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# Will India's Economics Be a Victim of its Politics?

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EDWARD LUCE: Thank you – thank you for coming. And it’s a great pleasure to be asked to moderate this part of the India series that Milan Vaishnav and others are doing excellent work here. And I like the title: “Will India’s Economics be a Victim of its Politics?” And I think D.C. – Washington, D.C. is the perfect place to pose – (laughter) – a question about what politics can do an economy. And I think I’ve got two excellent people to answer it, in India’s case, sitting with me.

[00:00:38]

Starting with Ila Patnaik, who I’ve known for many years, who is – actually, I won’t read it out. (Laughter.) Who is a senior fellow at the National Institute of Public Finance and Policy in New Delhi, a columnist for the Indian Express and the Financial Express and on various government commissions, most recently for financial reform.

ILA PATNAIK: Yeah.

MR. LUCE: Right. And then to my left, Jahangir Aziz, who’s the – sorry. (Laughter.) I was about to say – give you a generic title – but who is head of emerging markets, Asia, at JP Morgan and chief India economist, or?

JAHANGIR AZIZ: Yes.

[00:01:23]

MR. LUCE: Formerly an adviser at the Indian Ministry of Finance and before that the head of the China unit –

MR. AZIZ: IMF.

MR. LUCE: At the IMF. And so welcome to both of you.

So let me just start off by asking a very simple question. And I’ll start with you: India’s slowed down to, what, 3 ½ percent – as low as 3 ½ percent growth this year. It might pick up to 5, 5 ½ (percent) next year. But it’s a very, very far cry from the first decade of this century when most other emerging markets were growing very healthily too.

(Inaudible) – makes, I think, the very plausible claim that India’s miracle was actually pretty average given the credit – easy credit of the first decade of this century, and that doesn’t slip back into that very easily – much, much more painful reforms and changes will be required at the union level and the state level for India to get back to those kinds of growth rates. What’s wrong with that – (inaudible) – assumption? Why isn’t he right?

MR. AZIZ: So you can spin a story which will fit that description or that narrative extremely well. You look at globalization, you look at 2003 to 2008, most emerging market countries were averaging 6 ½, 7 (percent). Therefore,



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India's 9 percent average doesn't sound extraordinary. Then comes the slowdown. In the slowdown, India really gets hammered, both in 2008 and for a variety of reasons. But it – you know, subsequently growth goes up in 2010, '11, to about 11 percent, I think, in 2011. And then things come collapsing down.

[00:03:12]

The question is, in that collapsing down what story makes sense except quantitatively it's very difficult to look at the decline or proxies that you use for the decline in global demand, the increase or the tightening of financial conditions – so the opposite of the easy credit conditions that you talked about. And use those and try and figure out – and the amount of slowdown that those two factors would predict, India slowed down much more than that.

So quantitatively, the storyline – you know, it's a great storyline to say. But quantitatively, you can't match it. What explains that additional slowdown is the fact that since 2009 and '10, government – any proxy of government policy dysfunction that you use more or less perfectly matches that slowdown. So quantitatively we would say at least 1 ½ to 2 percentage points of the slowdown that is taking place since 2010, '11, onwards is attributable to essentially the –

MR. LUCE: Bad policy? Bad governing?

MR. AZIZ: Bad policy. Bad policies.

MR. LUCE: Which, by implication, means the first 10 years had some good politics over and above the easy credit fact.

[00:04:31]

MR. AZIZ: Or not as bad – as bad a policy as we've seen since 2009. I think – I think benign neglect was far better than active neglect.

MR. LUCE: Now, another way of putting the same question, Ila, is about a year ago India looked like it might be on the verge of a credit rating downgrade to junk status. And that galvanized – or at least helped galvanize the Manmohan Singh reshuffle, which brought Chidambaram back into the Finance Ministry and a sort of flurry of medium-sized reforms were announced with that.

Do you think India is out of the woods? Do you think the possibility of a downgrade of junk bond status is now ruled out? Or is that – is that something that could very well come back in the next year or two depending on the politics?

MS. PATNAIK: There are two things that go on going to the credit rating process. One is what's happening the fiscal deficit, as such, and the other is what is happening to growth. So the fiscal deficit as a ratio of GDP is something that



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I think Chidambaram will deliver on that because he's just – he's so clear that I don't want a downgrade at the moment that we'll do what it takes. A little bit might be juggling and a bit might be –

MR. LUCE: Even with the 10,000 – (inaudible) – food security bill?

