

The Indian Promise. *Notes of a travelling economist.*

Bart Le Blanc

1. Imagine if you would: you are (reasonably) well travelled, having visited almost every continent and are by nature curious (some people might even say: nosy). You are also a workaholic and an avid reader of any economic or political commentary.

And then you visit India for the first time (in my case with my 24 year old daughter Annabelle) and experience that most pre-conceptions go out of the window in the first 24 hours. Over time a new picture emerges which could capture India in ten words:

India in 10 words:

Populous

Fragmented

Big government

Unequal

Family

Entrepreneurial

Proud

Educated

Young/male

Promising

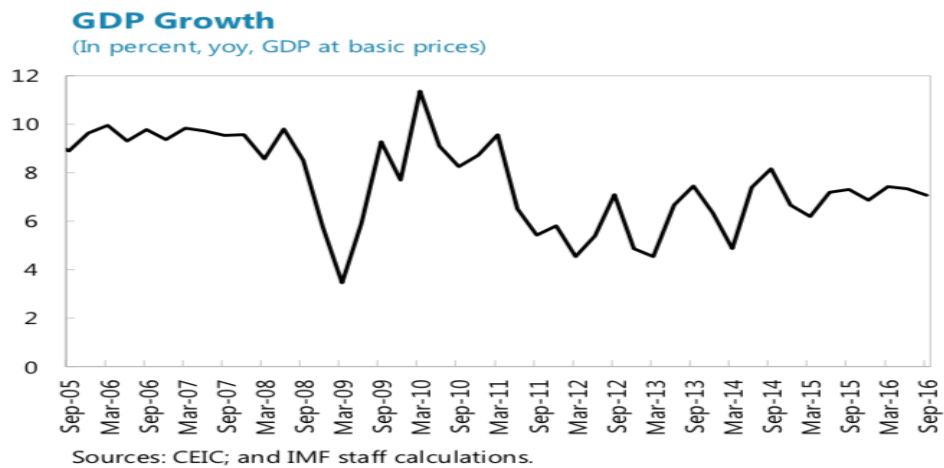
India is one of the (erstwhile exiting) BRICS group of advanced emerging economies (named by James O'Neill of Goldman Sachs Asset Management in 2001) referring to Brazil, Russia, India, China and South Africa. The first 2 have since dropped out of the top league (political instable and commodity dominated economies) as has South Africa. And China is following its own authoritarian path to world economic leadership.

So what about India?

My basic question was: should I invest my own money in India?

2. Let me share some observations gleaned from travelling in India, bolstered by reading expert reports and local media, speaking to Indian people as well as fellow travelers, and comparing notes with market researcher Annabelle.

So as to provide some context, the Indian economy grew at an annual rate between 6 and 7% over the last decade, in line with other emerging economies but behind China.



But reading through recent IMF and World Bank reports and together with those by the main rating agencies, one cannot ignore the fact that over the many years GDP growth has actually been lower than initially projected.

No surprise then that rating agencies have pegged India at a low level of investment grade.

At first glance India would appear to be a *young vibrant country* with a young population glued to their smart phones, looking very cool in jeans, fashionable shirts and Wayfarer sunglasses and zooming around on snazzy motorbikes and mopeds.

The photo below is a normal day life picture in Delhi.



What you see is a young couple in heavy traffic: him in jeans and a cool shirt, her in a more traditional sarhi and sits elegantly on the back of the bike while consulting her smart phone.
Urban cool...

3. Below I will outline three main topics: social, political and economic. These are based on general observations and situations hitting a travelling European economist in the face. Each of them contains sufficient material for more than one PhD study, and, in all honesty, they have no more than a “journalistic” pretension.

