



Slowdown in India: Rent-Seeking Squelches Growth

Arvind Subramanian analyzes the factors behind India's decelerating growth, saying that the failure to reform the government's stranglehold of the economy diminishes prospects in the future.

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Steve Weisman: The phenomenal growth of the economy in India seems to be slowing down with implications for the economy of the world. This is Steve Weisman at the Peterson Institute with Arvind Subramanian, senior fellow, to discuss the latest developments. Arvind, how much is the Indian economy slowing down and what are the main reasons?

Arvind Subramanian: The last GDP number for the fourth quarter of the last fiscal year, which is the first quarter of this calendar year, was 6.1 percent. And that's a kind of real come down from the close to 9 percent growth that was average just before the crisis. And you know it stayed even at about 8–8.5 after the crisis. So this is like a real slowdown, which is getting people worried in India.

Steve Weisman: How worried?

Arvind Subramanian: Very worried because I think there is this sense that India has gotten used to high growth and therefore this is called the “revolution of rising expectations,” and people think that anything less than 8 or 9 is bad.

Steve Weisman: Is the slowdown the result of government anti-inflationary policies or in any way a result of policies -- or is it just cyclical?

Arvind Subramanian: For one, as you said, Steve, inflation has been stubbornly high for two years, close to double digits – very, very high. I would say probably the highest amongst emerging markets on a sustained basis and in some ways this inflation is more a reflection of the fact that long term potential growth in India is perhaps less than people believed. Basically, we are seeing inflation because the government has stepped on the pedal on demand because subsidies remain high, fiscal deficit is high, and frankly, the economy doesn't have the capacity to match this demand and that is the simple reason why for two years this has resulted in high inflation.

Steve Weisman: What needs to be done to lift the constraints so that this demand doesn't push the economy into inflation -- and real growth and changes in productivity happen? You've written in the Business Standard in India that the reforms, especially of the government stranglehold on so many parts of the economy, have not occurred as rapidly as they should.

Arvind Subramanian: One way of thinking about this, Steve, is to start thinking about India being afflicted by the curse of rents. What has happened is that in key sectors like land, coal, spectrum, there has been a lot of corruption because these are all scarce resources and the government has basically allocated them in ways that has maximized corruption and rents for certain people.

The consequence of this is that I think it has taken a toll on the productive capacity of the economy. For example, government corruption problems in land means that infra-

structure cannot proceed at the pace that India needs. Corruption in the allocation of spectrum has led to a virtual standstill in government completely because of the scandals related to spectrum. Corruption in the allocation of coal has meant also that power in India, which is so reliant on coal, and therefore infrastructure, has been constrained.

In some ways, you could say that the fundamental Indian model, which was delivering 9 percent, is unsustainable because that model was built on skilled labor, the IT [information technology] sector. But that is in short supply because the Indian higher education system is not able to churn out skilled graduates at the level that the economy needs. And then social capital has been eroded because of all this corruption.

So two key kinds of factors of production which determine long run development are now choking. India's other abundant factor of production, unskilled labor, we've never utilized because we have distorted that market via regulation and labor laws and so on. So here is a paradox of an economy finally that has a lot of unskilled labor but which we don't use. And we have been using scarce skilled labor and scarce land and so on; but because of governance breakdown, these factors of production are not able to keep up with the demand capacity of the economy and that is why you see the slowdown in growth and higher inflation.

Steve Weisman: It used to be called the "License Permit Quota Raj," but Prime Minister Manmohan Singh is known for liberalizing that regime in a couple of phases, this goes back to the 1980s and then more in the 1990s. He is prime minister now. What happened?

Arvind Subramanian: That is a nice way of putting it, Steve, because in some ways the License Permit Quota Raj was dismantled in, I would say, the vast parts of the economy, especially the manufacturing sector. But it is essentially that the locus of the License Quota Raj has shifted to these rents. I call these terrestrial rents, subterranean rents, and ethereal rents because these are scarce commodities, but there is so much corruption that the License Quota Raj—because the government is again awarding licenses and quotas in these sectors which is what is determining and giving rise to rents and this is taking a huge toll on the economy.

So in a nutshell, one could say that having dismantled the License Quota Permit Raj in one sector, it has not been able to do so in vast swathes of the economy and I think that is the next challenge for India.

Steve Weisman: Of course, the anti-corruption campaign has been well-publicized in India; are they going after this aspect of corruption or others?

Arvind Subramanian: Steve, you should help me out in this. In Latin, there is a phrase which I don't know what it is "Quis custodiet ipsos custodes," who should catch the criminal. If everyone has corrupted the system, who is the "they" that are going to go after the corrupt people? So in some ways, I think finally all this change has to happen via exactly the kind of a popular outrage that we saw last year. But translating that into concrete institutional changes that will allow accountability on an ongoing basis, I don't see that happening for some considerable time in the future. So how this imperfect democracy will deliver improvements in governance is kind of the million dollar question going ahead for the Indian economy.

Steve Weisman: Arvind, thank you. Next week, we will talk about the strategic economic dialogue between the United States and India and I will welcome you back. Thank you again.

Arvind Subramanian: Thanks, Steve.

