

Growth in the time of UPA: Myths and Reality¹

Maitreesh Ghatak
London School of Economics

Parikshit Ghosh
Delhi School of Economics

Ashok Kotwal
University of British Columbia

This article challenges a prevailing view that diminished electoral prospect of the incumbent UPA government is the result of neglecting growth to launch populist welfare schemes. We look at a wide range of economic indicators to show that compared to the NDA regime, the UPA period has been characterised by faster growth, higher savings and investment, growing foreign trade and capital inflows, and increased infrastructure spending in partnership with private capital. The UPA's political troubles arise not from policies that hurt growth but from an inability to tackle the consequences of accelerated economic growth – increased conflict over land, rent seeking and corruption in the booming infra-structure and natural resource sectors, inability of public education to keep up with increased demand and rising aspirations, and poor delivery of welfare schemes made possible by growing revenues. The traditional branding of BJP as the party of market reforms and UPA as a centre-left coalition more committed to regulation and redistribution must be re-examined.

Introduction

India prepares to elect members of the sixteenth Lok Sabha. If opinion polls are to be believed, Congress is headed for a rout. Narendra Modi has positioned himself as the development candidate and Arvind Kejriwal as the anti-corruption czar. Congress has no inspiring message, no rallying cry. By default, it seems to be running on its record. Recent economic news – faltering growth, rising prices, weakening currency and burgeoning deficit – does little to improve its prospects. An air of defeat and ennui hangs over the party as it seeks a third term.

The general impression going around is that UPA has landed the country in an economic mess. There are two things to note about this perception, which has become conventional wisdom. First, there are sharply contradictory views about what UPA did wrong. If you listen to those on the right, Congress squandered resources on populist schemes like NREGA and NFSA, reversed liberalisation and starved growth enabling sectors like infrastructure. If you listen to the left, the government succumbed to massive corporate influence and became a promoter of destructive rent seeking rather than inclusive growth. It is a unique misfortune for any party to be charged with both crony capitalism and unbridled welfarism. The only consensus seems to be that UPA is an economic disaster and must go.

¹ We thank Arka Roy Choudhury for excellent research assistance and Patrick Francois and Amitava Gupta for helpful comments.

The other notable thing here is the gap between perception and reality. By many economic indicators, UPA's record in the last ten years (not just the last two) is good and compares rather favourably against the outcomes under NDA. It is a period during which growth accelerated, Indians started saving and investing more, the economy opened up, foreign investment came rushing in, poverty declined sharply and building of infrastructure gathered pace. Later in this essay, we will present evidence to this effect. Measures of human development – nutrition, educational attainment, life expectancy, etc. – continued to record slow improvement even as poverty at the lowest end fell quite sharply. However, this is not unusual in India's recent history. The collapse in UPA's support base, therefore, presents an intriguing puzzle. What really happened?

We think UPA has been a victim of its own success in more ways than one. The high growth of the first eight years raised expectations – what was considered par for the course in 2004 is seen as dismal performance today. But voters typically vote on living experience rather than the latest statistics. There is a deeper paradox here that needs to be resolved.

A period of fast growth in a poor country can put significant stress on the system which it must cope with. Growth can also unleash powerful aspirations as well as frustrations, and political parties who can tap into these emotions reap the benefits. Precisely because it was in charge of a rapidly changing economy, UPA faced two stiff challenges – one economic and another political. It was not able to tackle either very well.

The economic challenge before the UPA was to devise new mechanisms and institutional innovations to solve the unique problems that growth threw up. Land acquisition became a headline grabbing problem under UPA precisely because the economy was growing fast and there was pressure to convert a lot of agricultural land to high value use – industrial, residential or infrastructural. The new land acquisition law came too late and was full of flaws (Ghatak and Ghosh (2011)). Growth started creating a shortage of skilled labour, raised the skill premium and unleashed a widespread demand for education as a tool of social mobility. The government was unable to bring about a fundamental change in the public education system and solve the perennial problem of low quality.² Growth afforded UPA the luxury of launching new welfare schemes like NREGA – a vote winner perhaps after its first term. It lacked the wherewithal to run these schemes effectively by plugging the leakages

² According to the 2013 ASER report, learning outcomes in primary schools have declined since 2005 and the fraction of rural children enrolled in private schools has gone up from 17% to 29%, indicating a rising dissatisfaction with public education (Chavan (2013)).

and stopping the graft.³ In the process, they showcased not its egalitarian pro-poor politics but its ineptitude and corruption.

It is not that UPA lacked a vision for transforming the institutional framework of the country. It passed ambitious legislation aimed at increasing transparency in government and providing justice to citizens. The Right to Information, Forest Rights, Land Acquisition, Lokpal, Right to Education and National Rural Employment Guarantee Acts add up to a legislative record that is impressive in scope and aim (Banerjee (2014)). The UID scheme tried to clean up and modernise the entire infrastructure of providing entitlements and enabling experiments like cash transfers. But the initiatives too often suffered from faulty conception or tardy and inept implementation.

The political challenge UPA faced was to find a new political idiom for addressing the masses in an age very different from the one in which its previous generation of leaders coined their slogans (*garibi hatao!*) Especially to an increasingly young and aspirational electorate, it needed to speak a language of empowerment rather than a language of patronage. Modi, notably, does not talk down to his voters. He poses as the enabler of their dreams, one who will help them realize their strength rather than take pity on their weakness. His rise from humble origins reinforces this message, while Rahul Gandhi's background accentuates the impression of *noblesse oblige* that his rhetoric often conveys. Under UPA, the economy evolved but it failed to evolve with it.

Congress, of course, faces a leadership crisis at a more basic level. None of the principals – the Gandhis or Manmohan Singh – are masters at oratory or even communication. The dual leadership model did not serve it well in the end and only sowed confusion about who is in charge. Whoever we talk to, regardless of political bent, the dynasty seems to be deeply disliked. One reason is that it is seen to seek power without responsibility or engagement, lording over the land from its inscrutable, Kafkaesque castle. Incredibly, it couldn't even dispel the notion that in economic terms, its rule is a "wasted decade" for the country (Singh (2014)) – a conclusion that can only emerge from a complete unfamiliarity with the data. UPA's report card has been written entirely by its detractors.

Given the unreliability of opinion polls in India (UPA seat shares were under-estimated, often by big margins, in both 2004 and 2009) and the highly fragmented electorate, it is possible that these conclusions are premature and UPA may yet pull off a political Houdini act.⁴ However its

³ Jha and Ramaswamy (2010) estimate 70% of government spending on food subsidies does not reach the beneficiaries on account of leakages and excess economic cost. Subsequent studies have found improvements in some states.

⁴ Looking at data from a large sample of developing countries, Brender and Drazen (2013) show that reelection probabilities are higher for parties whose term in office was characterized by higher growth rates. Voters seem to reward strong growth performance on average. If UPA loses the coming Lok Sabha elections after overseeing the decade of fastest growth, it will be the exception rather than the rule.

unpopularity, at least among a lot of urban voters, was vividly illustrated by the demolition it suffered in the last Delhi elections. On top of it all, there is the usual drag of anti-incumbency.

Returning to the economic challenge posed by high growth, the infrastructure sector will very likely be UPA's Waterloo. The argument that high growth rates well into UPA's second term were delayed effects of the NDA government's investments in infrastructure, and the current slowdown is the price of diverting resources to entitlements and doles, is little more than political spin from the right. Under UPA, infrastructure spending as a percentage of GDP actually increased from 5 to 7-8%. The additional funding was harnessed by opening up a traditionally state dominated sector to private capital and PPP projects – a move that should have made it popular well beyond NGO circles. Where UPA failed was not the quest for productivity but the need to put in place a sound mechanism for keeping mischief at bay. It needed to abandon a long tradition of discretionary decision making and embrace transparent allocations, rational pricing, commitment to rules and consistency. The mega scandals that now plague the party, especially ones having to do with coal and spectrum allocations, derive from the expansion of infrastructure, not its stagnation.

A word about corruption, currently one of the pet obsessions of Indian politics, would be appropriate here. The link between growth and corruption is subtle and runs both ways. Corruption will surely slow down growth, but growth also tends to create corruption by generating new wealth, the claims on which are not properly established. It is, therefore, both a worry and a positive symptom, but the latter aspect gets lost in the excessively moralistic framework within which the problem is often discussed. There are very few thieves in Antarctica, but primarily because there is nothing to steal.

India needs new institutional infrastructure in addition to physical infrastructure and it is in this area that UPA's shortcoming was especially evident. When one looks across India's political landscape, however, it is not clear any political party is in a position to provide it. There is a surprising degree of lazy consensus and rhetorical commonality among various parties on many policy issues of critical importance, in spite of the rambunctious scenes that often break out in the wake of any new legislative initiative. Unlike western democracies, India's politics is not organized around competing economic ideologies, with a traditional left and right as understood in those countries.

Issues of identity and culture, whether sectarian, regional or nationalistic, seem to be the deep undercurrents of our democracy. Perhaps it is time to think beyond BJP as the party of market reforms and Congress as the party of regulation and redistribution. Even in an election where economic issues seem to be at the forefront, the debate centres on the ideologically neutral question of "governance" rather than clashing philosophies of the ideal society (*laissez faire* vs welfare state). Before discussing policy prospects, it is important to give a comprehensive account of India's economic performance under the two UPA governments, especially in contrast to the previous NDA régime.

