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When promises become due – an analysis of the Modi government’s term in the world’s largest democracy

“We promise according to our hopes, and perform according to our fears,” wrote the noted 17th-century French author, François VI de la Rochefoucauld.

When the Narendra Modi-led National Democratic Alliance (NDA), which promised inclusive growth, came to power through a landslide election victory in 2014, few believed that the government would transform India and make its “Good Days for Everyone” campaign slogan a reality within its five-year term. India is too big and complex a country and changes happen in decades rather than in election cycles. Indians are used to seeing initiatives remain slogans and become repackaged for the next election. Hence, announcements by the new government of initiatives like Skill India, Startup India and Swacch Bharath (Clean India) did not raise unreasonable expectations, at least among seasoned India watchers.



Murali Nair

Relevance



Economic reforms and political developments in the world's largest democracy have geopolitical and economic implications in an increasingly multipolar world. India is one of the few non-EU countries, which has a strategic partnership with Germany with regular intergovernmental consultations. Moreover, she is increasingly seen as a hedge against China from a strategic and economic perspective.

Focus



The BJP government led by the charismatic Narendra Modi came to power in a landslide election victory promising rapid economic development in 2014. Though some bold reforms like the bankruptcy code have been passed, Modi's reform agenda has been gradual. With 12 million new job seekers a year and an 800 million plus rural population, job creation and rural development are key to transforming the country. On both these counts, the results on the ground are at best contested. Top down policymaking neither works in a large and diverse country like India nor does it strengthen institutions – the recent dispute With the Reserve Bank of India and the following resignation of its governor is a case in point.

Forecast



In recently concluded regional elections, the BJP has lost states like Madhya Pradesh, Rajasthan & Chhattisgarh totalling more than 165 million people. With national elections in May 2019, the BJP has to take drastic steps to convince the voters to give Modi one more chance. This could be through economic populism like tax cuts and freebies or changing the discourse through extreme religious polarisation between Hindus and Muslims or even a military adventure with Pakistan. None of the above options would make India a modern, global and dynamic country that the BJP promised to turn India into.

Options



German and European governments should continue focussing on multilateral partnerships with India. With a belligerent USA and an assertive China, initiatives like the EU-India Free Trade Agreement need to move forward by putting aside the different interests between the EU member states. India being the only stable democracy in the region, needs to be strengthened by deeper institutional cooperation in political, legal and trade fora.

What experts did expect was efficient and business-friendly policy-making without the pressures of keeping coalition partners happy, along with corruption-free government and extensive job creation through high

economic growth rates. In short, they expected what Modi delivered in Gujarat where he was the chief minister for more than a decade.

Fast forward to 2018: in August, Ranil Salgado, India head at the IMF, described the Indian economy as an elephant starting to run. He projected growth rates of 7.3% in 2019 and 7.5% the year after, accounting for almost 15% of global GDP growth. In the World Bank's Ease of Doing Business ranking, India jumped from 130 to 100 by endorsing a business-friendly government. With less than a year until the general election in 2019, the Modi government has kick started its campaign – "48 Months of Transforming India" – by highlighting achievements in economic areas and social development. Like any other incumbent government, it has selectively focused on numbers that are rosy and avoided uncomfortable facts. The economic growth over the last five years for various sectors is depicted in **Table 1**.