MS. PATNAIK: Yeah, because, you know, you can always not roll it out at full speed. I mean, you don't have to roll it out at full speed. So you can manage that. I think that he'll be able to meet his fiscal deficit targets.

[00:06:05]

But the other part of what's going on, which is growth, that's also going to feed into the thinking of credit rating agencies and whether they decide to keep India where it is or to downgrade further. And there – I think there are three things going on on growth. And I don't disagree with what Jahangir's saying, but just to put it differently: One, there is a structural story. And that structural story is that, you know, we grew so fast in the last 10 years that our institutions were not able to match up. And what we needed to do along the way was to change laws, to build institutions, to find mechanisms for allocating resources – you know, to move away from the old system.

But we stuck to the discretionary, non-transparent sort of government handing out things. And that's clearly falling apart. And that's one part of the story. The other is that there are cycles and, you know, emerging markets are going through a cycle where a lot of them are today facing slower growth. And this is – this is part of the cyclical downturn. But thirdly, I think we have exacerbated the cycles by our pro-cyclical macropolicies. And we we've really – when, you know, we were at 10 percent we were not trying to contract.

[00:07:33]

We didn't have – at that time, we had a very high fiscal deficit. So we were really not – even monetary policy, we were – we were paying the exchange rate and getting pro-cyclical monetary policy because capital flows were pro-cyclical. So we were exacerbating the cycle. Now, coming back to the last two or three years, you've seen a fiscal expansion and a monetary expansion between 2010-9 and 2010-10. And that has just lead to a lot of inflation because perhaps it was more than what was required. So growth did go up, but you know, we're facing it – (inaudible) –

MR. LUCE: We live in the era of sex – I mean, as improbable as it sounds, sexy global central bankers. (Laughter.) And Raghuram Rajan is one of them. Mark Carney is another. Raghu's (sp) seen the rupee appreciate since he took this job. And he's made some very sort of clear and welcome announcements simplifying regulation of bank branches. Has there – is too much hope being invested in this guy or does this reflect the fact that if you have a good person with freedom of action running and important institution in India, lots of stuff can happen? It's mostly a hypothetical proposition, but with Raghu Rajan (sp) this is – this is actually bearing out so far.



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MS. PATNAIK: I would really think that what matters is how much is he going to change the institution, how much is he going to change RBI? And if he's able to do that, and their leadership does matter. So it absolutely matters who is in charge. Does he put in time and effort into reforming this organization? And if you're aware of the latest developments on what is being proposed in terms of reforms, is that RBI should be stripped of many of its other responsibilities and primarily become an inflation-targeting central bank.

And if he's able to not just help in getting the law changed – which is being proposed already – but also in getting the research department built up, in setting up an independent monetary policy committee, actually going after it both in the spirit of the law and the human capital and capacity required to do that – if he can change RBI, then that will have a very big impact because today RBI, it's not just the person who is there. RBI is conflicted. They have too many objectives, and these are conflicting objectives. And you cannot expect one person to solve all those if the mandate given to the institution is not clear.

MR. LUCE: There has been clarity in terms of the monetary policy; maybe I'll direct this. Is Raghu the best thing since sliced bread – (laughter) – or sliced japati, whatever the right –

MR. AZIZ: Umm – (laughter) – yes, probably. I mean, he has brought in a lot of expectation. But unfortunately, nothing that he has done so far has actually been tested. So if you look at what he has done and the reaction of the market to that, it's very strongly coincided with the FOMC delaying tapering. So we really do not know what the counterfactual is.

So just to give you a sense – so since the FOMC delay happened, Indian – the rupee has appreciated only one percentage point more than the Brazilian real or the Turkish lira.

MR. LUCE: So this fits in with the Ruchia Sharma (ph) view of the world.

MR. AZIZ: Absolutely. Now – and to make matters worse – so – you know, in May, June, July, those three months, the monthly current account deficit was probably running around \$10 billion. In the last three months, it's running about \$2 billion. On top of that, the RBI has taken out the entire oil demand by the local oil companies out of the spot market and taken it all RBI.

[00:11:53]

So all companies today transact directly with RBI and not with the spot market, which is about, what, five, six billions dollars a month? So if you have \$2 billion of current account deficit – (inaudible) – you are taking out five or six billion dollars out, you're essentially running a current account surplus of about three or four billion dollars. So even with a current account surplus of three or four billion dollars, and the tapering being off, EM assets back in play, the rupee still hasn't managed to get past 61.

