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The Indian Infrastructure Games

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Preparations for the Commonwealth Games, taking place October 3–14, have been a matter of much controversy in India. Anticipation of a global public relations boost has turned to fears of global embarrassment.

Hoping for the best may be a better strategy than it seems—things in India do have a way of coming through at the last minute. The real lesson here has nothing to do with any marred Indian arrival on the world stage, contrary to the comparisons being made to China's Olympics. The games will come and go. And many seem to have forgotten the public relations disaster of China's torch run or sparse Olympic attendance due to tight restrictions on local access.

It matters far more that the travails of the Commonwealth Games not be repeated on a much more important stage. The sprawling Indian state that mismanaged preparation for the games—and was widely criticized for inadequacy long before that—has taken upon itself to lead economic development. Infrastructure is one arena in which the games failed, and the government's numerous and stark troubles with infrastructure extend well beyond the games. Yet despite these troubles, India has turned from a market reform path to a state-led development path where infrastructure spending is the principal means of driving growth.

This statist path will lead eventually to stagnation. Such stagnation will harm American interests by pushing India backward to parochialism rather than forward as a vibrant democratic partner of the U.S. both regionally and globally.

Reform Path Ignored. Starting in 1991, India reduced the paralyzing role of the state, broke with the "Hindu rate of growth," and accelerated economic development. That process continued for over a decade before stalling in 2004, when the Congress Party came to power. Initially, the failure of Congress to continue market-oriented reform was blamed on the political requirement of a coalition with leftist parties. However, the 2009 election gave Congress the leeway to again choose reform. It has declined to do so.

The centerpiece of reform was to be changes to simplify the tax code. These changes have been delayed and gutted in order to protect federal and state revenue. Elsewhere, the banking sector, whose credit fuels the economy, is still 75 percent state-owned. It is arguably even being re-nationalized, most recently with the Reserve Bank asking state governments not to give new business to private banks. Private banks are required to lend on a priority basis to constituencies chosen by the government.[1] Foreign direct investment is sharply restricted from rail to retail.

Congress's oft-professed alternative to the market is infrastructure development. The goal for 2007–2012 was $500 billion spending on infrastructure. For 2012–2017, it is $1 trillion. The government

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seeks a great deal of private money to meet these goals, but the state controls almost every aspect of the process: identifying projects, controlling bidding, enforcing specifications, and, all too frequently, diverting funds.

State Control. If the definition of insanity is repeating the same action but expecting a different outcome, handing economic development over to state-led infrastructure spending qualifies. The record of the Indian state in managing the economy in general, and infrastructure in particular, is terrible.

Government rhetoric to the contrary, there is no doubt that the infrastructure push is state-dominated. India projects that the private sector will fund half of the next $1 trillion in infrastructure spending, but that is triple the current proportion. Foreign participation in most areas is almost invisible. At the end of last year, the foreign equity share of public–private infrastructure partnerships was 1 percent. For example, India wants to spend $70–80 billion annually from 2012–2017 on power, as compared to $1.4 billion in foreign power investment last year.[2]

Some of multinationals' recalcitrance is due to conditions—sectors bans, requirements of local partners, and payment restrictions. But even under favorable conditions, state control of the projects immediately undermines their commercial viability. At the root of state control are vague property rights, a fundamental problem that cripples efforts to genuinely alleviate poverty.[3]

An Awful Record. As is often the case with government programs, the massive increases in infrastructure spending to date have begotten not obvious improvements in infrastructure but more denouncements of the sorry state of Indian infrastructure and plans for yet more spending. This is hardly a surprise—with the partial exception of telecom, state-run infrastructure programs have performed extremely poorly.

The majority of government projects suffer delays, almost invariably incurring additional costs. The costs from the delays alone are comparable to the new $11 billion infrastructure fund the government wants to establish as an important part of the solution to funding shortages. Less than half of the pledge to lay 12 miles of roads daily has been met in the past two years. One reason is that less than half of the outlays on road construction was actually spent.[4] Underperformance is even worse elsewhere. India is on pace to add less than one-third of targeted seaport capacity for the current five-year plan.