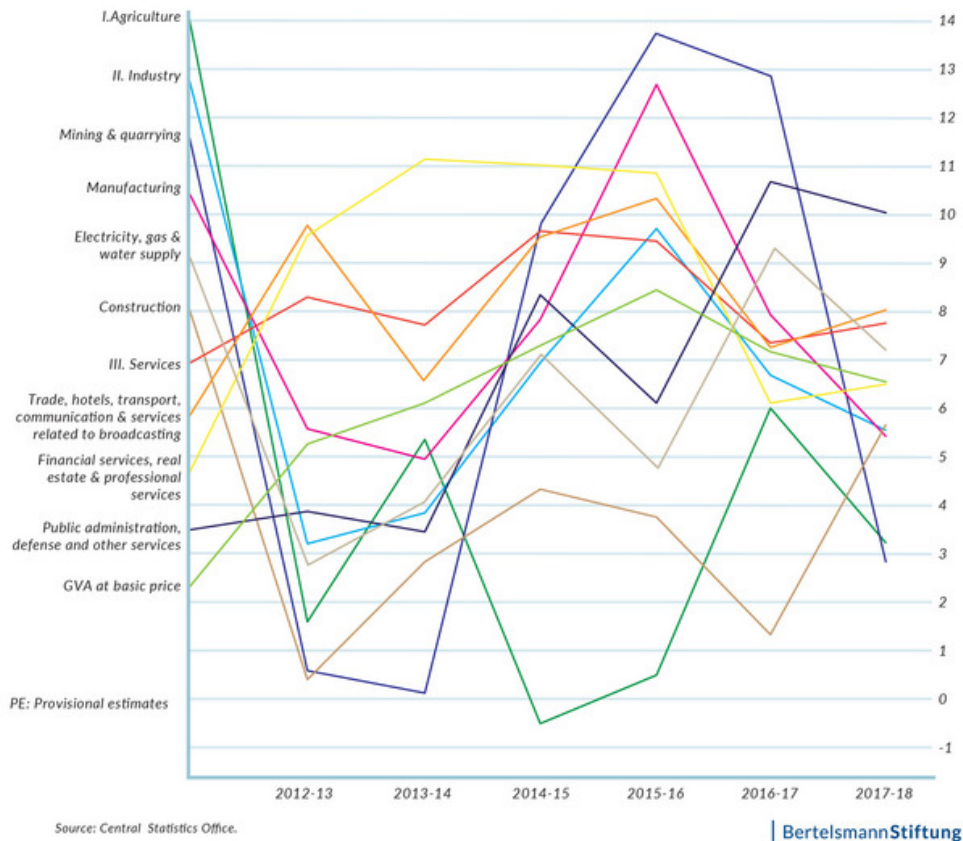


Figure 1: Growth rate of Gross Value Added at basic prices in constant (2011-12) prices (in %)

But 2018 also witnessed massive protests calling for quotas in government jobs for Marathas, a politically influential community constituting around 30% of the population of Maharashtra. The last four years have seen many such protests (in 2016 by Jats in Haryana and the Kapu community in Andhra Pradesh; in 2015 by Gujjars in Rajasthan and Patidars in Gujarat),

which have brought cities like Mumbai and Delhi to a standstill before turning violent and resulting in the death of innocent bystanders and the destruction of public property. Farmers across 130 cities went on a 10-day strike in June 2018 demanding a higher Minimum Support Price and loan waivers as their very existence was being threatened by a crash in commodity prices and low productivity. On top of this, the Rupee is at a historic low and the Bombay Stock Exchange has lost most of the gains it made in 2018.

