India must harness the profit motive in the spirit of Nehru

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Normal life has resumed in India since last week’s devastating power cuts, but there is no guarantee they will not recur. The power sector – an erratic blend of state-run companies and private sector players – is in disarray, just one reflection of India’s disappointing economic performance.

Economic growth in the past year was just 5.5 per cent, well below the previous year’s 8.4 per cent. Since 1990, at 6.6 per cent per annum, India’s growth rate has been the third highest in the world, surpassed only by China and Vietnam. But to resume this impressive run, India’s flawed capitalism has to be fixed.

One thing stands out in India’s embrace of pro-market policies since the early 1990s. No political party has mounted an ideological defence of capitalism, which is still to acquire political legitimacy. The spirit of Jawaharlal Nehru, to some extent, endures. He wrote 75 years ago: “It would be absurd to say that the profit motive does not appeal to the average Indian, but it is nevertheless true that there is no such admiration for it in India as there is in the west. The possessor of money may be envied but he is not particularly respected or admired. Respect and admiration still go . . . to those who sacrifice themselves . . . for the public good.” Doubts about the profit motive are lower today, but they have not vanished. India is embracing capitalism by stealth.

The country has witnessed the rise of three distinct flavours of capitalism: state capitalism, crony capitalism and entrepreneurial capitalism. Together these three constitute what might whimsically be termed “curry capitalism”. Though India’s public sector companies do not exercise the dominance of state-owned companies in China, the state has substantial or complete control of a host of pivotal sectors. Even when publicly listed, state-owned companies are run as bureaucracies and managed as instruments of the state. Politics play a big role: for example, India’s vast rural electorate gets huge power subsidies, making power generation unattractive commercially. Despite new investments, demand has outstripped supply for decades.

Crony capitalism has taken two forms. In sectors such as aviation and telecommunications, cronyism and entrepreneurship go hand in hand. While the government has awarded licences and contracts in an opaque way, competition has been so vigorous that millions of consumers benefited. But in power generation, mining and property, business conglomerates have operated primarily as crony capitalists, pursuing opportunities in collusion with government; an extractive elite has made vast fortunes.

Entrepreneurial capitalism, the child of liberalisation, dominates knowledge-based industries, capital markets and consumer goods. In those sectors, innovation and rising productivity have driven growth, job creation and wealth generation. This is the form of capitalism that the polity ought to encourage.

But two factors complicate the consolidation of entrepreneurial capitalism. First, India’s turn to markets has coincided with the rise of coalitions in politics. Since 1989, almost every government in Delhi has been a coalition of many parties. To survive, governments have had to satisfy more political players than ever before, often leading them to overlook graft.

Second, politicians have come under increasing pressure to show sensitivity towards poorer, especially rural voters, who have voted more than the urban middle classes. Keeping electricity prices artificially low for farmers is one of the ways in which the polity has responded to this pressure, but more creative solutions are clearly needed to respond both to political necessities and to economic imperatives.

Government policy must rest on three pillars: to unshackle India’s entrepreneurial energies by making markets more competitive, to reduce graft by simplifying regulation and making it more transparent, and to use tax revenues from higher growth to develop an efficient welfare state that attends to the poor.

Nehru’s invocation against capitalism requires reformulation. India’s key challenge is to harness the profit motive for the larger national purpose, not to shackle the private sector.

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