Growth Performance

Table 1 summarizes some key economic indicators for the UPA (2004 – 13) and NDA (1998 – 2004) years. Real GDP grew at nearly 6% per year under NDA, which has increased to 7.6% during UPA’s rule. Growth jumped above 8% in UPA’s first term and has come down to an average of 7% in the second, but is still comfortably above the NDA benchmark. 2012-13 is the only year under UPA when the economy grew at a slower rate than the NDA average and the current fiscal year will undoubtedly show similar results. Nevertheless, the broad fact remains that the Indian economy grew faster under UPA than under NDA. The picture is similar if one decomposes aggregate growth by sectors. Under UPA, industry grew at 7.7%, up from 5.4% under NDA. Service sector growth increased from 7.8% to 9.5%, while agriculture grew at 3.3%, which is higher than the 2.9% registered under NDA.⁵

| Annual Average | NDA (1998 -2004) | UPA I (2004 – 09) | UPA II (2009 – 13) | UPA (2004 – 13) |
|---|---------------------|----------------------|-----------------------|--------------------|
| Growth rate of real GDP | 5.9% | 8.0% | 7.0% | 7.6% |
| General Inflation (Industrial workers) | 5.4% | 6.1% | 10.4% | 8.1% |
| Food Inflation (Industrial workers) | 4.2% | 7.0% | 11.6% | 9.0% |
| BSE Sensex, average annual growth | 5.9% | 15.0% | 13.9% | 14.5% |
| Fiscal deficit (% of GDP per year) | 5.5% | 3.9% | 5.5% | 4.6% |
| Annual FDI inflow (billion \$) | 2.85 | 15.44 | 26.19 | 20.22 |

Table 1. Key indicators during NDA and UPA years
(Source: Reserve Bank of India and Planning Commission)

Figure 1 plots India’s annual growth rates since the onset of liberalisation. It clearly shows that the UPA decade has seen some of the fastest growth of this era except for the last 2 years. Bear in mind, however, that in today’s interdependent globalized world, the ups and downs of national economies are driven by global trends as much as their own governments’ policies. This is illustrated in figure 2, which plots India’s year-to-year growth rates against the average growth of the world economy and that of China (the fastest growing major nation). Observe that for the last two decades, India’s growth

⁵ Authors’ calculations based on data from the World Bank.

consistently lay somewhere between that of China and the world and all economies have experienced similar fluctuations. It is perhaps fair to say that global forces have a big role to play in the decline of the last few years as well as the boom that came before it, though India's growth rate has dropped more than the world's in the last 2 years.

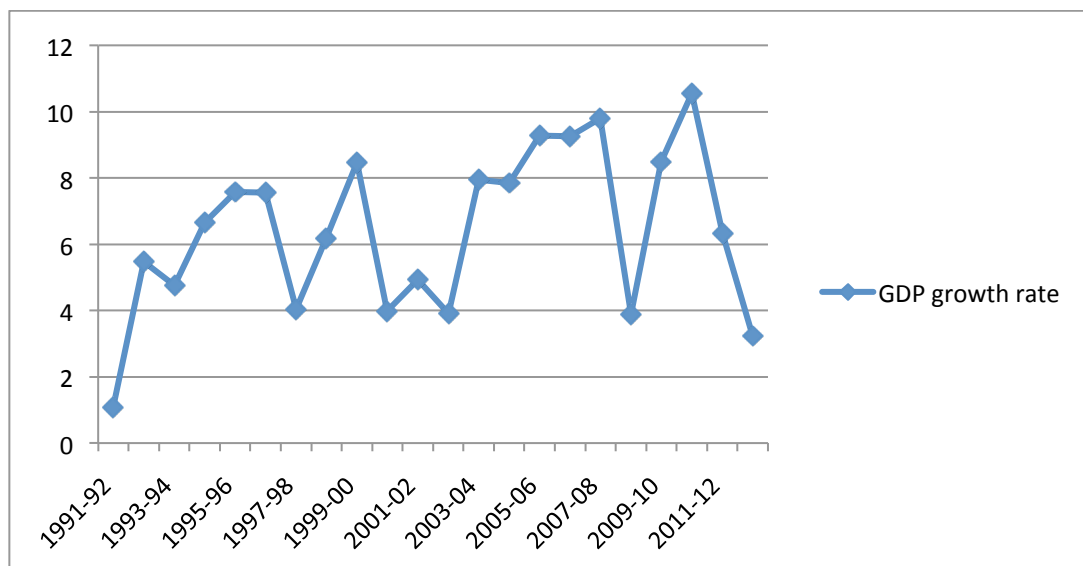


Figure 1. Annual growth rate in real GDP (Source: Reserve Bank of India)

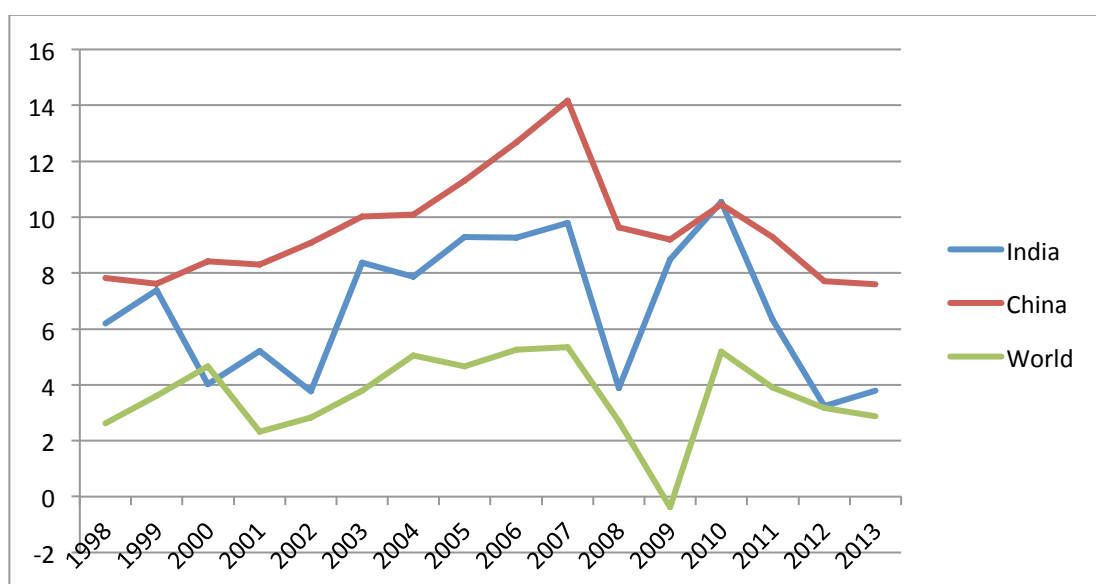


Figure 2. International comparisons of GDP growth rates (Source: Planning Commission)

Given that global shocks affect national economies, one way to make a fairer comparison of growth performance under different political regimes is to look at *how much* faster or slower India has grown relative to the world economy. In the NDA period, India's growth lead over the world was 2.5 percentage points, which increased to about 3.5 percentage points under UPA. Even relative to the rest of the world, growth has clearly accelerated.

Perhaps the greatest testament that UPA has not quite destroyed growth prospects or played Robin Hood comes from the stock market. The rise of the Sensex (see figure 3), an index of 30 leading stocks traded on the Bombay Stock Exchange, is nothing short of spectacular during the UPA years, especially up until the financial crisis of 2008. Stocks took a tumble after the crisis hit, losing almost half their value in quick time, but have since recovered and gone past where they were before the crash. Note that the Sensex is relatively flat during the NDA years.

In the 6 years of NDA rule (April 1998 – April 2004), the Sensex grew at a compound annual rate of 5.9% per year. Over the UPA period (May 2004 till March 2014), this rate of growth was more than double, standing at 16.4%. Of course the latter period has seen higher inflation rates too. Adjusting for this, we find the real rate of growth of stock value (average annual growth rate of Sensex minus average annual inflation rate) during the NDA and UPA years are 0.5% and 8.3% respectively. Investors have reaped much higher capital gains under UPA, so its reputation as an anti-market régime doggedly pursuing wealth redistribution must be rethought. Conversely, the BJP’s record during its previous stint at the Centre also calls into question whether it is as business friendly (in effect, if not in intent) as is usually supposed.