[00:12:28]

MR. LUCE: And I mean, if we're going to focus on an individual making a difference, the conversation amongst nongeeks is not about a central banker, it's about Narendra Modi, and that's, you know, clearly the great – and I'm going to put this to both of you, because this is such a hugely important issue – is the uncertainty about what the outcome of next spring's general election is going to be a drag on growth or conversely – or concomitantly, if there is a sort of clear outcome and there is confidence that this might be a slightly more efficient coalition government that comes into place, how big an impact would that have on growth? I want to put that to you, first, Ila, and then we'll drill down into what I like and dislike about Modi in a minute, but – (laughter) -



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MS. PATNAIK: So I'm not really seeing a single party, even the BJP – none of the opinion polls seem to be suggesting that you will have a single party get in, but I don't think that's a problem. So, you know, put Modi aside for a moment. I mean, the big fear is we'd have a third front. In Hindi, we call it a Mili-Juli Sarkar, you know, some random characters put together who would form a government. And whether it's that, whether it's Jayalalithaa supported by Modi, whether it's Modi, whether it's Manmohan Singh – (inaudible) – I don't think that –

MR. LUCE: You don't think it makes much difference?

[00:12:28]

MS. PATNAIK: – that it is, at this stage, going to make that much of a difference.

MR. LUCE: Do the markets think it make a –

MS. PATNAIK: No, it might make a difference to the markets. So sentiment might change. So if you – you know, business supports Modi and is very optimistic about him. So sentiments might change. But will investment come back on track tomorrow? Because investment – what are the problems that we have, and how many of those problems can be solved and at what speed?

[00:14:23]

So there are problems which will take some time to get solved. And my sense is that immediately, we will – even if we have, you know, whoever in charge, you're not going to get a rapid turnaround. You might see – (inaudible) – go up, but are you going to get a rapid turnaround in investment growth?

MR. LUCE: Unlikely.

MS. PATNAIK: Unlikely.

MR. LUCE: Just out of interest, what would be your best case, realistic outcome for next May – best case, and what will be the dispensation – (inaudible) – you'd like to see most in terms of economic reform?

MS. PATNAIK: Well, I'm not – in terms of economic reform, which government? So I think that whether – there are three possibilities that I see, and – actually, there are many, but let me say top three, would be that it could be a BJP-led government. It could be a UPA government or it could be somebody like Jayalalithaa being supported by NDA.

And in terms of economic reforms, I don't see that much of a difference. I mean, there might be some policies on which some of them will go slower than the others; BJP might say, OK, we didn't get it last time; they came up the – (inaudible) – as, you know, the NHIA – that was something that they pushed.

But then, what did they come up with? They came up with a PFRDA, and then they opposed it for the next 10 years. So I'm not very clear about, if Modi does come in or if BJP does come in, I don't even know very clearly what their economy policy – what their agenda is, because if I go by what they supported and opposed in the last 10 years, I would think that's the worst thing that can happen, because they'll oppose the GST, they'll oppose FDI and retail –

MR. LUCE: Explain some of this – the goods and services –



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MS. PATNAIK: OK, OK. The goods and services tax, which will make the tax system much more efficient, which they had proposed when – originally, but when they – so I don't know whether now it's supported, because they had originally proposed it, or they will oppose it, because for 10 years they opposed it. (Laughter.)

MR. LUCE: Does it make no difference whether Jayalithaa or, you know – (inaudible) –

MR. AZIZ: I think it doesn't, to a large extent. And I'm going to start off from a point that Ila made, that in – so when we are looking at this growth slowdown as that we didn't make any institutional changes in that 10 years, and that these institutions really required the framework to be changed – no change in investment framework, no change in the way in which resources of India were being priced – nothing of that – (inaudible).

[00:17:04]

Another way of looking at it is to say that the institutions that delivered for 60 years a 3 percent growth rate all of sudden started delivering growth rate of 10 percent. And when it was delivering 10 percent growth rate, no one asked the question, how come institutions that were delivering a 3 percent growth rate for about 60 or 70 years delivering growth at 10 percent?

Today, because growth rate has come down, urban middle class have suddenly turned self-righteous and indignant, and all of a sudden, urban middle class is questioning that institution.

MR. LUCE: They're even considering voting in the next election.

