Beruni. This sense of Indian exceptionalism and inward
orientation persists to this day. While East Asia, including China, scour the world to learn and implement global best practices in a bid to catch up rapidly, India seems to think that India is different, has little to learn from the experience of others and must chart its own unique policies. Emblematic of this is the sartorial style of senior official delegations from India that stands out in sharp relief against the business suits in meetings of major economies. There is of course no need to uncritically follow everything western, but if India is to tap its infinite potential, and not fall behind yet again, it needs to engage more with the outside world – both west and east.

**Social Plane: Unequal Opportunities**

A good way to underscore the critical importance of constraints at the social plane is to ask why the third largest economy in the world, and the world’s biggest democracy, comprising about a sixth of humanity, struggles to win a single gold medal at the Olympic games. Does this reflect lack of talent or a lack of opportunity?

The 'Caste System' has long been a defining feature of India. It segmented society into commensal communities with limited social contact. It gave asymmetric, hierarchical access to opportunities. Its pernicious socio-economic effects were recognized by the thinkers and social reformers of the Bengal Renaissance.

These reform movements receded into the background, and some even parted company with the freedom movement, as the focus shifted to national unity to overthrow the foreign yoke. It was not possible, according to Rabindranath Tagore, to "build a political miracle of freedom upon the quicksand of social slavery". The impact of Mahatma Gandhi’s attempts at bridging social divides was limited.

Extreme forms of socio-economic disenfranchisement, such as untouchability, have loosened considerably, especially in fast expanding urban spaces. It’s lingering after effects however still segment access and opportunities and undermine the dignity of labour in civil society at every level. It is difficult to explain to westerners why the lady of the house and the maid cannot sit together at the same table over tea and engage in small talk, woman to woman.

A startling outcome of this lingering after effect is the human development indicators of the world’s most populous democracy. They compare unfavourably with large parts of the less democratic developing world. On average, even sub-Saharan Africa does better nowadays. This cannot be attributed to scarcity of resources because the State has pampered a large middle class, crowding out resources for investing in social infrastructure for those on the margins of society. Tagore’s skepticism regarding basing freedom on the quicksand of social slavery continues to haunt Independent India.

But it is not the moral argument, strong as it is, that needs to be underscored, but the economic one. A large chunk of the population is denied opportunities for educational and skills advancement. The full potential of a large talent pool comprising a sixth of humanity cannot be tapped. India’s performance in Olympics is only symptomatic of Indian’s overall underachievement by global benchmarks. It extends to basic student skills in rural schools, the output from our higher and technical institutions of learning, research, various areas of economic activity, etcetera. India’s best talent may be invisible because it is not given opportunity for expression. In the memorable words of Thomas Gray full many a flower is born to blush unseen and waste its sweetness in the desert air.

This is yet another area where the State – market balance has floundered. Instead of putting in place the infrastructure for equipping every individual to effectively compete and expand incomes under a market framework, the State has instead tried to equalize outcomes through reservations, regulation and poorly targeted redistribution that puts increasing restrictions on the market. The tendency to shift the burden of social protection from the State to non-State market participants has resulted in a vicious cycle de-capitalizing affected sectors, or pushing them towards informality, depressing investment, productivity and growth and further constraining tax revenues available for redistribution.
Free markets do not, of course, lead to equality of outcomes. But they also abhor indigent poverty which depresses demand and stifles their growth. Public goods and social protection can be provided most effectively when markets grow. Cutting the cake into smaller pieces only equalizes misery. In the absence of such growth India risks falling into the politically volatile middle income trap.

**A Tide in the Affairs of Men**

The global economy is still recovering from the biggest financial and economic crisis since the Great Depression of the 1930s. The old growth model, based on leveraged consumption in advanced economies has broken down. A major global rebalancing of demand and structural reforms are required to get growth back on track. A stagnant global economy is in search of new engines of growth.

Even as the medium term prospects of a robust global recovery are distinctly downbeat, the short view gives reason for cautious optimism with regard to India. First, the two major drivers that recently pushed Indian trend growth from 5.5 – 6.5% into the 8-9% trajectory are intact. The dependency ratio continues to decline, while the roughly ten per cent increase in domestic savings as a share of GDP is largely intact but for some short term damage to financial savings. Second, unlike other EMs dependent on external levers for a return to high growth, its economy is balanced. The levers that need to be pulled are mostly domestic. This is therefore the opportune time for an Indian resurgence.

To summarize, India's history and its natural advantages are pointers to its vast potential. To realize this, India needs major policy and structural reform over the short to medium run. In particular, it needs to fire three arrows, agriculture, labour intensive manufacturing and fiscal restructuring, from the bow of good governance.

But if India is to realise its true potential, sustain high growth over an extended period, beat the middle income trap and become a major global player, it needs to change its mindset on three separate planes. At the economic level civil society needs to overcome its fear of markets; at the cultural level it needs to engage more fully with the outside world; and at the social level its needs to empower its citizens with equal opportunities. The real wealth of nations lies in its people. Pulling these three levers is the big leadership and managerial challenge for the new government in New Delhi.

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