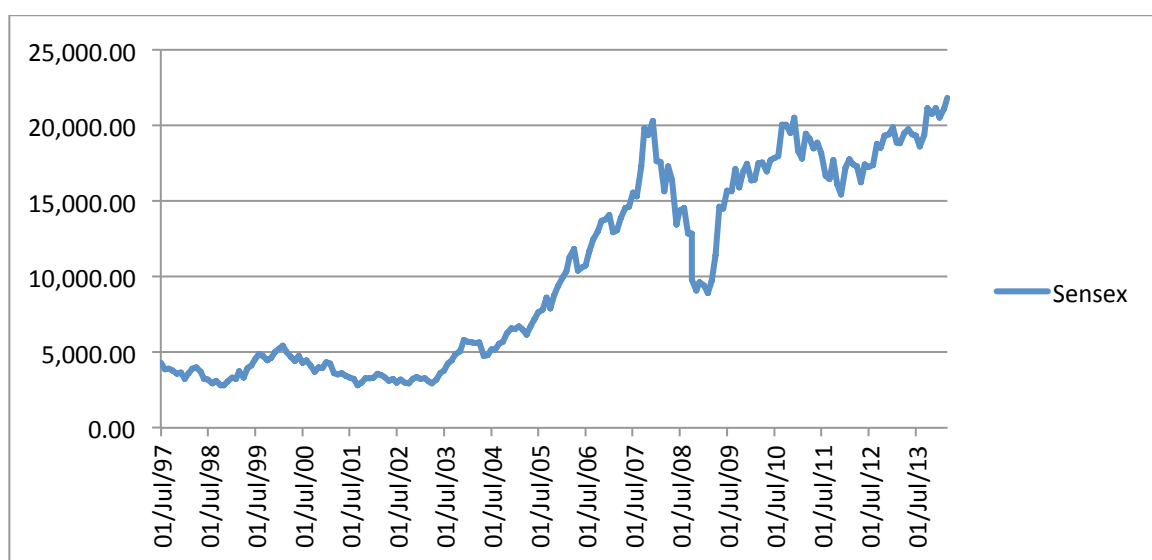


Figure 3. BSE Sensex index, 1997-2014 (Source: Yahoo! Finance India)

Since GDP in any given year is subject to all kinds of shocks, it is important to look beyond that at structural features which may give some indication of future growth prospects. From this perspective, some of the charges against UPA are potentially serious. The gist of these charges is that by focusing excessively on redistribution, the current government has weakened the foundations of growth and has put too much strain on the state’s finances. The real picture turns out to be quite different if one looks past the last few quarters.

Public Finance

The government has also attracted much criticism ever since the fiscal deficit shot above 5% of GDP, with successive budget figures being bandied about as indicators of its proclivity for overspending and fiscal mismanagement. As with growth, this critique draws its strength from a considerable degree of amnesia. It is true that the volume of subsidies has gone up under UPA, from 1.6% of GDP in the last year of NDA to 2.6% in 2012-13, but there have been offsets, partly in the defence budget. As figure 4 shows, the deficit had hovered between 5 and 6% of GDP since the mid-90s and through the NDA years. A considerable reduction in the deficit was achieved only during UPA's first term. It has struggled in its second term to beat that expectation.

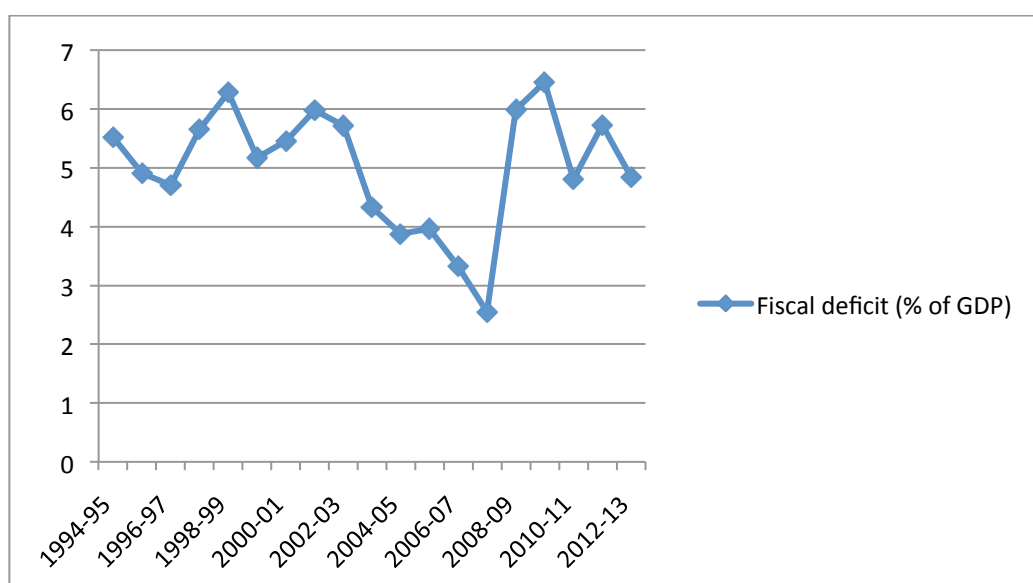


Figure 4. Fiscal deficit as percentage of GDP (Source: Reserve Bank of India)

One notable feature of the graph is the dramatic spike in 2008-09, the year of the financial crisis, with the associated slowing of growth, fall in revenues and need for stimulus spending in economies across the world. Again, a big part of the suddenly worsening fiscal situation can be found in global events rather than new welfare schemes like NREGA.⁶

An even more striking pattern is revealed in figure 5, which plots outstanding public debt of the central government⁷ as a fraction of GDP since 1992. Under NDA, the debt grew from 50% of GDP to 61%. Since UPA took over, it has come down to 48%. Indeed, a look at the graph will tell the

⁶ NREGA was launched in 2006. The fiscal deficit continued to decline for two years since its launch. In 2008, programme outlay was significantly increased, but the extra spending was no more than 0.5 percentage point of GDP. This can explain only a small fraction of the 3.5 percentage point increase in the fiscal deficit that year.

⁷ We exclude debt of state governments since it is clearly not the responsibility of the government at the centre. Overall public debt (state and centre) increased from 68% of GDP in 1998 to 85% in 2004, and has since come down again to around 68% of GDP. The pattern is the same, no matter how one looks at it.

reader that the debt has always declined under Congress governments, while it has steadily gone up in the non-Congress years, 1996 – 2004. It is remarkable that UPA has so meekly surrendered to the charge of fiscal indiscipline when the record is so completely in its favour.

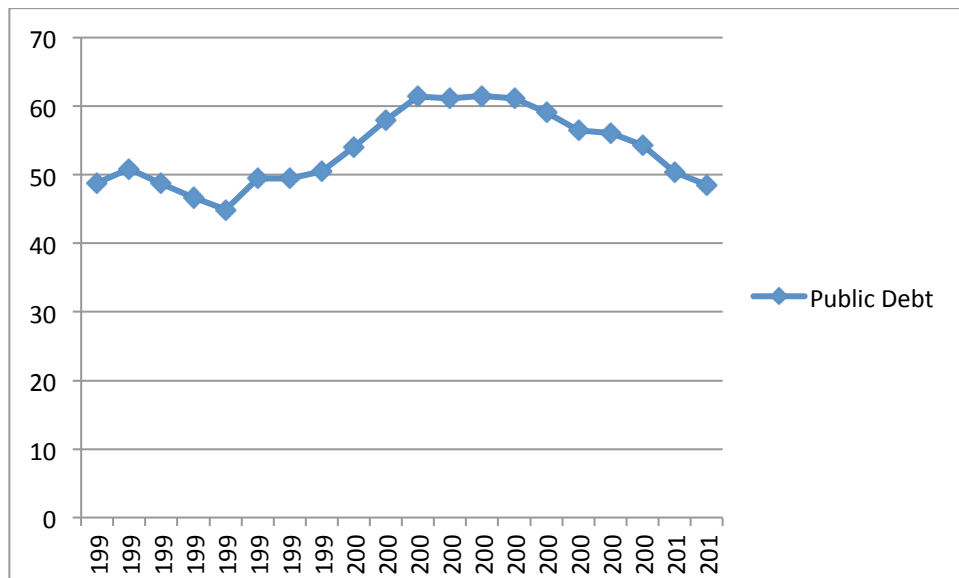


Figure 5. Central Government debt as percentage of GDP (Source: World Bank)

Apart from issues of fiscal sustainability, there is direct evidence that UPA’s signature welfare schemes have not seriously damaged productive capacity in the economy, at least relative to earlier levels or trends. Government consumption as a fraction of GDP has remained nearly flat through the NDA and UPA years. More pertinently, during UPA’s rule, India has moved to significantly higher levels of savings and investment (figure 6).

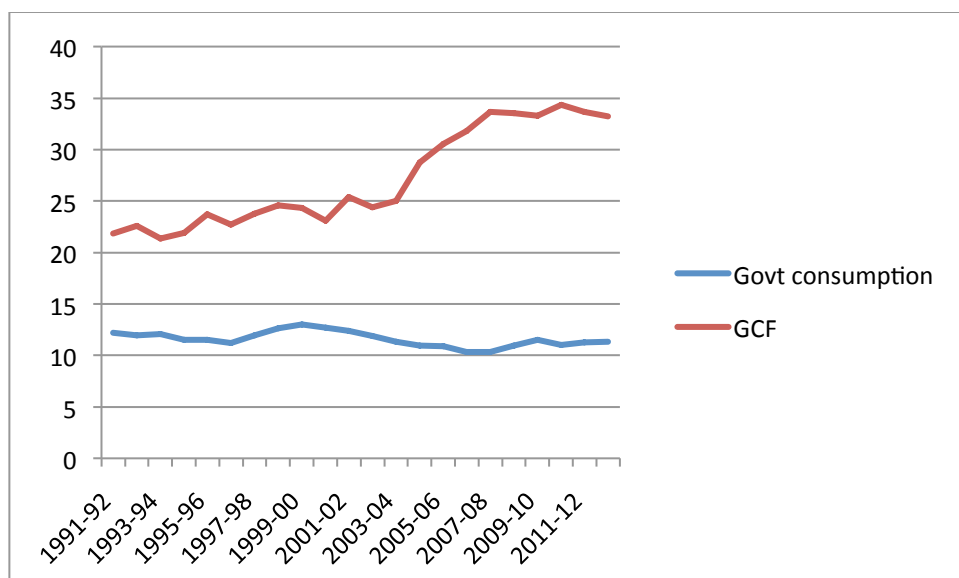


Figure 6. Government consumption and gross fixed capital formation (GCF) as percentage of GDP (Source: Reserve Bank of India)

Roughly a third of GDP has gone towards capital formation under UPA. The corresponding figure during the NDA years was only a quarter. Similarly, gross fixed capital formation in the private sector was nearly constant at around 17% of GDP in the NDA years, but quickly crossed 23% once UPA came to power. A similar quantum jump in household and national savings rates, to the tune of about 4.5% of GDP, occurred in 2004-05, the first year of UPA's rule.⁸ It is quite evident from the data that a structural shift happened in the Indian economy around 2004-05 towards greater savings, investment and growth, in both the public and private sector. Whether this shift has anything to do with government policies is certainly a debatable issue but it is difficult to argue in the face of these facts that the UPA government actively suppressed productivity and income growth.