MR. AZIZ: Absolutely – absolutely. (Laughter.) And I think the rule that was played by the technocracy and the implicit contract, I would say, to – lack of a better word – between the technocracy and the politicians – that got broken down in the last two, three years. And whether it's a Jayalithaa government or it's a BJP government or a UPA III government, they have to go back and repair that relationship back. In the absence of somebody doing that –

MR. LUCE: Can I just challenge you on that? I mean, 1996 – and you'll both remember this well – after five years of Narasimha Rao and Manmohan Singh economic reform, which had dominated the world's view of India, Yogendra Yadav – and he is India's leading electoral – leading – (inaudible) – I guess, polled voters at exit polls, and only 11 percent knew that economic reforms had happened.

How do you connect the technocracy to the masses in India to get a mandate for economic reform? How do you do that? Is it easier now than it was in 1996?

[00:18:52]

MS. PATNAIK: I'm not sure. That's –

MR. LUCE: I mean – but presumably, this is part of the question. Will India be able to reform and grow at a higher rate? And governance isn't an irrelevant –

MR. AZIZ: Yeah. So if Ila had her way, she would change the institutional structure. There would be institutional reforms. The investment framework would change. The manner in which resources are priced would change; the manner in which services are being delivered would change in a – in the manner in which she wrote the Indian Financial code.



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In reality, that will take a very, very long time to happen, the actual change in the institutions. So in the middle, you are left with the technocracy trying to navigate within the same institutional setup, making sure that, you know, you are easing off on some things, you are not doing on some things; you're making sure that you don't get – you know, nothing really falls apart through the cracks. And that's how you're delivering growth.

MR. LUCE: And what would happen if Jahangir got his way?

[00:19:52]

MS. PATNAIK: I think there is a lot more pressure today for transparency and less discretion. So that's something that the government has to confront, whoever is there in power has to confront. And earlier, they were getting away without confronting it. You know, they tried to find ways, and they could navigate their system through the existing institutions. I'm not sure that, looking ahead at the next five years or 10 years, that that's going to be acceptable to people. The push for – I mean, look at the coal scam, for example. One could have – people are truly questioning –

MR. LUCE: Do you want to give a quick thumbnail of coal gate – (inaudible) –

MS. PATNAIK: Yeah. So the policy framework in place was that a government committee would decide –

MR. LUCE: An even quicker thumbnail. I mean, just the scale of corruption so that – so that I don't interrupt your – the point – (inaudible) – I'm interrupting – (inaudible) – (laughter) – massive corruption scandal to do with allocation.

MS. PATNAIK: No, sorry – (laughter) –

(Cross talk.)

MS. PATNAIK: The question – no, what is corruption? If I have a policy framework policy in place which says that the government will allocate coal, and then there are ministers who say, OK, this is how we're going to allocate coal, and then, coal mines, OK, because otherwise it was only a public sector enterprise that got coal, and now you start giving it to users who – captive users who will, you know, extract the coal and use it.

And that was the policy framework in place. Now, if someone does allocate coal, within that policy framework, is it corruption? It has not violated any law. In fact, the problem with the investigative agencies today is that though they feel that lots of favors had been done, but there was no quid pro quo. There was nobody took money to do anything. How do you establish corruption if –

MR. LUCE: This is getting very philosophical – (inaudible) – doing a very good job – I stand corrected. (Laughter.)

[00:21:58]

Let me – because I know in a moment I'm going to have to go to questions. I haven't got a watch on me, but let me just sort of get back to the Modi thing. Part of the reason why a lot of the middle classes are yearning for Modi, and some foreign ambassadors, is because he has a reputation for quick project execution. The delays, the setbacks, the continual recostings that we associate with government of India projects and the permissions are supposedly absent in Gujarat, and he would at least be able to address or identify that as a big problem if he were prime minister. That's not an unreasonable expectation, is it, for a Modi prime ministership?



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MS. PATNAIK: Yes, but, you know, to go back to that philosophical point – (laughter) – if I may – if then the Environment Ministry opposes a project clearance has been given to, and there is no clear law in place, or the law in place actually allows somebody to go to court and say, sure, stop, what will the prime minister do? So what you need is institutional change. It is today not enough to say that somebody will come in and do something. Yes, he may be able to do something, sure. So you need a powerful – you need a prime minister – a PM that is more effective, more functional, stronger and so on.

[00:23:21]

But if the institutional framework doesn't change, then today there is a cabinet committee on investment that is trying to give clearances to projects. And what is stopping it? The laws. So you, too, need to have institutional change. There aren't – I don't think there are shortcuts anymore. This government would have tried all the shortcuts. I mean, you know, they're also seeing that growth has –

MR. LUCE: Has this government tried institutional change?