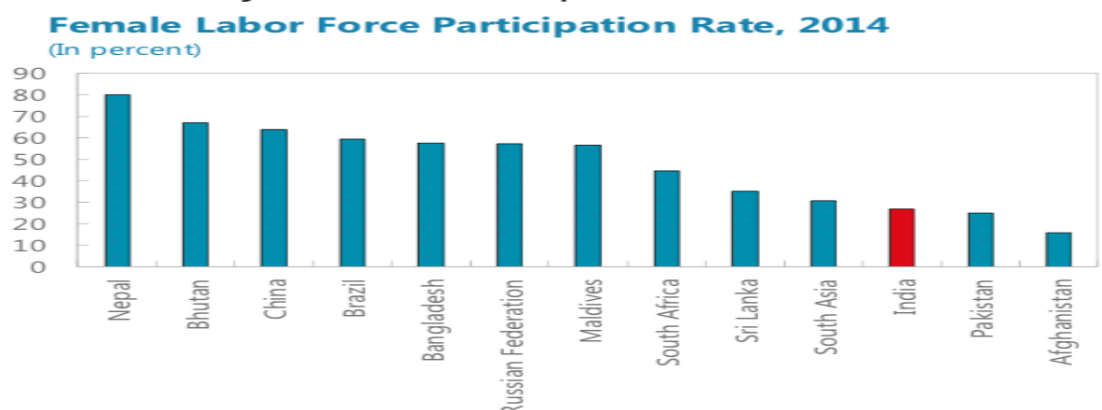
Topic I: Social Issues

The Indian “urban cool” image hides one of the major issues in the country: ***gender inequality***

Young male workers dominate both the education system and the labour market. Female workforce participation is critically low: around 35% over the last decades, compared to around 80% for male workforce participation levels according to the IMF’s Article IV India Consultation of 2017. The female participation level has even been falling in recent years to below 30%.

Furthermore, we observe that female labour is concentrated in low quality jobs particularly in agriculture (62%) and manufacturing (13%).

The graph below shows that India also lags behind other developing countries and significantly below other BRICs.



This is a big shame for a country that had its first female prime minister 13 years before Margaret Thatcher (Indira Gandhi became India’s PM for the first time in 1966).

However it is possible that she rose to power more on the basis of the fact that she succeeded her deceased father Jawaharlal Nehru, the first prime minister of the independent India, rather than on the basis of gender choice.

And that brings us to another issue of the Indian social puzzle: **family, social class or caste.**

The notion of family is very important in Indian life. Elders are dominant in families and require respect!

Parents chose the partners for their children: 70% of Indian Hindu marriages are still arranged by families.

The Sunday edition of the Times of India has multiple pages of advertisements aimed finding a suitable girl/boy to marry (see image below).

It seems that the suitability of prospective partners is to a large extent determined by social and religious backgrounds. Advertisements are grouped by caste, religion, profession, etc. and a specific category: "caste no bar" (for the more liberal Indians?!).



Families are also a prominent issue in the business sector, but more about that later.

The last topic in this social issues section relates to **religion.**

India is a diverse country in terms of religion with Hinduism being the dominant religion (around 75%), followed by Islam

around 15% and Christianity some 3%. The smaller remaining groups are Sikhs, Buddhists and Jainists each count for 3 -2%.

This religious diversity finds its roots in India's history. Big parts of the country were for extended periods "occupied" by foreign powers such as the Turks (11th - 16th century) after which it became part of the Mongolian Empire in the 16th till 18th century until the Brits made it part of the British Empire until independence came in 1947.

The cultural heritage of these different religious and traditions is still very much visible with many great monuments scattered across the country. While in general the various religious groups live peaceful together, tensions do flare up from time to time between them.

The British forced partition of India between Hindu dominated India and Islam dominated Pakistan (East and West Pakistan later Pakistan and Bangladesh) has largely moved the tensions away from between religious groups in the country to creating new tensions at nation state level, which are a constant source of international concern.

Topic II: Political Issues

As mentioned, India is a relatively young independent nation following its independence in 1947. Before that it was long dominated by other "foreign" forces. Interestingly enough these foreign "occupiers" were never purely political but mainly inspired by trade opportunities.

The rulers were predominantly entrepreneurs and businessmen rather than warriors with strong territorial ambitions. This is still tangible today. Many of the former ruling families do still have an important role in Indian society as major powerhouses in terms of wealth and ownership (and sometimes still live in their former palaces now owned by government).

It explains why India today is such a ***proud independent nation***. Many share this view as people see India as a beacon of democratic force on the Asian continent and happily talk about it.