One critical macroeconomic parameter on which UPA is genuinely vulnerable even upon a sober reflection on its record is inflation. The UPA period is characterized by consistently higher and rising inflation rates compared to the previous régime, as figure 7 illustrates. A notable feature is that though food prices were rising at a slower rate than the general price level during the NDA years, this trend has reversed soon after UPA came to power. We do not have a ready explanation for these phenomena. Surely excess buffer stocks the FCI started accumulating towards the latter part of the decade did not help to put the brakes on food price inflation. However, governments are often torn between the opposing political pressures of boosting agricultural incomes and lowering the cost of living of the urban poor. Inflation is also one of the least understood macroeconomic phenomena especially in a developing economy where the effects of monetary and fiscal policy are considerably muddled by rapid structural changes and financial evolution. Nevertheless, when it comes to the inflation question, the incumbent government will find it difficult to get off the hook.

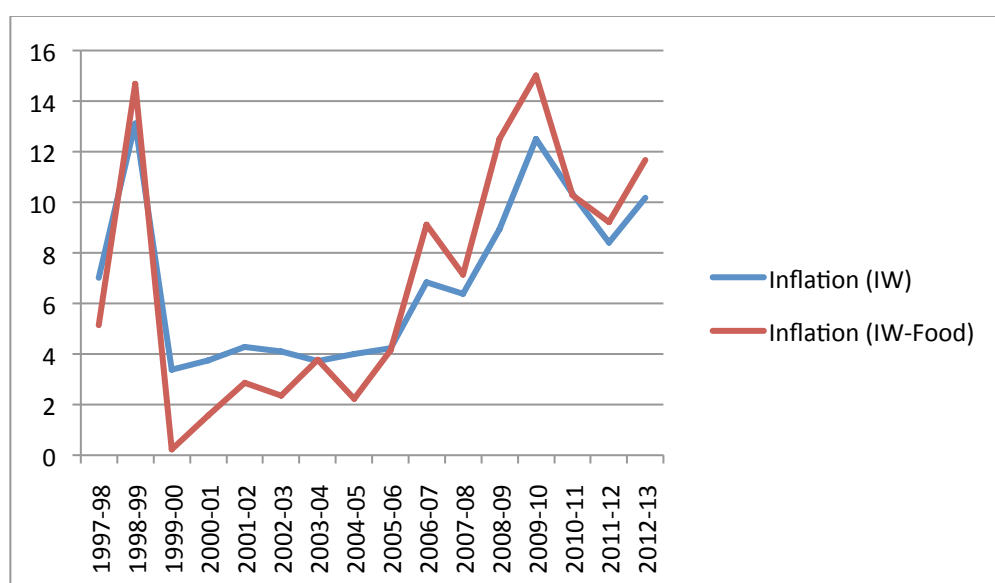


Figure 7. Annual inflation rate for industrial workers (Source: Reserve Bank of India)

⁸ Data source: World Bank.

Infrastructure: UPA's Waterloo?

When attention is drawn to the high growth rates achieved during UPA-I and even the first half of UPA-II, critics sometimes respond with the notion that these are delayed fruits of the previous NDA administration's good work, especially its investment in new infrastructure (Jagannathan (2013), Panagariya (2013)). Panagariya claims "progress in infrastructure, which had acquired great momentum under NDA...slowed down (under UPA)." There is no evidence to support this claim. Indeed, data shows the opposite is true.

Infrastructural investment even as a fraction of GDP (let alone absolute value) has been substantially higher during the UPA régime, hovering in the range of 7-8% in recent years as opposed to the 5% or so that was invested annually by NDA. The graph (figure 8) also shows a rising trend, i.e., over time, a greater fraction of national income is being poured into power generation, building of roads and railways, extraction of minerals and expansion of telecom networks. If the targets of the 12th Plan are met, infrastructure investment will cross 10% of GDP.⁹

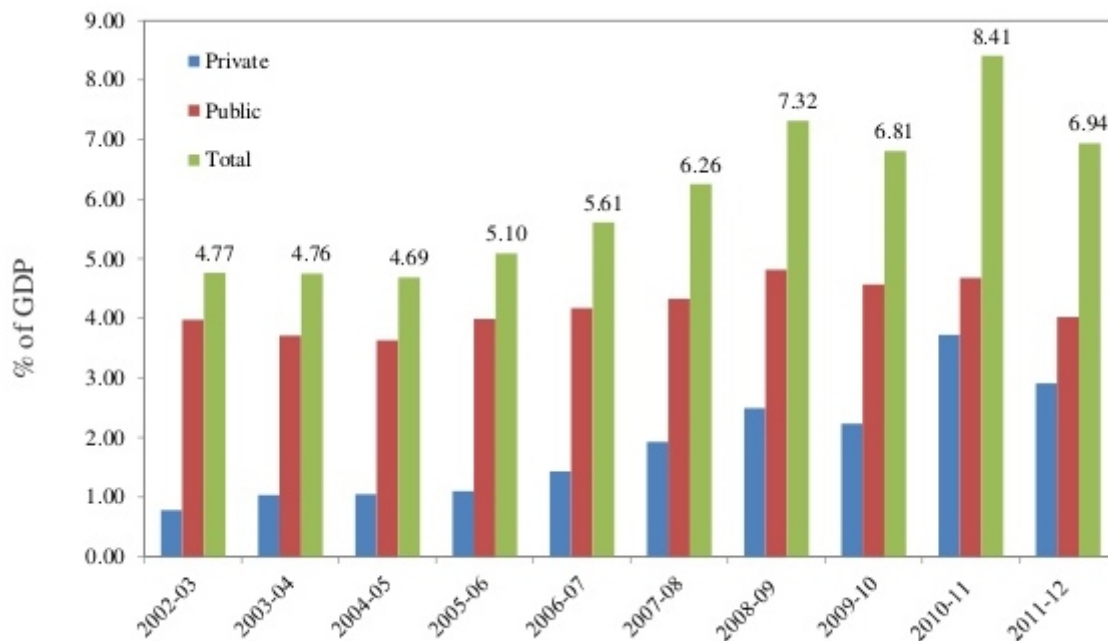


Figure 8. Investment in infrastructure as percentage of GDP (Source: Planning Commission)

A notable feature of the infrastructure building drive during UPA's reign at the centre is the increased entry of private capital through PPP projects and other financial arrangements. Public investment, as a proportion of GDP, remained roughly at the same level as in the NDA years, but private investment steadily increased and accounts for almost the entire growth in infrastructure spending. In the first

⁹ Report of the Working Subgroup on Infrastructure, Twelfth Five Year Plan.

three years of the Eleventh Five Year Plan, only 45% of the infrastructure spending got budgetary support; the remaining part was funded by borrowing from commercial banks and insurance companies as well as equity and FDI. Sectoral breakdown of actual spending shows that plan targets were nearly met or exceeded in those sectors where private capital played a significant role (power, telecommunications, oil and gas pipelines, roads and airports), but there were shortfalls of 25% or more in the sectors that relied primarily on public funding (irrigation, railways, ports, water supply and sanitation) (see Deloitte (2013)).

Increased resource allocation in infrastructure, aided by large infusions of private capital, must be regarded as a significant development during the UPA years, which helped boost growth but also led to some of the problems that now plague the government. The other noteworthy change with similar effects is the massive surge in FDI inflows, some of which went into infrastructure sectors like telecommunications (figure 9). From US \$2.8 billion per year on average during the NDA years, annual FDI inflow ballooned to an average of \$ 26.2 billion during UPA's second term, nearly a tenfold increase. What figure 9 also reveals is that the trend growth in FDI was very high especially in UPA's first term. The curve is relatively flat during NDA's tenure.