MS. PATNAIK: It can't be done that fast, so –

MR. LUCE: Right, because you need political will to have institutional reform – (inaudible) –

MS. PATNAIK: You do – you do.

MR. LUCE: Sorry – I'm going to get you into very – (inaudible) – (laughter) –

MR. AZIZ: No, because there is no consensus on that institutional change. So let's look at the example of consensus that we have actually seen – Latin America. In 1980s, Latin America go into a massive debt crisis. 1980 to 1990s, that's the rise of middle-class Latin America. From 1990 – middle of 1990s till today, there is a consensus across Latin America what should be macroeconomic policy framework. And if you look at most countries, except Brazil, in the last few years, most countries have stuck to that. Fiscal deficits need to be controlled. Inflation has to be brought down, and you do not interfere with the exchange rate. So there is some sort of a middle-class consensus that you have been created.

In India, there is no middle-class consensus that has been created. Middle class would be perfectly happy if, let's say, the current – the super cabinet committee, who is supposed to, you know, approve these storage projects, is able to do that. And, you know, in terms of growth models, I would say that Gujarat is a growth model, but equally successful is a Madhya Pradesh growth model, which is also run by the BJP government. Equally successful is a Charakhan (ph) growth model by the BJP government and by BJP ally the Bihar Juk (ph) growth model.

[00:25:14]

So there is nothing to say that the Gujarat growth model is somehow superior, and across dimensions – not just economic dimensions, but social dimensions, it is very difficult to say that the Gujarat growth model delivered better welfare, for lack of a better word – better welfare than the Madhya Pradesh, Charakhan (ph) or the Bihar model delivered.

MR. LUCE: Do you agree with that?



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MS. PATNAIK: Yeah, pretty much, because, I mean, one can – I look at investment data, and when I look at – and that’s really what business is talking about. So then they don’t – they often say that we don’t want to worry about infant mortality, so don’t tell us about whether – how bad infant mortality is or not. But I just look at investment data, and Gujarat has not performed better than Maharashtra. Maharashtra has performed better. So both are above the whole India average, and Maharashtra is more above the whole India average than Gujarat is.

So, I mean, that’s a good model, but Maharashtra, Gujarat, so – you know, whoever, can get investment in –

MR. LUCE: A quick, very short answer from both of you, then I will go to questions. Whoever gets elected next May, what would be the top three things that you would like to see to change the economic perspective?

[00:26:42]

MS. PATNAIK: OK. So, first is, of course, what I’ve been working on – (laughter) – which is financial sector legislative reforms. At the moment, particularly because of the growth downturn, there’s scam after scam after scam – there’s no consumer protection, there’s just – the regulation is so poor. And that’s – we’ve got already a draft law. We’ve got everything in place; they should just go for it. So that’s number one.

Number two, I think that they really need to start doing a similar effort, which was a two-year-long effort on thinking about and redrafting laws about the environment, because environment is an issue that is – you will have a tradeoff. At a stage of growth of an economy like this, people are going to – you know, some – there are always some losers and some gainers, and these will be issues that need to be resolved, otherwise we are not going to get the investment in place.

MR. AZIZ: I would say, at least the acceptance of low growth or lower growth for the next three years. I think that’s – to me, a critical thing, that if they do not accept low growth as fact of life, they will do things that will lead to consequences, like the ones that we’ve seen over the last two years.

MR. LUCE: Such as not tackling the fiscal deficit.

MR. AZIZ: Fiscal deficit, high inflation, and with that – you know – yeah, the exchange rate will be fine for a few years, and then it will come crashing down, and all sorts of macroeconomic instability will come up very soon thereafter. I think that’s a political acceptance. I think the technocracy has accepted low growth. I think that it requires a political acceptance of a low growth environment, that that’s what we’re going to face in the next three or four years’ time.

[00:28:24]

MR. LUCE: That’s number one.

MR. AZIZ: That’s number one. Number two, I would agree with Ila that we really require financial sector changes. Serious financial sector – I mean, there is this sense in India that somehow or the other, magically, India got saved both in the 1998 Asian crisis as well as in the 2008 global crisis. If you actually look at – in 1998, India was not even a blip in the radar of foreign investors. In 2008, if you look at the cost of the policy that India actually implemented since October of 2008, and let’s say, March of 2009, this was one of the costliest across every emerging market, by far, the costliest policy package that India had to put up in order to, quote, unquote, “save itself” from the damages of the global –



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MR. LUCE: And number three?