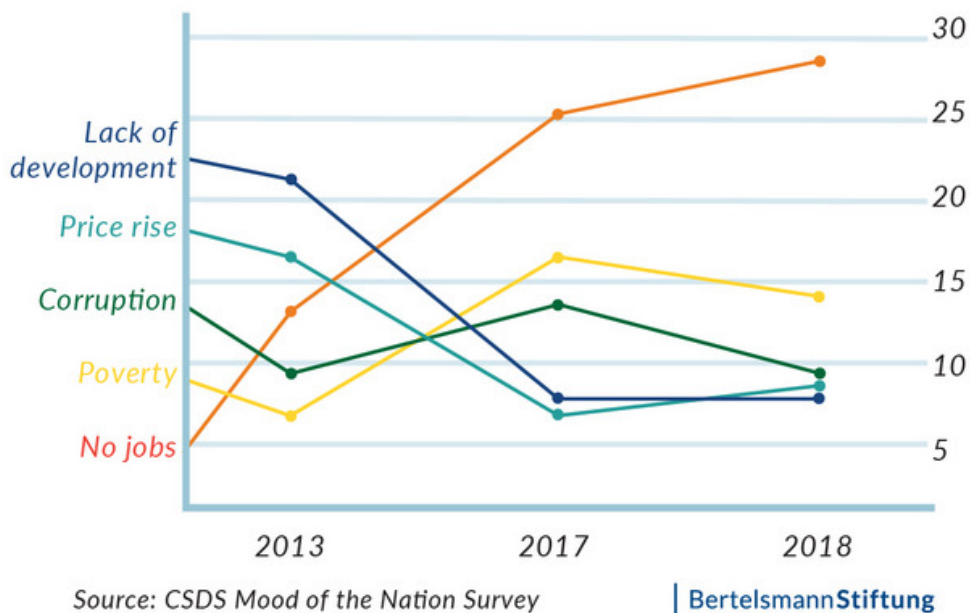


Table 2: Mood of the Nation Survey 2018 showing the major concerns of the population (in %)

In Mood of the Nation, one of the most exhaustive all-India surveys, too few jobs and poverty were identified as India’s biggest problems, with the numbers doubling from where they stood five years ago.

So where are the promised “good days for everyone”? The conundrum of high GDP growth rate and lack of jobs is not a phenomenon unique to India. Yet it is worth taking a detailed look at the Modi government’s approach to economic and social development and the major initiatives – both positive and not so positive – which have had a perceptible impact on the country. Under the headings Economy, Social Development and International Relations, the major achievements and let-downs can be grouped into three categories: **Very Good**, **Good** (could be better) and **Poor**.

Economy

Very good: The Insolvency and Bankruptcy Code, 2016

Possibly the most successful of the reforms enacted by the Modi government, this law allows defaulting companies to be auctioned off quickly and transparently. Many of the large Indian conglomerates with political nexus get credit from state-owned banks without undergoing the necessary due diligence. As the economy slowed, weak fundamentals and leaky governance pushed many of these companies into non-performing loans. The volume of bad loans has nearly doubled in the past four years and amounts to about \$210 billion or 11.2% of all advances. India's bad debt ratio is the second highest among G20 countries after Italy. The new law has pushed about \$52 billion of non-performing assets into bankruptcy processing. This has boosted the mergers and acquisitions market, which hit a record of \$104.5 billion by September 2018. Releasing precious capital into the market and strengthening the corporate governance structure, this is one reform that has structurally altered the Indian business landscape.

Good: Goods and Services Tax

In discussion since 2006, the national Goods and Services Tax (GST) was meant to replace at least 15 different tax codes at the central and state level and was blocked by the BJP when in opposition. The GST was a much-awaited step as the World Bank rated India 172 out of 190 countries in ease of paying taxes. Simplifying the byzantine tax system in a federally regulated country like India is a nightmarish exercise. The GST council is chaired by the union finance minister and has state ministers of finance and taxes as members; it also sets the tax slabs for various goods and services. It is one of the rare federal, consultative formats that seem to be working beyond political boundaries.

After a decade, the time frame, which allowed six weeks to implement such a complex law without a pilot, was neither fair nor expedient. In a country where 75% of enterprises have less than 10 employees and where 85% of small firms operate in the unorganized sector with no compliance capacity, the cold start without any transition period was a blow to many, who could not cope with it. There are still five tax slabs from 5% to 28% and the allotment of slabs to goods is a political and arbitrary issue. For example, air-conditioned restaurants had a tax rate of 18% and non-air-conditioned ones 12%, which the GST council reduced to 5%. But if the restaurant is within a hotel that charges more than 7,500 rupees a night on its rooms, then the tax is 18%! When one also considers the unstable IT backbone, filing correct tax returns and waiting for tax refunds becomes unmanageable for small players.

The registered tax base has increased from 6.4 million to 11.2 million companies. The tax compliance rate has increased from 57% in 2017 to 65% in 2018. The monthly tax collection of 940 billion rupees is more than the 2017 average of 890 billion, but below the 1,040 billion targeted by the

government. All in all, this much-needed reform is headed in the right direction. However, the haste and the arbitrariness make it less of the potential game changer it could have been.