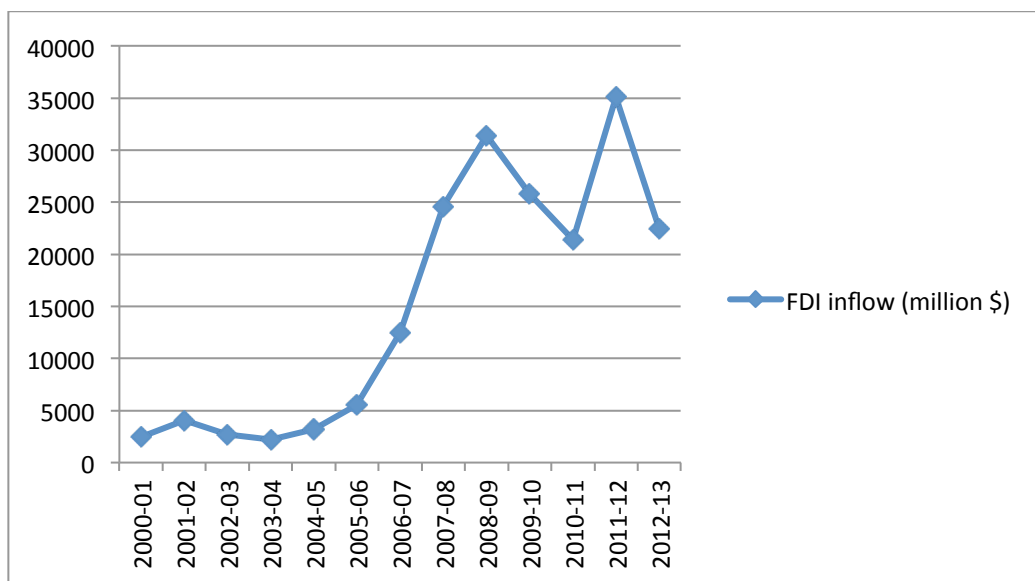


Figure 9. Foreign Direct Investment in India (Source: Planning Commission)

The positive effects of infrastructure funding, achieved to a great extent by mobilising private and foreign capital, are visible in many areas. Table 2 provides some examples and also reveals some interesting patterns. There has been significant acceleration in the growth of electricity consumption and passenger air transport in the latter half of the decade. Rail transport shows more modest acceleration and has grown at half the rate of air passenger transport in the 2004-11 period. While this difference between the railways and air travel may reflect demand side factors to some extent (substitution to quicker modes of transport due to rising incomes), the supply bottleneck in the

railways caused by lack of investment and modernisation must share part of the blame. Observe that in the last decade, airline deregulation and airport expansion under the PPP model has energized the airline industry while railways remains firmly ensconced in the public sector.¹⁰ The relative slowdown in mobile subscription growth (from 84.6% to 47.9%)¹¹ probably reflects market saturation. Mobile penetration started earlier in the decade with private players playing a leading role.

| | NDA (1999-2004) | UPA (2004-2011) |
|--|-----------------|-----------------|
| Electricity consumption (Kwh per capita) | 2.5 | 6.4 |
| Air transport (passengers carried) | 6.4 | 17.6 |
| Rail transport (passengers carried) | 5 | 8.8 |
| Mobile cellular subscriptions (per 100 people) | 84.6 | 47.9 |

Table 2. Percentage growth in infrastructure usage, compound annual rates (Source: World Bank)

In seeking private capital to expand infrastructure, UPA opened up a traditionally state dominated sector to big private corporations and arguably put more faith in markets than its predecessor. Some of the biggest corruption scandals that are now haunting the ruling party (recall the coal block and spectrum allocations), and which has put its re-election in peril, arise from this association.

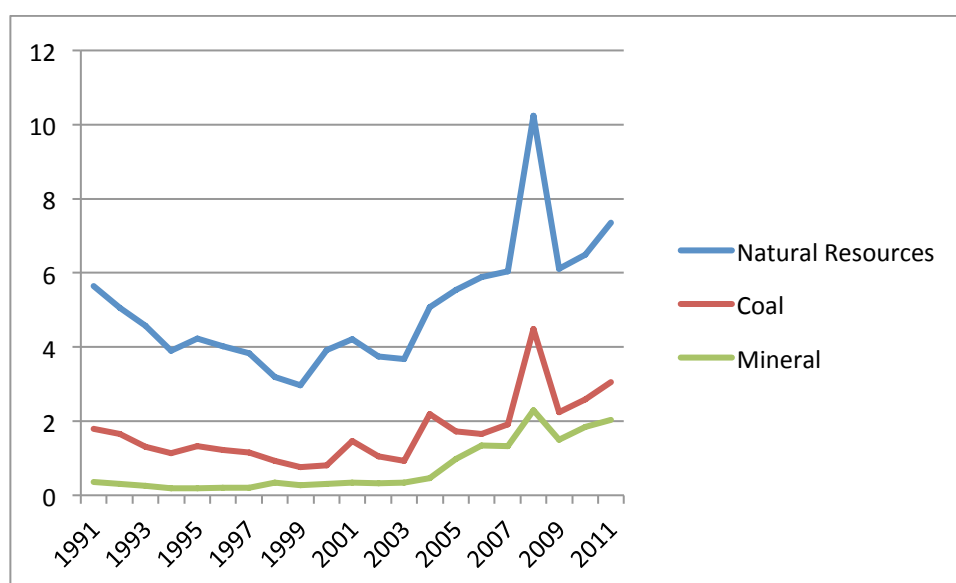


Figure 10. Rents from natural resources and its select components as percentage of GDP
(Source: Reserve Bank of India)

¹⁰ In the Eleventh Plan period, there was a 25% shortfall in meeting planned investment targets in the railways. Investment in airports fell short by only 5% (Deloitte (2012)).

¹¹ The extremely high growth in subscriptions is probably due to multiple SIM card usage.

Problems of land acquisition have also grown with the mushrooming of projects, precipitating severe conflicts with farmers, tribals and the rural poor. The natural resource sector has played a prominent role in the recent boom, as illustrated in figure 10. Since 2003, rents earned from extraction activities¹² as a percentage of GDP have nearly doubled. The overwhelming impression in India is that unclear pricing and allocation rules, as well as lax property rights, have created a scramble for these lucrative rents using political connections as leverage. *The Economist* (March 15, 2014) quotes a recent poll where 92% of respondents thought corruption has gone up in the last five years. In the magazine's own estimate, \$80 billion has been earned through rent seeking in the last decade.

These developments have enabled the left to construct a narrative that the development model pursued by the government puts profits over people and the state has been reduced to a corporate tool rather than a benevolent representative of the common man. The right's narrative portrays the same government as an irresponsible populist more eager to please the electorate with handouts than expanding its productive capacity. The right's narrative is simply wrong, but the outlook on the left also seems too morally stark and simplistic. While the concentration of wealth at the top, achieved to some extent by bending rules and exploiting political connections, is a serious problem in India today, the need to raise productivity is also critical to our development efforts. Restricting the task of infrastructure creation to a fund starved and inefficient public sector will be a retrograde step. We must find a way of combining economic dynamism with probity in public life.

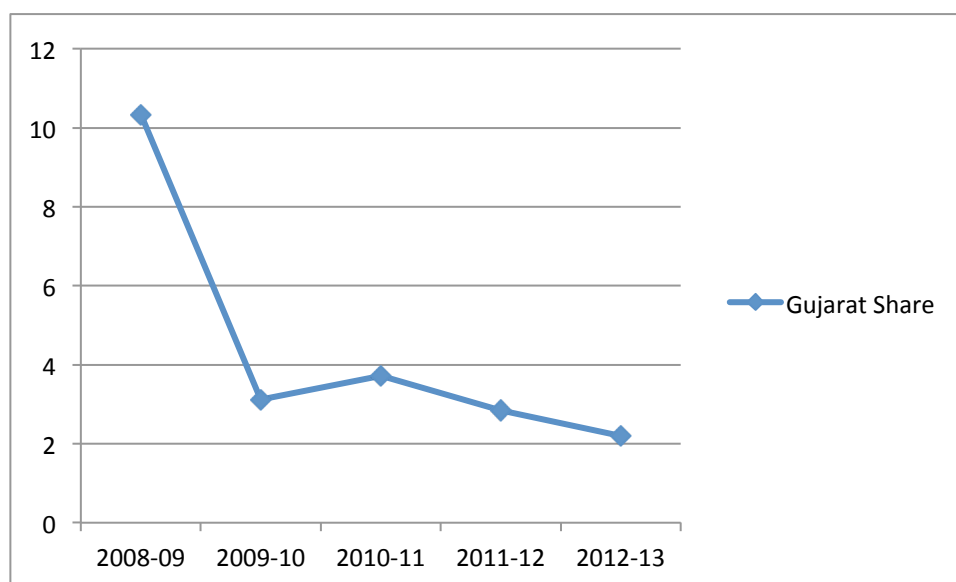


Figure 11. Gujarat's percentage share in FDI equity inflows

(Source: Department of Industrial Policy and Promotion, Ministry of Commerce and industry)

¹² The commodities covered in these figures are coal, minerals, forest resources like timber, oil and natural gas.

In the light of the fact that infrastructure and FDI have been on an upswing in India under UPA, it is worth reviewing some of the claims coming from the supporters of Gujarat chief minister Narendra Modi. According to this camp, two critical aspects that distinguish Modi's governance from that of UPA's is his emphasis on developing infrastructure in his state to aid industrial growth and his efforts to attract domestic and foreign investors through the Vibrant Gujarat Summit. As a matter of fact, Gujarat's share in the cumulative FDI inflows into India since 2000 is only 4%, which is exceeded or matched by many states (Maharashtra 31%, Delhi 19%, Karnataka 6%, Tamil Nadu 6%, Andhra Pradesh 4%). It is quite obvious from the list that main attractor of FDI is the presence of a major metropolitan centre in the state. As figure 11 illustrates, Gujarat's share is also falling in recent years for which we could gather data.