In a recent book Arparna Pande of the US think-tank, the Hudson Institute of Washington wrote:

"India has always taken pride in its civilizational inheritance and made it an integral part of its world view. This pride has also created a sense of Indian exceptionalism: belief that India is unique, it is special, was once one of the centers of the world and will, once

again, find its rightful place” (From: Chanakya to Modi published in 2017)

It was in this spirit that Rahul Gandhi, chairman of the Congress Party (and son, grandson and great-grandson of former prime ministers Rajiv Gandhi, Indira Gandhi and of the first post-independence prime minister Nehru respectively) stated at his Party’s annual conference on 18 March:

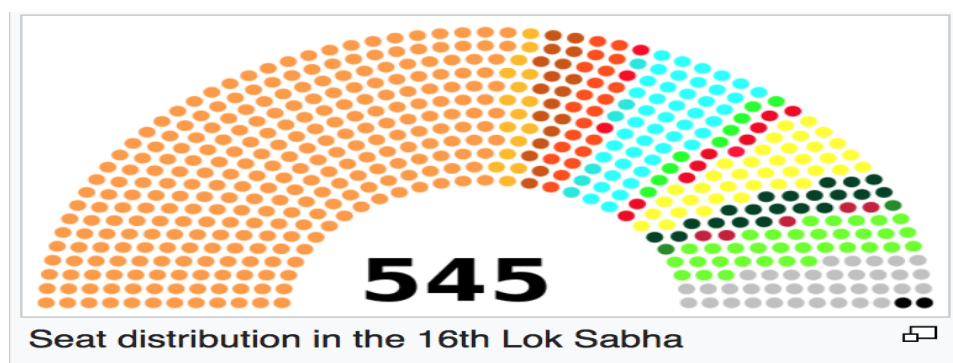
”There are two visions in the world- of US and China. In 10 years, I want to see India’s vision there”.

After many decades of political dominance by the leftish Congress party of Nehru and different generations of Gandhi, the country is now governed by a coalition under Prime Minister Narendra Modi, a free market reformist leader from the BJP party.

The Modi government has launched a constructive reform program for India’s progress as an advanced major economy.

However with 36 political parties in the Lower House of Parliament Indian politics shows an even more ***fragmented political landscape***.

It is difficult for an outsider to understand politics in India as so many forces influence political movement. Apart from left-right ideological views, there are many other forces that play important roles such as religion, vested interest, federal versus state, inequality, etc. The result is that there is no stable majority in Parliament.



A perfect example of fragmentation is the political war around the decision by the current Modi coalition on “demonetisation”, the 2016 decision to scrap 500 and 1,000 Rupee banknotes (representing values of \$ 7.67 and \$15.34).

This policy was meant to root out “black” and criminal money and corruption.

In the eyes of a western economist this looks like sound monetary and economic policy. It has however been demonized by political opponents as a “reverse Robin Hood policy” i.e. stealing from the poor and giving to the rich.

Systemic corruption has again become the main topic of political debate as the cartoon below illustrates, and will without doubt dominate the next general election of 2019.



The existing political coalition is as a result weaker and recent by-elections in March have reinvigorated the leftish opposition led by the Congress party and its new young leader Rahul Gandhi. As a result the March 2018 by-elections have re-launched political commentators to call for a “grand coalition” or a “grand alliance” on the way to the 2019 elections. Sounds familiar to European ears??

The consequence is that central government is not very strong. This is a drawback in a country where significant reforms need to be implemented in order to progress on the ladder of advanced economies.

This brings us to one of the biggest political issues of today’s India: the **need for structural reform**.

The Times of India wrote on 17 March 2018: *“Unless the system is reformed, changing governments or leaders won’t help”*.

The article presents the case for urgent action on multiple fronts:

- *reform the civil service,*
- *fix the banks,*
- *make agriculture work,*
- *simplify doing business,*
- *introduce an independent anti-corruption authority,*
- *create a better judiciary,*
- *fix the country's appalling infrastructure.*

It is clear that many of these reforms will give a positive impulse to the economic development of India.

At the same time such reforms require broad political consensus and strong government in order to push these through.

And there may be significant doubt whether the current coalition can generate the necessary traction to create consensus around these issues, which encounter on many fronts major vested interests.