The infrastructure performance is no surprise to anyone who has followed the Indian economy: The turn to reform in 1991 was prompted by the state's miserable record. With the reemergence of close state management, more failures have appeared, including in highly touted programs outside infrastructure.

Take, for example, the program to distribute food grain. This program is corrupted by exclusion of the eligible and inclusion of the ineligible, with

1. Shika Dalmia, "India's Faulty Exceptionalism," *The Wall Street Journal*, April 2, 2009, at *http://online.wsj.com/article/SB123861220879979199.html* (October 4, 2010); Sugata Ghosh, "RBI Tells States to Stop New Biz to Pvt Banks," *The Economic Times*, September 27, 2010, at *http://economictimes.indiatimes.com/news/economy/finance/RBI-tells-states-to-stop-new-biz-to-pvt-banks/articleshow/6632805.cms* (October 4, 2010).
2. *Economic Times*, "RBI Tells States"; Arun S., "Foreign Equity Minuscule in Public-Private Projects," Hindu Business Line, December 25, 2009, at *http://www.thehindubusinessline.com/2009/12/25/stories/2009122553300100.htm* (October 4, 2010); Reuters, "Domestic Firms to Lead India Power Sector Growth," *The Economic Times*, September 27, 2010, at *http://economictimes.indiatimes.com/news/news-by-industry/energy/power/Domestic-firms-to-lead-India-power-sector-growth/articleshow/6637860.cms* (October 4, 2010).
3. Derek Scissors, "What a Market Economy Offers India," Heritage Foundation *WebMemo* No. 2918, May 27, 2010, at *http://www.heritage.org/Research/Reports/2010/05/What-a-Market-Economy-Offers-India.*
4. Nepal-India Chamber of Commerce and Industry, "Delay in 327 State Projects Cost Rs.54,717 cr," December 18, 2009, at *www.nicci.org/index.php?nav=news_and_events&type=business&id=267* (October 4, 2010); Geeta Anadn, "Indian Road Hits Unexpected Bump," *The Wall Street Journal*, at *http://online.wsj.com/article/SB20001424052748703369704575461622844955894.html* (October 4, 2010); Live Mint and *The Wall Street Journal*, "Infra Projects Under New Purview," May 17, 2010, at *http://www.livemint.com/2010/05/17223810/Infra-projects-under-new-purvi.html* (October 4, 2010).

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the ensuing misallocation approaching 100 percent in some states. The federal government has recently decided to increase grain distributions due to a scandal in which millions of tons grain were found to be rotting across the country, stored only under tarpaulin.[5]

Can the U.S. Help? If American policymakers are simply assuming a dynamic India based on straight-line projections of high growth rates, they are making a mistake. India's current success is due primarily to opportunities unlocked by earlier reform of a then-horribly inefficient economy. Those opportunities are not by themselves endless. State control—most recently exemplified in the Commonwealth Games—will sharply curtail them, limiting India's long-term prospects.

American strategy should be to encourage fulfillment of India's huge economic potential. In particular, American economic and commercial engagement should focus on resumption of market-oriented reform without direct regard for future gains for American companies. Those gains will materialize only if India returns to the reform path. American encouragement of Indian reform—through open, conducive U.S. economic policy and pressure for reform in areas of legitimate interest—will strengthen both economies and the bilateral relationship.

President Obama travels to India next month. Because the goal is a long-term U.S.–India partnership, one visit is not exceptionally important. Nonetheless, the President can shift the focus from short-term irritants in the bilateral economic relationship to the larger picture. It is market reform that has brought India this far. As unlikely a messenger President Obama may be for the market, there is no better place to start than India—and no better time than right after the Commonwealth Games.

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5. M. R. Subramani, "Study Finds Large Diversion of Rice, Wheat from PDS, Welfare Schemes," Hindu Business Line, September 22, 2010, at *http://www.thehindubusinessline.com/2010/09/23/stories/2010092353360400.htm* (October 4, 2010).