The idea that BJP is a more market friendly party than Congress at least as far as capital flows are concerned has very little evidence to support it. This is not only evident from outcomes (much higher FDI growth under UPA than NDA), but also from policy statements and decisions. It is the UPA which has pushed for opening up many sectors to FDI, most notably in multi-brand retail. A wide range of opposition parties and even some alliance partners opposed it, and the BJP explicitly adopts this stance in its 2009 manifesto (p. 24). One of the first decisions taken by the newly elected BJP government in Rajasthan was to disallow the entry of FDI in the retail sector of the state (*Times of India*, February 1, 2014). Narendra Modi himself sends conflicting signals. He has expressed his opposition quite categorically in the past (Modi's website) but sounds more ambiguous in recent speeches (*Indian Express*, February 28, 2014).

External Sector

Did UPA turn back the clock on globalisation and pull us back from integrating with international markets? Based on the evidence, the answer has to be a clear no. Again, one may welcome or oppose this trend, but there is little evidence to support the claim that Prime Minister Manmohan Singh's government halted or reversed India's liberalisation programme.

Figure 12 shows average import duty on goods and services have steadily gone down since the onset of liberalisation and is now in the single digits. The only mild upswing in this declining trend is seen in the early years of the NDA government. Unsurprisingly, foreign trade has increasingly assumed greater importance for the India economy, as illustrated in figure 10. Exports have grown from below 15% of GDP in the NDA years to nearly 25% in 2012-13. Imports have more than doubled relative to GDP – starting from 17% in the last year of NDA rule, it now touches 35%. Under UPA, India has embraced globalization rather than shying away from it. Whether this is a welcome development depends on one's economic philosophy, but the underlying fact cannot be denied.

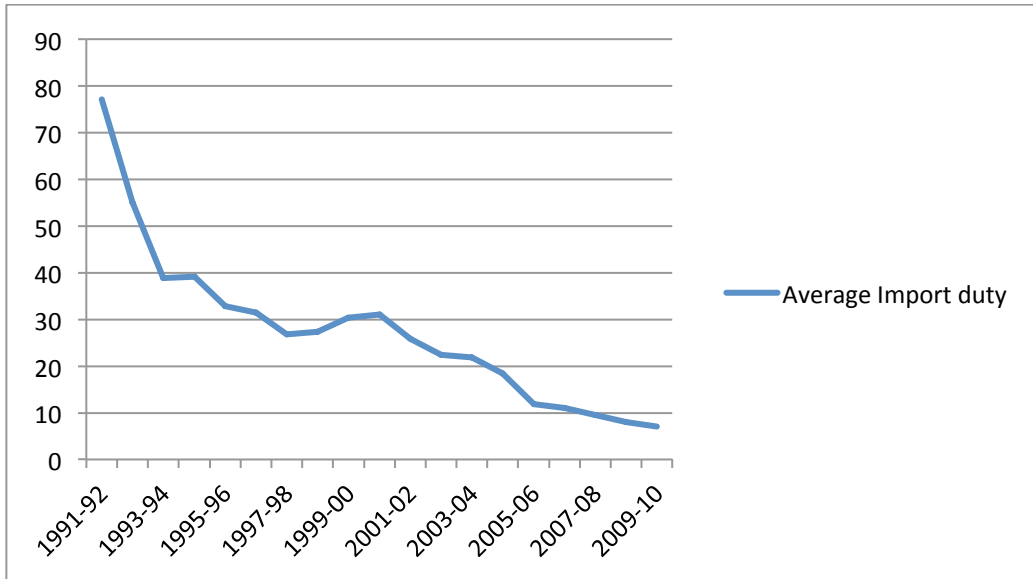


Figure 12. Duty on imports, weighted average (Source: Planning Commission)

Figure 13 also shows imports have been rising faster than exports in recent years, leading to a growing trade deficit. This has been balanced to some extent by a surge of foreign capital inflow, which we documented earlier (figure 9). Both the data and public positions of the major parties on issues like FDI in multi-brand retail suggest that it is the Congress rather than the BJP that has taken up an agenda of relaxing import and capital controls further.

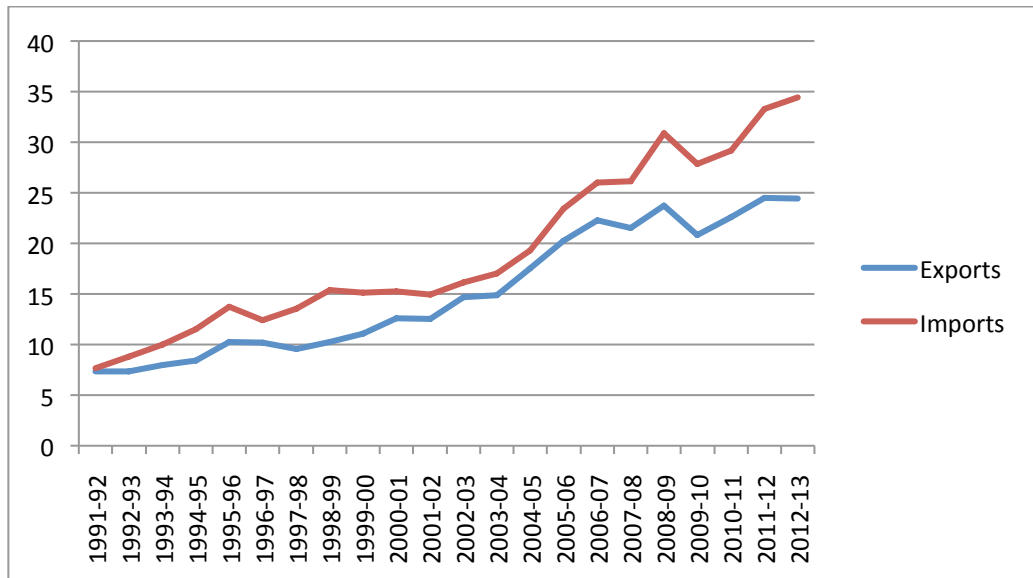


Figure 13. Value of exports and imports as percentage of GDP (Source: Reserve Bank of India)

A final word about the falling rupee. The summer of 2013 saw a sharp depreciation of the currency. In just four months, between May 2013 and August, 2013, the rupee fell 20% to the US dollar. This has caused much gnashing of teeth in the Indian media and the rupee depreciation has been cited as yet another indicator of economic mismanagement and India’s slipping position in the global economy.

Two things must be kept in mind in this context. First, as we have repeatedly stressed throughout this article, it is important to keep one's eyes on long term trends rather than draw sharp conclusions from short term fluctuations. Second, it is more pertinent to look at the real effective exchange rate rather than the nominal exchange rate. India is a more inflationary economy than the USA or the European Union, so it stands to reason that there will be a persistent downward pressure on the nominal exchange rate for that reason alone. What matters (say to a consumer wishing to import products from the USA) is not whether the dollar is getting more expensive but whether its cost in terms of rupees is rising faster than prices and wages in the country.

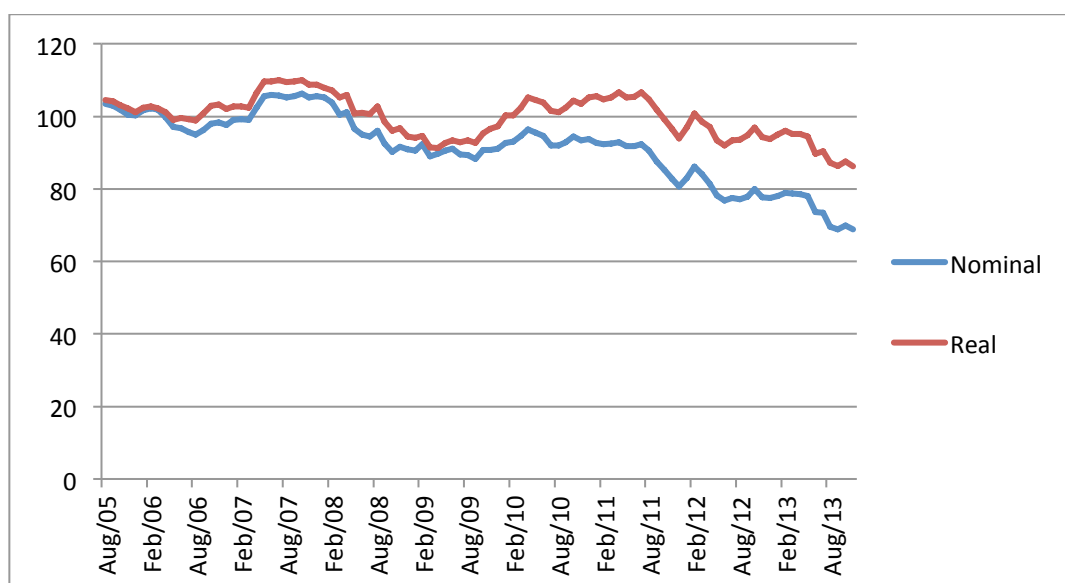


Figure 14. Nominal and Real Exchange Rates, Aug-2005 – Nov, 2013
(36-currency index, base: 2004-05 = 100. Source: RBI)

Figure 14 plots the movement of nominal and real effective exchange rate of the rupee through most of UPA's tenure. The Reserve Bank of India calculates the real exchange rate based on inflation figures and against a basket of 36 world currencies. From the time UPA took over, the rupee has lost nearly 30% of its value in nominal terms. However, it currently stands 11% below its value in 2004-05 in real terms. A quick glance at figure 14 will tell the reader that while there is a steady downward trend in nominal value of the rupee, the real exchange rate shows no such persistent decline but has experienced fluctuations around more or less stable mean (the figure 100 represents the normalized real value of the rupee in 2004-05). We are currently at a trough rather than a peak of these cycles, but note that at the time of the general elections in 2009 when UPA was re-elected, the rupee was trading at 8% below its baseline value of 2004-05 in real terms. The current strength of the Indian currency is not outside its normal band for the last decade.

