India’s Latest Reforms Provoke a Backlash

Arvind Subramanian says that India’s steps to lift some subsidies and welcome more foreign investment have broad popular support and will go through despite some politically inspired opposition.


Steve Weisman: A series of economic reforms in India have provoked a backlash among some Indian parties in the opposition and even in the government. Arvind Subramanian is here with me, Steve Weisman, at the Peterson Institute. First, what are the reforms that have, as I said, been welcomed by especially in the West, and have now caused some controversy?

Arvind Subramanian: I think, Steve, the reforms have been welcomed, not just in the West but also across the spectrum in India as well. I think that there are two and half-big measures. One is a first stab at reducing the fuel subsidy. It’s a modest increase in diesel prices. Second, a pretty ambitious opening up the foreign direct investment [FDI]: multi-brand retail, which is allowing Walmart into India. FDI in aviation, which was really forced upon them because Kingfisher, which is this big airline, is basically bankrupt and needs a foreign airline to rescue it, and also FDI in a couple of other areas.

Those are the two big measures. They’ve also agreed to partially selling off four state-owned companies. The bottom line is these are measures highly welcomed, taken in some part because the downwardly of an investment downgrade that was hanging over the authorities. Not really great substantially, or huge substantially, but certainly in terms of arresting the funk and the slide that Indian policymakers may have gotten into, this was fantastic.

Steve Weisman: Let’s talk about the FDI or Foreign Direct Investment, which is since Indian independence been an issue of nationalism and a country that was under colonial authoritarian rule for so long is wary of foreign corporations dominating the economy. There’s been some opposition but you think it’s going to go through?

Arvind Subramanian: Yes, right. One party supporting the government from within, just part of the coalition, has withdrawn and is saying it’ll support it from the outside – maybe, maybe not, whatever. That party is against FDI. But the interesting thing is that [the government] doesn’t need legislation to get this thing through. It’s not really in hock to this party.

Second, this is almost like a permissive piece of executive order. That is, some states that choose to welcome FDI are welcome to do so. States that don’t wish to welcome FDI are free not to do so as well. So it’s very interesting, because then it exploits what I’ve always called the competitive dynamic between states.

Steve Weisman: Right, one state that welcomes it means that another state loses out.

Arvind Subramanian: Well, no. It says, wow, we will follow, because if FDI comes in and has positive impacts, then other states will say, “Wow maybe we were stupid not to allow them in the first
place.” So that competitive dynamic is what I think the government has cleverly exploited this time around, i.e., it hasn’t said, “Everyone has to welcome FDI.” The states are free to choose.

Steve Weisman: What about fuel subsidies. There are a full array of subsidies, especially in the energy area.

Arvind Subramanian: Right. India has subsidies for diesel, for cooking gas, and above all, for kerosene, which is most politically sensitive and big. This is a modest attempt at reducing the subsidy with diesel, which has a lot of both industrial and consumer users. This is less politically sensitive than kerosene, which goes to the poorest people. This a stab at saying subsidies are getting out of control, we can’t afford it, and trying to club that back to some extent.

Steve Weisman: Again, this can be done without legislation.

Arvind Subramanian: Yes, again without legislation. I think the opposition to this is probably greater than the opposition to FDI. I think there might be some compromise. Maybe the government will roll it back a little bit, but I think it’ll broadly stick.

Steve Weisman: You’ve made the point though that parties opposing this seem to want to have it both ways. They want to oppose it, but they don’t want to topple the government.

Arvind Subramanian: Yes. I think the reason why these measures will broadly hold, and this government will not be toppled, is because at least two of the minority parties whose support is needed to topple this government -- [the party led by] Mayawati, which is the party in Uttar Pradesh, and another party, called Samajwadi Party which is actually now ruling Uttar Pradesh -- both these parties, I think don’t want elections immediately for different reasons. It’s because the BJP [Indian Peoples Party], which is the main opposition party – the only credible leader they have is Narendra Modi. I think the minority parties really fear his rise because he has these slightly anti-minority leanings.

Steve Weisman: More than slightly.

Arvind Subramanian: More than slightly. I think they want to prevent that kind of bad guy from coming in. You stick with status quo, so I think that’s the kind of political arithmetic going on now.

Steve Weisman: Could this be a phase, a little toe dipped in the water, leading to further lifting of subsidies and other reforms?

Arvind Subramanian: I think there is an opportunity here for more reforms. Again I think things that can be done without legislative passage are more likely to go through. I think one thing the government will now try and do, is actually accelerate the investment approval process to get investment going, and growth going. But the really big-ticket item now looming is the Indian equivalent of value added tax (VAT). It’s called the GST [goods and services tax]. That is a big one, but that not only requires legislative approval, it requires two thirds of legislative approval in Parliament.

Steve Weisman: To impose one?

Arvind Subramanian: To impose a nationwide value added tax. Not to impose, [but] to re-modify the existing one, and make it into a proper value added tax. Also, to extend it to services,
it’s called the Goods and Services Tax, GST. I think this would be a real game changer, in terms of three things. One, the revenue buoyancy. It was very buoyant. Two, in creating a common market in India. And three, VAT has to create anti-corruption properties, because it’s self-reinforcing. One man’s output is another man’s input, so the paper trail is very good to keep track of, and it’s conducive to fighting corruption and tax evasion.

Steve Weisman: Americans can certainly appreciate how daunting it would be to have this kind of tax.

Arvind Subramanian: If and when India implements this, Steve, the US should turn and take a lesson from India.

Steve Weisman: Thank you Arvind.

Arvind Subramanian: Thanks Steve.