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India's Lost Economic Opportunity and the Implications for the U.S.

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Indian gross domestic product (GDP) growth for fiscal year 2012 was just announced at a surprisingly low 6.5 percent. Attention is focused on the present—slow growth, still-high inflation, and balance-of-payments instability. There is even talk of a crisis similar to that in 1991, which launched now-distant market reforms. The real danger, though, is the future. India is early in a powerful demographic expansion—a rare opportunity for sustained, rapid growth. It is wasting that opportunity.

The waste can be traced to the past. Current difficulties should surprise no one—the Indian federal government's mistakes were plain by mid-2009 at the latest.[1] The government has been blinded by the belief that, because India could grow at 9 percent to 10 percent, it would. In fact, just as in 1991, the bridge from economic potential to reality is built by market reform. The notion that deficit spending and loose money could drive the economy forward, so that difficult reform choices did not have to be made, has proven false.

The implications of India's faltering are unpleasant for the U.S. No economy can substitute for a thriving India—what will soon be the world's largest workforce. America's public and private sectors should make the best of a deteriorating situation by working with as many economic partners as possible, starting with individual Indian states. The U.S. is already cultivating these states, but the Indian federal government's economic failures make it a more urgent task.

India's Economy Right Now. The initial estimate for Indian fiscal year (FY) 2012 GDP growth is a sharp slowdown from 8.4 percent in (FY) 2011. The performance was worst in the final, January–March quarter, where the GDP gain was only 5.3 percent. The January–March result may be revised higher, and, at first glance, 6.5 percent annual growth might still look satisfactory. However, in addition to the discouraging trend, there are critical flaws that have been building for some time.

First, the general economic trajectory is unsustainable. While officials can point to a double-digit rise in per capita income of around 14 percent, debt per capita rose more than 20 percent in FY 2012.[2] The public contribution to this has been much discussed: While boasting of high growth, the government has failed to cut the annual fiscal deficit below 5 percent of GDP. Pledges that an improvement is right around the corner are based not on budget discipline, but on higher GDP growth that never materializes.

There is another unsustainable trend that receives less attention. From April 2006 to March 2010, real GDP expanded 50 percent, an outstanding result. However, the broad measure of the money supply, M3, ballooned 150 percent. In FY 2011, credit growth in particular accelerated sharply past 22 percent. This cannot last. The fiscal and monetary stimulus India has relied upon is not working, and it cannot continue.[3]

Another critical flaw is inflation. Year after year, the government insists inflation is soon to drop to 6 percent. Consumer inflation was 9.5 percent at the end of FY 2012. The wholesale price index rose "only" 6.9 percent, but previous readings have all been revised higher, and

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wholesale prices appear to be accelerating again. During the two terms of the ruling United Progressive Alliance (UPA), overall prices have increased 63 percent. Food prices have doubled, overwhelming the UPA's promise to make growth more inclusive.[4]

Losing an Irreplaceable Opportunity. This is the context for the GDP report. Rather than spreading benefits, the UPA government spread inflation and debt. These, in turn, are now undermining growth.

Of course, other countries have experienced weak economies over the past five years, and India has done well in some areas. But India is in the midst of a demographic expansion, where the labor force grows. Moreover, it is early in that expansion—the labor force is still getting younger. In this situation, economic growth can be rapid for a full generation or more. If that occurred, it would transform the world.[5]

Thus, government officials are correct to insist double-digit growth is achievable, but the possibility only highlights the extent of the ongoing failure. This is another critical flaw. The economy could grow at 9 percent to 10 percent without high inflation or debt. It has the labor endowment and a demonstrated capacity to innovate, at least in some sectors. Global capital would indeed flow to a liberalizing, price-stable, responsible India. This India does not presently exist, however, and its absence is extremely costly.

The country's performance should not be compared to the rest of the world; others do not have an unparalleled opportunity to lift 1.2 billion people from $1,500 annual per capita income to $15,000 (in today's terms). Every year wasted reduces the real income level that can be reached in the demographic expansion. Every year wasted raises the prospect of an economy near mid-century that is much older and needier but remains all too poor.

Delhi should shift from deficit spending and loose money to labor market liberalization and an investment climate that favors risk-taking over government revenue, and it should do so now. Waiting two more years for an election that may change nothing is two more years of lost potential that cannot be regained. If India is truly incapable of the necessary steps, there will be no demographic dividend, and the India of the future will suffer greatly for it.

America's Response. Washington's influence over Delhi's economic policies is minimal. A thriving India would benefit America economically, but as that possibility starts to slip away, the U.S. must also prepare for a global economy without it.

In this light, other economic relationships become more important. Indonesia in particular has a large labor force and is growing strongly at present. Jakarta will not be easy to deal with in light of protectionist tendencies. However, Indonesia's young labor force, combined with others such as Vietnam, could be a reasonable substitute for India's contribution. Finally, the current situation in India as a whole obscures large pockets of strength. If national policy remains harmful, individual states have some leeway to deviate and are large enough to be valuable partners.

The U.S. should:

- **Increase engagement with Indonesia and others with similar demographics.** Bilateral investment treaties are one means, and the Trans-Pacific Partnership or some of its provisions could form the basis of enhanced ties.

- **Reorient its economic approach to India from the national level to the state level.** This process has begun but should be intensified, as the situation is genuinely unprecedented.

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3. A. Seshan, "No Baby Steps This Time," *The Hindu Business Line*, April 27, 2011, http://www.thehindubusinessline.com/opinion/columns/a-seshan/article1770357.ece (accessed June 1, 2012), and C. P. Chandrasekhar and Jayati Ghosh, "India's Schizophrenic Banks," *The Hindu Business Line*, June 28, 2011, http://www.thehindubusinessline.com/opinion/columns/c-p-chandrasekhar/article2139495.ece (accessed June 1, 2012).
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5. Derek Scissors and Michelle Kaffenberger, "U.S.–India Relations: Ensuring Indian Prosperity in the Coming Demographic Boom," Heritage Foundation *Backgrounder* No. 2274, May 15, 2009, http://s3.amazonaws.com/thf_media/2009/pdf/bg2274.pdf.

A Ticking Clock. Put simply, Delhi is blowing it. The Indian government is right to point to marvelous potential, but the flip side is that potential is not forever: Irreplaceable years are being lost to bad policy. While hoping for Delhi to choose reform again, the U.S. should engage labor-rich economies that are willing to liberalize—both other countries and Indian states.

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