Topic III: Economic Issues

While travelling through the country, speaking to various people and reading local media, one cannot fail to notice the big economic issues of current-day India. While the Modi government is actively addressing many of these issues, the nature of many problems is such that change is slow and may take generations.

The first issue is ***labour as export-product***.

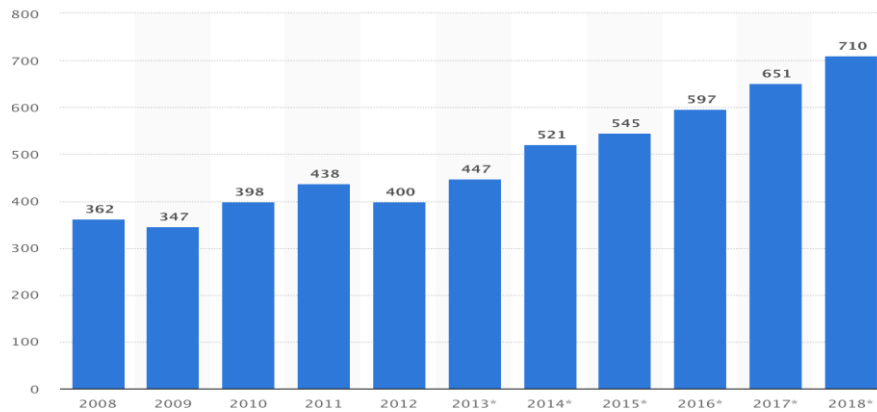
40% of India's population is below the age of 18 years, which at 400 million is the world's largest child population. The overall youth unemployment level is around 30% and particularly high among women.

As a result India seems to have become one of the major global labour reservoirs. In recent decades Indian call centres have absorbed the demand for remote labour supply for many Western companies providing digital and voice client-related services.

The Financial Times reported in 2011 on the growth and the vulnerability of the call center business.

“India became the call-centre capital of the whole world but it was often built on a cost-saving agenda, not a quality agenda,” says Partha Desarkar, head of Hinduja Global Solutions.

Revenues in call centers in India (in \$ millions)



Regardless the growing call centre business, the recent ILO World Employment and Social Outlook 2017 reports on continuing stagnating employment in India and thus additional pressure through persistent unemployment.

In consequence, a different approach for tackling unemployment has taken off through “exporting” labour.

Many workers in nearby Arab countries are already of Indian origin.

On the 13th of March 2018 the Hindustan Times published an article with a positive twist on “exporting” labour under the title ***“India to help Japan fill manpower gap”***. This article reports on the India-Japan Business Partnership’s approach to complement the Japanese demographically induced shortage of skilled workers by “exporting” young educated Indian workers to Japan.

In any case both the in-sourcing through call centers and the “export” of labour may not provide structural solutions. They are open to increasing competition on price and quality levels for example from other countries such as the Philippines.

Inequality is another major topic in India. It affects many parts of Indian society: between rich and poor, between men and women, between civil servants and corporate workers, as well as within companies, between management and workers, etc.

Unequal chances in education lie at the root of this and this is particularly noticeable for the female workforce. The literacy rate is 76% for the male population but stands at only 54% for the female population. As a result men have a more advantageous position on the labour market than women. According to the IMF male workers earn on average 1.7 times the average female pay.

But once in work, the system does not smooth this out, nor does work create more equal opportunities. One statistic illustrates the skewed income distribution in the Indian corporate sector: the ratio of CEO to average workers' salaries in India is the highest in the world after the US! Top executives are paid 243 times more than the average worker. For reference, this ratio is significantly lower in European countries (e.g. on average varying between 50 and 100).

The levels of inequality in India could be one of the most explosive issues in the years to come.

India seems a very business and trading oriented country and for a country of over 1.3 billion people, India seems to have surprisingly few major international companies. The 2017 Fortune Global 500 contains only 7 Indian companies, compared to 115 Chinese companies!