Poverty Decline

Aggregate growth may be desirable not so much for its own sake but for the possible effect on poverty reduction and human development. The debate often centres on the question whether growth automatically translates into lower poverty or if specific government policies are needed to achieve this translation, or speed it up. Table 3 presents the poverty figures for two phases: the period from the early years of liberalisation till UPA came to power, and UPA's governing period starting from 2004-05 until 2011. The estimates are from the Planning Commission and are based on NSS data and the Tendulkar poverty line.

| | Poverty Ratio (%) | | | Number of poor (million) | | |
|--|-------------------|-------|-------|--------------------------|-------|-------|
| | Rural | Urban | Total | Rural | Urban | Total |
| 1. 1993-94 | 50.1 | 31.8 | 45.3 | 328.6 | 74.5 | 403.7 |
| 2. 2004-05 | 41.8 | 25.7 | 37.2 | 326.3 | 80.8 | 407.1 |
| 3. 2011-12 | 25.7 | 13.7 | 21.9 | 216.5 | 52.8 | 269.3 |
| Average annual decline: 1993-94 to 2004-05 (% per annum) | 0.75 | 0.55 | 0.74 | | | |
| Average annual decline: 2004-05 to 2011-12 (% per annum) | 2.32 | 1.69 | 2.18 | | | |

Table 3. Poverty estimates, Tendulkar method (Source: Planning Commission)

Poverty declined at 0.74% per annum before UPA and accelerated three-folds to 2.18% per annum in the 11 years under UPA for which we have data. Clearly, poverty declined at a much faster rate since 2004-05 than in the first decade or so after liberalisation. Direct comparison of the NDA and UPA years is difficult due to methodological problems with the NSS 1999-2000 survey that raise issues of comparability.¹³ Although we cannot arrive at a precise quantitative estimate of poverty decline during the NDA period, indirect calculations suggest it was lower than the rate under UPA, perhaps significantly so. If one assumes that poverty declined at the same rate (i.e., 2.18 percentage points per year) from 1999-2000 to 2004-05 as it did after 2004-05, then simple back-of-the-envelope calculations show the head count ratio in 1999-2000 should have been 48.1% (add 2.18% x 5 = 10.9% to the poverty ratio in 2004-05, which is 37.2%). However, the poverty ratio in 1993-94 was already below that level (standing at 45.3%) and it is inconceivable that poverty actually increased over the period 1993-94 to 1999-2000 (Deaton's (2003) calculations confirm a decline if one is needed). Hence, it is safe to conclude that the rate of poverty decline was faster under UPA than under NDA.

¹³ The questionnaire in 1999-2000 had an additional set of questions with a shorter recall period of 7 days, biasing the answers of respondents (Deaton (2003)).

Human Development

It is well known that India has traditionally lagged behind in the areas of health and human capital. The incidence of malnutrition, stuntedness, disease and illiteracy are higher in India than many countries with comparable (or lower) levels of per capita GDP (Drèze and Sen (2013)). The low levels of public spending on health¹⁴ and education¹⁵, as well as institutional failures like corruption and low quality of service delivery must be counted as major reasons for this discrepancy. There is little difference between the NDA and UPA governments in this regard, and whatever little can be detected goes against the usual image of BJP being the pro-business party and UPA being more inclined to spend on the social sector. Public spending on health has been flat at around 1% of GDP under both governments. Perhaps surprisingly, there was a significant increase in public spending on education in the initial years of NDA, from under 3% to well above 4%, around the time when the Vajpayee government launched the *Sarva Shiksha Akiyan*. The budget share for public education gradually declined over the rest of NDA's term and returned to old levels (marginally above 3%). UPA has not significantly increased this allocation (figure 15).

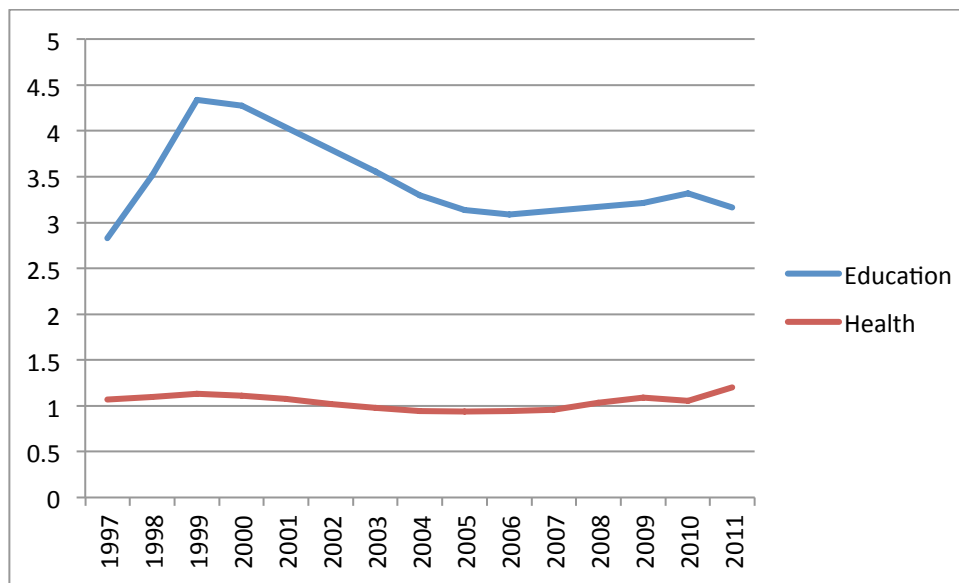


Figure 15. Public spending on health and education (Source: World Bank)

¹⁴ Public spending on health as a percentage of GDP in some leading emerging economies in 2010 are as follows: China 2.7%, Mexico 2.8%, Thailand 3.1%, Brazil 3.8%, Turkey 4.4%. Countries with high and very high levels of human development spent on average 3.6% and 8.2% of GDP respectively on public health. India spent only 1.2% in contrast (UNDP (2013)).

¹⁵ Public spending on education as a percentage of GDP in some leading emerging economies in 2009 are as follows: Turkey 2.9% (2006 figure), Thailand 4.1%, Mexico 5.3%, Brazil 5.8%. Figures for China are unavailable. For countries with high and very high levels of human development, the figures are 5.2% and 5.4% respectively. India spent 3.2% of GDP on public education in 2009 (UNDP (2013)).

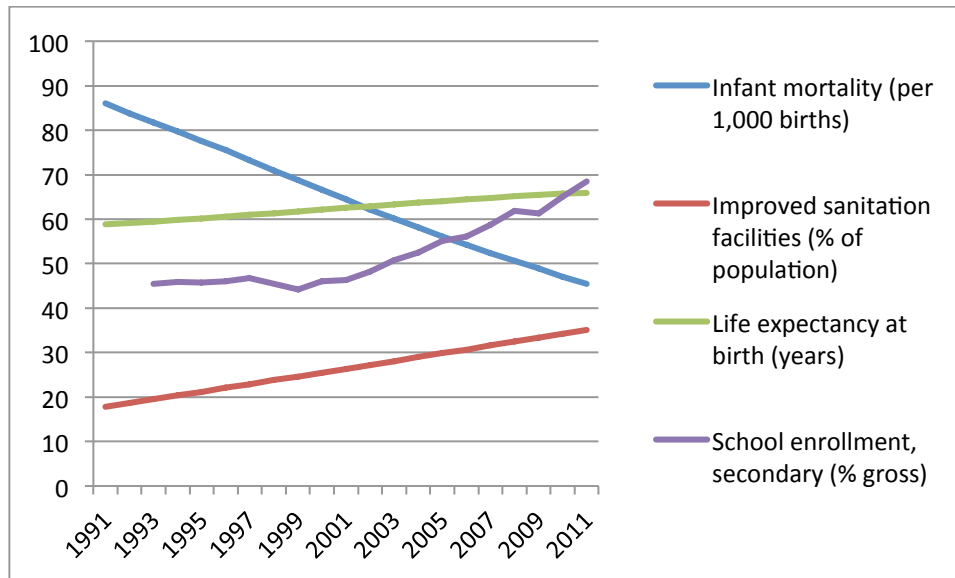


Figure 16. Selected health and education indicators since 1991 (Source: World Bank)

Unsurprisingly, many of the human development indicators show improvements at a steady but slow rate over the years and dramatic breaks cannot be detected with change in political régimes. Figure 16 illustrates this by plotting four common measures of human development since the onset of liberalisation: infant mortality rate, access to sanitation, life expectancy at birth and secondary school enrollment rate. Notice that the time gradient of these graphs are quite small and show little change except for a slight acceleration in secondary school enrollment around the turn of the century (i.e., the time when NDA increased spending on education). It is possible that the high growth rates for much of UPA’s rule at the centre will translate into faster improvements in health and educational outcomes with a few years’ lag, but such a shift is not discernible yet. On the whole, there is little to choose between the NDA and UPA administrations. Neither government made public health or education a top priority. The results are what one would expect.

