

Why This Is India's ABC Election

Inflation explains why voters now think Anything But Congress

Ruchir Sharma



There was no mystery about what rankles the voters. From the badlands of Bhind in northern Madhya Pradesh to the colourful bazaars of Pushkar in central Rajasthan, the neighbourhood barber, the local carpenter and the small farmer would angrily reel off to the exact rupee the rise in prices for onions, potatoes and ghee over the last five years.

On the campaign trail, talk of inflation trumped other hot button issues such as corruption and unemployment. While it is hard to reduce the complexities of an Indian election to a single factor, it seems inflation played a decisive and yet underappreciated role in the Congress's resounding defeat in the state elections held over the past month.

Prime Minister Manmohan Singh has now presided over one of the worst inflation episodes in the post-Independence history of India. With consumer prices rising at an average annual pace of 10% over the last five years, India has never seen inflation so high for so long, or at such an unlikely time. India now sticks out as an outlier in a world where many countries are worried about deflation. Historically, India's inflation rate was lower than the emerging market average, but it is currently double the average. For decades, India's ranking among nations by inflation rate had hovered in the mid-60s, but lately it has plunged to 142nd out

of 153 emerging markets.

The inflation problem says a lot about what has gone wrong with India's economic model under the Congress party. The Singh government has let fuel and fertiliser subsidies spin out of control and bought wheat and rice at artificially high prices to appease large farmers. It has been building an expansive welfare state, rather than pursuing reforms to boost productivity, which would allow for higher growth without rising prices. The government has also been pushing up wages through, for example, measures to guarantee employment to rural workers. Over the past five years, rural

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wages have been rising at an annual pace of 15% – faster than productivity growth and higher than in any other Asian country.

Now India appears to be catching the Latin American disease of rising prices and falling growth. As workers come to expect higher prices, they increasingly demand higher wages, lead-



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ing to a destructive wage-price spiral. Indian households expect consumer prices to rise another 13% next year, according to a survey of inflationary expectations by the Reserve Bank of India.

One reason Indian voters are turning so sharply against Congress is that its policymakers do not seem to understand the depth of the inflation problem. Early on they dismissed inflation as a temporary threat, or a threat only to food prices, even as prices started to rise in other areas such as services. In recent years, government officials posited that inflation is a natural reflection of rising demand in a prospering economy, a view that may be commonplace but does not square with the facts. Singh, an economist, should have known better. But his anti-inflation credentials have long been suspect. The last time India had to grapple with the problem of double-digit inflation was during

his much-heralded term as finance minister in the mid-1990s.

Most countries that have managed to sustain rapid growth for a long period – including Japan and Korea – did so by investing heavily in roads, factories and other new capacity that helped to meet rising demand while keeping prices down to less than the emerging market average. In India, the rate of growth in private investment has been slowing due to concerns about rising corruption, corporate debt and regulatory uncertainty – feeding that general sense of an economy going to pot.

The irony here is rich. Many of India's leading economists have in recent months been consumed by the rather puerile debate between growth and equity. The Congress, true to its socialist roots, has come down on the side of equality, and has ramped up its class warfare rhetoric. But no

one is hurt more by inflation than the poor. The next government needs to control populist spending and find ways to encourage new investment, but India's central bank needs to act too. Up to now, the bank's mandate has given it multiple and shifting objectives, including ensuring adequate credit growth and securing financial stability, but it is time for India to adopt an explicit inflation target.

The inflation target works by keeping easy money in check, putting pressure on the government to control its spending habits. Research shows that low-income countries tend to fare better after adopting an inflation target, which is why virtually every major emerging market has done so, with the exception of India. The central bank now has a governor who is much more popular than the Congress government, and has the clout he needs to get tough on inflation.

Whatever India does, it is not likely to be done under the Congress party as the mood of the nation is for an Anybody But Congress or an ABC government. The state elections were billed as the 'semi-final' before national elections. The results knocked the Congress party out of serious contention, at least for now and the finals in May are shaping up as a face-off between the opposition BJP and various regional parties. If these parties are listening to the voters, they will make the fight against inflation priority number one.

The writer is head of emerging markets at Morgan Stanley Investment Management.