Poor: Demonetization

Haste and arbitrariness were also the hallmarks of the hare-brained idea which made 84% of the currency in circulation invalid in November 2016. The reasons given for the move were fighting “black money” (non-taxed wealth), corruption and illegal political contributions. Against the predicted estimate of about 12 trillion rupees, 15.28 trillion of the 15.44 trillion (99.3%) of the country’s cash was returned to the banks; the wealthy either managed to launder their cash into banks or held it in non-cash or non-rupee currencies. Demonetization shaved off an estimated 1.5% of GDP growth (2.25 trillion rupees), cost the Reserve Bank of India 130 billion for printing new currency and led to 1.5 million lost jobs (according to the Centre for Monitoring of the Indian Economy). Moreover, 105 people lost their lives in the rush for cash. Promoting digital payments was an add-on argument to demonetization. However, despite the continuing growth in digital transactions, the data on ATM cash withdrawals post demonetization and cash in circulation suggest the cash transactions level has returned to where it was. As to fighting corruption, economic offenders like Vijay Mallaya and Nirav Modi, who cheated the state-owned banks of billions of dollars, managed to leave the country and now live freely in the UK.

Politically, however, it has paid dividends to the BJP as Modi was seen to be fighting ill-begotten wealth. Consequently, the 200-million-strong electorate in Uttar Pradesh rewarded the party with a handsome victory in the regional elections following demonetization.

Social Development

Very good: Digital Services

The NDA government in general and Modi in particular have been digitally savvy. The Digital India initiative, for example, is increasing public accountability by mandating electronic delivery of government services. Common Service Centres function as access points to deliver digital services, such as e-learning, e-banking, insurance and healthcare. 119,000 of 620,000 villages are now connected by optic fiber. In the UN’s E-participation Index, which measures citizens’ access to information and public services as a way of promoting participation in public decision-making, India is ranked 15th, ahead of industrialized countries like Germany and Canada. Moving ahead from merely providing services to transforming into a digital economy is of course the bigger challenge. The Aadhar project, which gave a digital biometric identity card to 1.21 billion Indians, is a major step toward building

an accountable and transparent welfare system, provided data-privacy issues can be sorted out.

Good: Healthcare

Healthcare in India is an underperforming sector with a dysfunctional public healthcare system for the poor and high-end hospitals catering to the rich and to medical tourists. The country has improved its ranking marginally on a global healthcare access and quality (HAQ) index from 153 in 1990 to 145 in 2016, performing below its economically weaker neighbors like Bangladesh. The government spends a dismal 1.1% of GDP on healthcare. The cost of healthcare services affects families and the economy as a whole. Out-of-pocket health expenses (68% of total expense as compared to 18.5% globally) drove 55 million Indians into poverty in 2017. After neglecting this socioeconomic disaster for years, the government started a new initiative called Ayushman Bharat, which aims to cover more than 500 million poor and vulnerable families for secondary and tertiary care. In addition, 150,000 primary healthcare centers are in the process of being established across the country. The challenge will be to provide quality healthcare and not to begin competing with programs in states like Rajasthan which have their own healthcare schemes.

Poor: Social inclusion

When Modi was elected in 2014, India's liberals hoped he would keep tight control over the extremists in his Hindu nationalistic party and the Rashtriya Swayamsevak Sangh (RSS), its ideological parent. This has not been the case as more than 23 Muslims have been lynched by mobs, predominantly in the BJP-ruled states, supposedly for storing or consuming beef. Jayanth Sinha, the union minister for civil aviation and a Harvard graduate, even publicly honored eight men convicted of beating a Muslim to death. Belated statements by Modi condemning such acts do not instill public confidence in India becoming an inclusive state.

The BJP has tried to create a unified Hindu identity by targeting Muslims as the enemy. Despite nominating a Dalit (the lowest in the caste hierarchy) for the post of president, it has been a party driven by upper-caste interests, which prefer a strict caste hierarchy to an equal society. Experts point to increasing prosperity and education among the Dalits, prompting the upper castes to show them their place. The simultaneous pre-dawn arrest of five human rights activists and people working for the marginalized – ostensibly for inciting violence among Dalits – shows the low threshold of tolerance of dissent.

