Landslide puts pressure on Modi as Indians seek economic revival

By James Crabtree in Mumbai

India’s next prime minister Narendra Modi has said little about his plans to restart the country’s stuttering economy following Friday’s landslide victory in national elections. But the sheer scale of that triumph has already raised hopes for a rapid restoration in its battered fortunes.

Mr Modi’s task would be intimidating even without these suddenly higher expectations, as he grapples with growth rates that fell to 4.5 per cent in 2013, alongside a record of political inaction and rising corruption that thoroughly undermined India’s reputation as a global investment destination.

But as other emerging nations like China and Russia face struggles of their own, and with a leader finally unencumbered by the limitations of coalition government, India now has a rare opportunity to shed its status as the laggard of major developing economies, says Eswar Prasad an economist at Cornell University.

“India is still in a rough spot, given the policy status of the last few years,” he says. “[But] there is a strong sense that given the size and clarity of the mandate, they will be able to move forward aggressively.”

Much of that responsibility will fall to Mr Modi’s finance minister, who is set to be named this week – although investors will be just as keen for reassurances over the fate of widely admired Reserve Bank of India governor Raghuram Rajan, after campaign speculation over a possible change at the central bank.

Assuming he does stay, neither Mr Rajan nor the finance minister can do much to engineer a boost to growth. Inflation remains stubbornly high, leaving little room for interest rates cuts, while allies of the new prime minister are already muttering darkly about strained public finances.

“The fiscal situation is much worse than is known publicly,” says Arun Shourie, an economist and a former Bharatiya Janata party minister. “Manoeuvrability for the government will be limited.”

Tight finances make cuts to subsidies in areas like diesel an early priority, alongside moves to restart stalled infrastructure projects, provide coal to idling power stations and resolve a simmering dispute over gas prices.

Here progress will be awaited with particular interest among India’s heavily indebted industrial conglomerates, many of whom contributed generously to Mr Modi’s election. “It isn’t a secret that some of our biggest companies donated tens of millions of dollars,” says the head of one major business house, who asked not to be named. “They are going to want something for that, although Modi mustn’t be seen to be doing favours.”

Anxious foreign investors want reassurances too, notably on tax policy, where a spate of global businesses have become entangled in rows with revenue officials. With Mr Modi’s first budget due by July, any repeal of the so-called “retrospective amendment” to taxation laws brought in under the previous Congress-led government would be especially welcomed.

This amendment allowed tax officials to reopen a case against the UK telecoms group Vodafone, but came at huge cost to
India's reputation abroad — something Mr Modi will want to correct, according to Harsh Goenka, the head of RPG Goenka group, a large Mumbai-based industrial business. “I think he will solve all these tax issues affecting Vodafone, Shell and Nokia pretty easily,” he says.

Such measures would hearten financial markets. Yet they are also far from the type of structural changes that economists say are needed to shift longer term growth rates, such as a widely touted nationwide goods and services tax, which business groups say stands a good chance of being agreed later this year.

Other changes, including amendments to restrictive labour and land acquisition laws, or moves to privatise stressed state-run banks, could prove much more contentious, even given Mr Modi’s parliamentary majority.

“The reforms that are required in these areas are detailed, and these details have not all been worked out,” says Arun Shourie. “Bringing government equity in nationalised banks below 50 per cent would meet the type of resistance that [former UK prime minister Margaret] Thatcher faced over the mines, from the unions and the whole political class. Therefore some craft will be required.”

Facing fewer constraints than any Indian prime minister in decades, it is Mr Modi’s ability to face down such opposition that is likely to become the ultimate test of his premiership. Even so, many counsel caution, at least in the short term, with economists at Citi projecting growth picking up only slightly to 5.6 per cent over this financial year.

Others are more optimistic, however, arguing that Friday’s election triumph provides a rare opportunity to repeat the far-reaching liberalisations of the early 1990s, which transformed India’s economy and powered its growth for well over a decade.

“A lot of these things are do-able, but ultimately it is going to depend on the political will of Mr Modi,” says Arvind Panagariya, an economist at Columbia who has advised the BJP.

“I’m not pessimistic. I think in a couple of years we can return to 7 per cent, and in the following 3 we can get back to 8 or 9. There is no reason why not.”

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