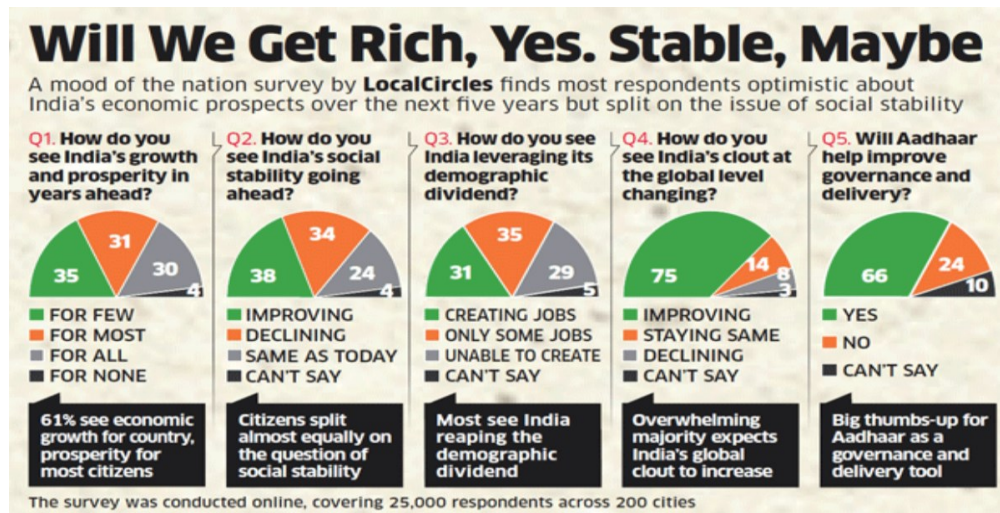
The Indian corporate sector shows many characteristics of businesses dominated by ***small and medium sized companies with a strong family ownership***.

Even when successful in their international dealings – and there are many examples of that - they remain “commodity-type suppliers”. Many big businesses do not have strong (international) brands. That makes many of these companies vulnerable for competition on price.

On top of that weak governance and stakeholder management from these companies make it difficult for major international Indian companies to enter into longstanding business arrangements and investment partnerships.

But India is an optimistic, proud and ambitious country with a clear self-belief.

The table below summarises the ***Indian Promise*** perfectly: “*we will prosper, and our influence in the world will grow*”.



Note: Aadhaar is biometric ID system for all Indian residents

The importance of popular support and commitment cannot be underestimated.

The strong belief that things will get better in a country that is young and vibrant can create the foundations for successful development.

But when tangible progress falters for many, it can lead to regressive politics.

Hence the warnings in the most recent IMF Board's assessment:

"Directors welcomed the authorities' strong progress on structural reforms, and encouraged them to prioritize labour market reforms at both the center and state levels. They also urged continued efforts to reduce poverty and inequality, increase female labour force participation, and make further efforts to improve financial inclusion. They noted the importance of further trade liberalization and enhancing the business environment to help boost exports and attract greater FDI flows."

IMF Executive Board 2017 Article IV Consultation with India, February 2017.

In that context, next year's general elections will be extremely crucial for delivering on the Indian Promise.

4. It is impossible to draw firm conclusions on the basis of such high level observations and amateur assessments. However my personal answer to the question: *Should I put my own money in India*, calls for the moment a cautious response.

Many of the issues discussed here weigh in on this answer.

I will not repeat all of the issues but it is clear that India needs to (continue to) address a significant numbers of the above mentioned social, political and economic problems.

But in a fragmented India, a strong central government may be difficult to achieve. Its corporate sector does not carry many prominent international brands and is generally known to have weak governance practices. And with so many unaddressed issues around inequalities, investors may continue to sit on the fence.

So what is a cautious approach to the Indian Promise?

Be selective is the motto.

Blanket portfolio investments do not fit the Western investor's risk/reward profile, so no passive Indian investment funds.

Selective investing in India calls for thorough analysis of both equity and credit opportunities from listed companies having:

- *Broad shareholders base; no major family equity holdings*
- *Best practice corporate governance*
- *Compliance with general accepted rules re. executive pay*
- *No major outsourcing to other emerging countries (e.g. Bangladesh)*
- *Well-developed brands and USPs.*

Reality will show that by applying these criteria, only a relatively narrow investor universe may open.

Better use it as a tentative first temperature "toe-test" of the Indian Promise-waters.

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