The government also proposed a bill to amend the Citizenship Act of 1955 which would make illegal migrants who are Hindus, Sikhs, Buddhists, Jains,

Parsis and Christians from Afghanistan, Bangladesh and Pakistan eligible for citizenship by relaxing the mandatory waiting period to six years from 11. Excluding Muslims not only violates the Indian constitution, it also goes against the ethos of a nation that has offered refuge to Jews, Zoroastrians and other persecuted minorities for millennia. However, the government has shelved this bill due to protests against it in the state of Assam.

International Relations

Very good: Indo-US relationship

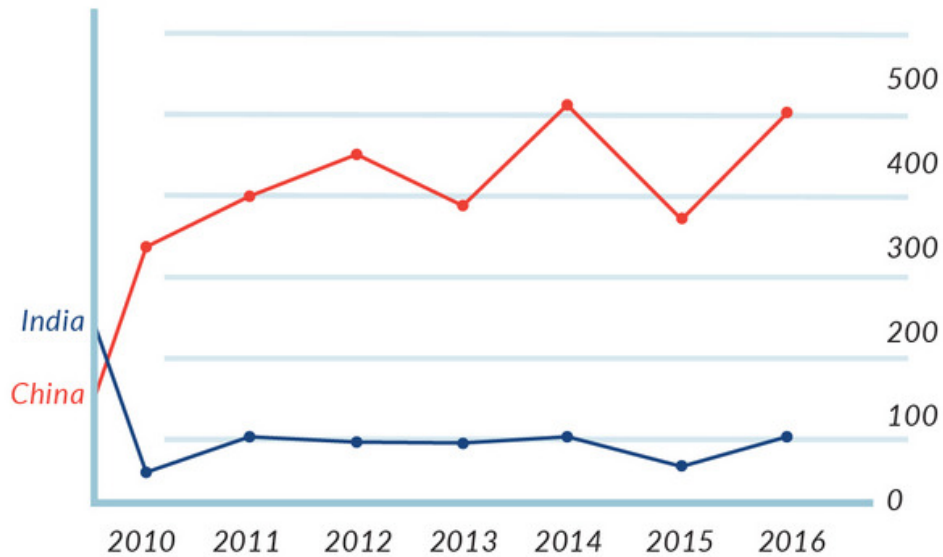
A major realignment was set in motion between India and the US with the civil nuclear agreement in 2005. The relationship between the world's largest democracies has reached a "defining moment," according to James Mattis, the US defense secretary, commenting after the first 2+2 meeting involving and defense and external affairs ministers of the two countries last week in New Delhi. The two countries signed the Communications Compatibility and Security Agreement (COMCASA) after the US assigned Tier 1 Strategic Trade Authorization (STA) status to India. The US is currently the second biggest supplier of arms to India, behind Russia. The US sees India as a major defense partner in the region and its military command was renamed the "Indo-Pacific Command" to highlight India's centrality to regional security. For India, the close relationship with the US is a counterweight to the rise of an aggressive China. Though Russia has played this role for India for decades, it is developing closer ties to China both economically (due to western sanctions) and militarily. Russia's joint military exercise with China in eastern Siberia in September was its largest since the end of the Cold War. This makes the case for a closer Indo-US partnership.

The Modi government has been rightly pursuing closer economic and military cooperation with the US. The annual Malabar naval exercise involving India, the US and Japan has been going on for 22 years despite protests from China, and the first Indo-US tri-services exercise is planned for 2018. India is one of the US's few partners that have not been significantly affected by the unpredictable Trump administration. Engaging in close security cooperation while maintaining a trade surplus with the US is something not many countries have managed and India has been making good headway in this regard.

The EU could have played a more strategic role for India, but due to its internal differences and India's preference for bilateral ties, India sees France as a security partner and Germany as a trading partner. The promising EU-India Free Trade Agreement has been dormant in recent years and serves as an indicator of the untapped potential between the two key players, who could have come together to weather an ever more dominant China and a saber-rattling Trump.

Good: India and ASEAN

In a historic ceremony, the leaders of all ASEAN countries were in attendance for India's Republic Day on January 26. With a diaspora of more than six million in the region, India shares deep cultural and historical ties with ASEAN countries, although trade ties are less than impressive.



