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India to test Singh's 'big bang' theory

By Victor Mallet in New Delhi

Diesel fuel subsidies have been cut by 14%, prompting protests across India

When the Indian government of Manmohan Singh, prime minister, decided last Thursday to slash diesel fuel subsidies to curb the country's budget deficit, business leaders and foreign investors were pleased – but far from satisfied.

Increasing the diesel price by 14 per cent was politically bold, they acknowledged, but would hardly dent India's $34bn annual fuel subsidy bill given the recent rise in world oil prices and the fall of the rupee. They wanted more reforms, and quickly, to liberalise the economy and restore rapid growth.

To the surprise of almost everyone, the government delivered many of those reforms less than 24 hours later.

After a Friday cabinet meeting, Mr Singh's ministers unveiled a flurry of measures that include the opening of the retail and aviation sectors to foreign investors and the sale of stakes in state companies.

The prospect of companies such as Walmart, Tesco or Carrefour holding majority stakes in supermarkets is no small matter in a country of more than 1.2bn people almost devoid of modern shops, and the reaction in the business community was little short of ecstatic.

"From a famine of policy action, we've moved to a feast," tweeted industrialist Anand Mahindra. "The government's got back its gumption! We cheer and urge that they stay the course."

Sonia Gandhi, Congress party leader, and the Congress-led coalition government of Mr Singh seem to have belatedly realised that radical steps are needed to reinvigorate economic growth, which has slowed to an annual rate of 5.5 per cent from over 8 per cent two years ago.

With less than two years before the next general election, Mr Singh was quoted by the Indian media as telling the cabinet he was prepared to face down the opposition with these "big bang reforms" because "If we have to go down, we have to go down fighting". His office denied those were his words, but they accurately reflect the sentiments of reformers in government and in business.

On Saturday, Mr Singh opened a meeting of the Planning Commission by saying it would take "courage and some risks" to ensure strong economic growth with the help of increased foreign investment.

"What's creating the space for doing these things is a growing sense of crisis," said one senior government official. "The crisis helps you override gridlock, vested interests ... We could tip if we're not careful into something a lot more dramatic, so there's a sense of urgency."

One Indian chief executive highly critical of corruption and policy paralysis in the government since it first took office eight years ago said: "The government could fall anyway, so they should just go for it."

Mr Singh, an economist credited with an earlier round of reforms when he held the finance portfolio in the 1990s, and Palaniappan Chidambaram, his newly reappointed finance minister, will nevertheless find it hard to implement the sudden rush of liberalising measures they have announced.

The problem is not merely the opposition Bharatiya Janata party, a Hindu nationalist group supported by many small shopkeepers who fear competition from efficient multinationals, but the leftwing of the Congress party itself and its coalition allies.

Mamata Banerjee, chief minister of West Bengal and a partner in the coalition, is among those who reject the changes.

Demonstrators took to the streets in several towns and cities on Friday and Saturday, complaining mainly about the diesel price increase and the plan to allow foreign investment in supermarkets and department stores. A group of political parties has called for a day of protest on Thursday.

One risk is that the government will take fright at the protests and back down, as it has already done once, less than a year ago, in the case of the retail reforms.

Ministers insist that there will be no backtracking this time, but even if the central government holds its ground investors could find it a slow and laborious process to take advantage of reforms that fall well short of enforcing a free market in goods and services across India.

For supermarkets and other big "multi-brand" stores, for example, Mr Singh's government has allowed each state in the union to decide whether it wants to allow in foreign investors. Akhilesh Yadav, chief minister of the northern state of Uttar Pradesh – whose 200m population makes it bigger than Brazil – has already said No.

"The immediate challenge now is to resist reactionary forces that are already gathering to block the proposed reforms," said Eswar Prasad, professor of economics at Cornell University. "The outcome of what is likely to be a fierce tussle could determine India's growth trajectory for years to come."

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