The Policy Landscape

Most western democracies have economically left wing and right wing parties. The right wing party believes broadly in free markets and minimal government, while the left wing party’s mission is to support a strong welfare state and regulate private enterprise. There is some degree of positioning with electoral calculations in mind, and social issues do complicate matters, but politics is largely a contest between contrasting economic ideologies. In India, in analogy with the political alignments of the west, the socially conservative nationalist party (BJP) is assigned the role of the economic right wing, while the secular and socially liberal party (Congress) is assumed to be the economic left or centre-left. A historical association of the Congress with Nehruvian socialism, or the close ties of the BJP with the business community in Gujarat, reinforces this framework of thinking.

This is a wrong model of contemporary Indian politics. It leads to distorted readings of the past and false expectations about the future. Most political parties in India (with the exception of the communists) are founded not on a strong economic ideology but on notions of culture and identity – national, regional, ethnic, caste-based or linguistic. Positions on economic policy are usually a derivative, influenced by vote bank calculations or the need to attract funds for election campaigns. Since policy choices do not arise from deep ideological commitments to preferred economic paradigms, they are often incoherent, shifting and lacking in the sort of essence that may qualify for labels like socialist or libertarian. Parties also adopt similar positions and rhetoric on many issues in response to similar electoral and financial incentives.¹⁶

The two major national parties' election manifestos from 2009 make interesting reading and provide some important clues about their orientation towards economic policy. In the BJP's manifesto, the Chairman's opening remarks make no mention of any economic issues at all – it dwells on India's glorious past in a variety of fields, the decline following foreign invasions and the promise of civilizational renewal. Economic issues first make an appearance on p. 17 in a 49 page document, after national security, foreign policy and the nuclear programme. When it comes to laying out its promises to the electorate (Section IV), the Congress manifesto starts with economic policy and ends with foreign policy, the reverse sequence of its rival.

Economics is clearly not the BJP's primary concern, let alone free market doctrines. Consistent with its founding philosophy, it is still primarily a Hindu nationalist party. This simple and obvious fact is often forgotten by certain sections of its supporters and critics alike. Narendra Modi's rhetorical emphasis on *vikaas* (development) has reinforced these interpretations. But Modi's "developmental" philosophy has no real content in terms of policy ideas, let alone the ideas that many of his market fundamentalist supporters would like to incorporate into state policy (cutting taxes and entitlements, privatizing PSUs, relaxing environmental regulations, labour market reforms and curb on union power, and generally reducing the role of government). It consists, instead, of the promise of good 'governance' – an ideologically neutral commodity that reduces politics to management. "Good governance is more potent than policies," Modi has dismissively announced in a recent speech (*Zee News*, March 29, 2014).

A survey of the BJP position on various economic issues in its 2009 manifesto shows that many of its stances are not traditionally right wing economics. Other than dishing out boilerplate, it talks of expanding the PDS, revamping mid-day meals, waiving agricultural loans, raising minimum wages, banning GM seeds, keeping FDI out of the retail sector, expanding reservations and investing 6% of GDP on public education. Words can also be matched with deeds, as we have seen. On many of these

¹⁶ Kohli (2012) makes a similar observation looking at the record of the last three decades.

issues, the BJP's position is identical to that of the Congress (and most mainstream political parties) and in some (e.g., FDI in retail), it is actually further to the left.

While economics seems to be a more dominant concern in the Congress leadership's thinking, it would be a mistake to put a simple pro-market or pro-welfare label on the party. It is not a monolithic organization – internal conflicts and divergent concerns are quite evident from the record of the last ten years. The ire of the right is probably inspired by the Sonia wing and the National Advisory Council, with their high profile welfare schemes, anti-capitalist sentiments and rights based legislative agenda. At the same time, the Manmohan wing has quietly gone ahead with tasks like import liberalisation, removal of capital controls, privatization, infrastructure investment and fiscal discipline. In the best of times, the Congress's divided leadership could combine to produce truly inclusive growth. In the worst of times, it is a recipe for drift and disarray, or worse, unchecked corruption and stultifying regulation. The last ten years has seen some evidence of both.

Conclusion

In India *circa* 2014, much of the corporate sector, the middle class and sections of the intelligentsia seem impatient with the country's political and intellectual climate, which has traditionally been left leaning at least in rhetoric. There is a new yearning for meritocratic pride rather than Gandhian austerity or egalitarian guilt. India's political parties, which must still win the votes of the masses (a majority of whom remain poor) to capture power, can ill afford to embrace the laissez faire ethos of the elite too overtly, nor do they find it a natural vocation given their ideological roots. Nevertheless, great passions breed extraordinary delusions. A ruling party which has actually liberalised markets, courted capital and overseen the strongest decade of growth since independence, is being picked out as the arch enemy of free enterprise and entrepreneurship. An opposition party, traditionally more concerned with rebuilding temples and reshaping culture, has suddenly been appointed as the hard-nosed champion of 'market reforms'. A period witnessing remarkable gains for the privileged and some for even the not-so-privileged has been confidently declared a disaster zone. The obvious leadership gap has played a role here, but nonetheless, this manufactured reality will no doubt marvel future historians when they look at the actual records.

Negative energy is infectious, especially in an age where media penetration even into remote villages is nearly complete, and when dreams of upward mobility have become more pervasive. The coming elections will tell us how far the myths of 'UPA's economic disaster' have spread.

References

1. Banerjee, A. (2014): "UPA is Not Able to Take Credit for What it Has Done." *Hindustan Times*, March 25, 2014.
2. Brender, A. and A. Drazen (2013): "How do Budget Deficits and Economic Growth Affect Reelection Prospects? Evidence from a Large Panel of Countries." *American Economic Review*, 98(5), 2203-2220.
3. Bhagwati, J. and A. Panagariya (2012): *India's Tryst with Destiny*, Collins Business.
4. BJP Election Manifesto (2009), http://www.bjp.org/images/pdf/election_manifesto_english.pdf.
5. Chavan, M. (2013): "Old Challenges for A New Generation." http://img.asercentre.org/docs/Publications/ASER%20Reports/ASER_2013/ASER2013_report%20sections/madhavchavanarticle.pdf.
6. Deaton, A. (2003): "Adjusted Indian Poverty Estimates for 1999-2000." *Economic and Political Weekly*, January 25, 322-326.
7. Deloitte, India (2013): *Funding the Infrastructure Investment Gap*. <http://www.deloitte.com/in>.
8. Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India: *FDI Statistics*, http://dipp.nic.in/English/Publications/FDI_Statistics/FDI_Statistics.aspx.
9. Drèze, J. and A. Sen (2013): *An Uncertain Glory: India and Its Contradictions*, Allen Lane.
10. Ghatak, M. And P. Ghosh (2011): "The Land Acquisition Bill: A Critique and A Proposal." *Economic and Political Weekly*, 46(41), 65-72.
11. *Indian Express* (2014): "Don't Run From Big Retail Chains, Face them, Modi Tells Traders." February 28.
12. Indian National Congress Election Manifesto (2009), <http://incmanifesto.a-i.in/manifesto09-eng.pdf>.
13. Jagannathan, R. (2013): "Growth Stats: Why UPA-2 Record is Shrinking Towards NDA's." *First Post*, September 13.
14. Jha, S. and B. Ramaswamy (2010): "How Can Food Subsidies Work Better? Answers from India and the Philippines." Asian Development Bank.
15. Kohli, A. (2012): *Poverty Amid Plenty in the New India*, Cambridge University Press.
16. Narendra Modi website: "CM Strongly Opposes FDI in Retail!" <http://www.narendramodi.in/cm-strongly-opposes-fdi-in-retail/>
17. Panagariya, A. (2013): "New Government Could Make Quick Gains in Growth by Fixing Paralysis in Decision Making." *Times of India*, December 14.
18. Planning Commission, Government of India: *Data Tables*, <http://planningcommission.nic.in/data/datatable/index.php?data=datatab>.
19. Report of the Working Subgroup on Infrastructure, Twelfth Five Year Plan.
20. Reserve Bank of India: *Database on the Indian Economy*, <http://dbie.rbi.org.in/DBIE/dbie.rbi?site=statistics>.
21. Singh, Tavleen (March 9, 2014): "Welcome this Election." *Indian Express*.
22. *The Economist* (March 15, 2014): "Fighting Corruption in India: A Bad Boom."
23. *Times of India* (February 1, 2014): "Rajasthan Joins Delhi in Banning FDI in Retail."
24. UNDP (2013): Statistical Tables from the 2013 Human Development Report. <http://hdr.undp.org/en/data>
25. *Zee News* (March 29, 2014): "India Lost A Decade of Growth Under UPA Rule: Narendra Modi."