Source: Asean secretariat, Times of India, www.commerce.gov.in

| BertelsmannStiftung

Table 3: ASEAN trade with India and China (in million USD)

India's focused engagement with the ASEAN region started in 1992 with the launch of the Look East policy. After more than 20 years of dormant activity, this policy was reframed as the Act East policy in 2014, with the aim to deepen economic engagement and build a more strategic partnership. The cornerstone of Act East is infrastructure connectivity. The planned India-Myanmar-Thailand Trilateral Highway, which will run from Moreh in Manipur to Mae Sot in Thailand via Myanmar, would connect the northeastern part of India with ASEAN. The plan also involves extending the highway in a later phase to Cambodia, Laos and Vietnam, giving India a significant role in the region's proposed transportation architecture. The project has faced several delays and the first phase is now expected to be completed by 2020. India is finally on the right path to tap into these historical ties, but it needs to strengthen the implementation pace to win credibility in the region, which it views as a counterbalance to an assertive China and a disinterested US.

Poor: Immediate neighbors

Setting a new precedent, Prime Minister Modi invited the heads of state of the SAARC governments to be the chief guests at his swearing-in ceremony. All of them, including Pakistan's then Prime Minister Nawaz Sharif, attended. Prospects of peace were never so promising since the historical Agra summit in 2001. Modi dropped by Pakistan spontaneously to have tea with Sharif, betting that a personal relationship could restart the peace process. Terror attacks in Kashmir followed by the first publicly announced military strike in Pakistani territory by the Indian army, coupled with a muscular "no hostage" security policy by India in Kashmir, have led to many ceasefire violations and destabilized the region.

In the case of Nepal, India's demand in 2015 that it make changes to its newly approved constitution, followed by an unofficial blockade of fuel supplies to the land-locked nation, was inhumane and drove the country closer towards China.

Maldives, a traditional ally of India has also made overtures to China. Its autocratic president, Abdulla Yameen, signed a free-trade agreement with China last year and even leased an island to it for military use. Sri Lanka's Hambantota port is also a part of the Belt and Road Initiative and gives China a base a few nautical miles from India. The military standoff between India and China in Bhutanese territory did not end in an armed conflict, but is probably a sign of things to come with a highly militarized and assertive neighbor. India's "big brother" approach does not work when countries have the option of working with an economically stronger partner. In short, if a strategic and concentrated neighborhood policy is not acted upon, India will lose its sphere of influence to China.

Conclusion

This government, like most of those before it, has delivered on some of its promises and reneged on many others. The promised radical transformation has not seen the light of day, at least not in the everyday lives of the country's citizens. The new slogan for 2019 – "Saaf Niyat, Sahi Vikas" (Clean Intent, Right Development) – smacks of an admission by the government that it has not met the targets it set itself and that it at least intends to do the right thing. After the recent loss in regional elections in the Hindi heartland, it remains to be seen which way the development discourse goes.

Prime Minister Modi still remains India's most popular political leader. Demonetization and GST woes reduced his approval ratings to 34% and Rahul Gandhi of the Congress party is a close second at 24%. According to the Centre for Study of Developing Societies (CSDS), whose Mood of the Nation survey is the largest pan-India survey with 16,000 respondents, 44% of the voters feel that the country is headed in the wrong direction and only 39% of Indians want to give the Modi government another chance. Modi's

polarizing style of politics has cemented the support of hardcore Hindutva advocates but has probably diluted it among non-ideological supporters, who are more concerned about their daily bread. However, the lack of a unified opposition and a charismatic leader who can mobilize the masses across India could still hand the Modi government another term in the coming elections.

The sheen of transformational leadership has worn off and the political discourse has shifted from development to identity politics, reflecting a global trend towards polarizing, authoritarian and populist politics. If economic growth does not translate into concrete improvement in everyday life, the effort to win votes devolves into polarizing tactics and playing on identities. Free and fair elections and an impartial Supreme Court have kept India largely free of demagogues and authoritarian rule in a neighborhood which has not exactly been democracy friendly. With its diverse ideological, linguistic, religious and caste identities, the Indian electorate has forced rulers to be non-hegemonic and inclusive in return for democratic power. The elections in 2019 will be a litmus test of this theory.

PROJECTS

Germany and Asia