MR. AZIZ: And number three, environment. I mean, that's – environment – (inaudible) – brought a sense, because environment, in a sense, from mining to land acquisition to everything, is related to, what is it that we want to do in terms of environmental protection?

MR. LUCE: But we have a new land acquisitions bill, don't we? But anyway, we'll – (inaudible) –

MR. AZIZ: Yeah, yeah.

MS. PATNAIK: To add to that, I think there's a lot of – and I didn't have a third point, so I lied to it – (laughter) – that the interaction between firms and state needs to change. I mean, today it's all based on, go get permission for everything you want to do, and you have to run around getting permissions. And the government – you know, they'll be – bribes get taken, and that whole – the interface between this – there has to be a complete, overall thinking about this, because they had this command and control economy.

[00:30:01]

MR. AZIZ: Well, yeah, but that's basically where – my point is that a technocracy played that role between the firm – between the state and the private sector, in the absence of any institutional change for a very long time. That technocracy – and I agree with you, Ila – that technocracy is being shackled by all sorts of transparency and right to information, et cetera, et cetera, and lack of political protection.

MR. LUCE: Yeah, yeah. Let's have some questions. And we've got a – we've got a mic. And I think I'll take them one-by-one; I know often people collect questions, but I think it's better one after the other. So Isabel (sp).

Q: Thanks. I was in India in the – (inaudible) – when the rupee was depreciating very fast, and everybody was asking for the Minister Chidambaram to come and say something to the public. And I was surprised that he came with a list of investments that were being cleared by this committee, and that would be what would solve the growth problem in the short run, but none of you even mentioned them. Why is that disconnect?

MR. AZIZ: Because I think that those – all those projects were cleared, and not a single shovel to the ground was actually applied. No one actually did anything with those approved projects.

Q: Why?

MR. AZIZ: Because of the concerns about what happens once they start the project, what happens two years down the road. How will the political environment change in the next six months? And corporate India has not been investing since 2008. It just hasn't been investing, period. And, you know, we – there are lots of ad hoc reasons, but I would say –

[00:31:50]

Q: (Off mic.)

MS. PATNAIK: There's a lot more to that.



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MR. AZIZ: Yeah, I mean – I mean, it is very difficult to – for anyone to do any kind of investment today. I mean, the costs of investment in terms of the implementation – risks that you are taking is seriously high. And unless that is taken care of – and that’s where the implicit contracts broke down. And I think the costs of breaking down the implicit contract is that the costs of – the implementation risks now of any project is significantly higher than it was, let’s say, in 2007 and 2008.

MS. PATNAIK: So one is the implementation risk, and that’s very high – global uncertainty and implementation risk – but also that many people had – people were very optimistic before, and so then they had bid for projects; those projects were over-optimistic. Today, even when you clear them, they are not viable projects. So that’s part of the problem.

[00:32:45]

Another big problem today is that, especially for infrastructure, most infrastructure companies have very damaged balance sheets because they’re proud. They had overbid, or their projects got stalled, or there were environmental issues, because of which they got stalled. About 20 of the big infrastructure companies are in restructuring – the CDR, which is the corporate debt restructuring. And their balance sheets are not in a position to start new projects. Their bankers’ balance sheets are weak as well. They’re not performing as it’s arising. The bankers are not in a position to help them restart new projects. So both financially and in terms of uncertainty, implementation risk, it’s not a time to – that’s why investment announcements have gone down like that.

MR. AZIZ: Last year, India added 21,000 megawatts of power. This year, they haven’t managed to run any of those plants, because there is no coal.

MR. LUCE: (Off mic.)

Q: Thank you. Salmaan Al-Dumir (ph) from the American Enterprise Institute. I have a question for both of you. Let’s just say, hypothetically, that India doesn’t get this wonderful government that puts in place financial sector reforms and fixes the environment issue and does all these good things, and instead, you get a sclerotic, weak, say, UPA III, worse than this government, no decisions. What does that mean? Does that mean you sort of – that India stays at this three-and-a-half, four, or does that mean that if this is cyclical to a large degree, that even with a really bad government, we can expect India to bounce back? So what’s your kind of – what’s your worst case scenario, or what’s your scenario where governance – I don’t mean gets worse, but let’s just say governance remains at the level we’ve seen, doesn’t improve. What is the outcome – what’s the outlook for the economy under those circumstances?

[00:34:47]

MR. AZIZ: You want to go, Ila?

MS. PATNAIK: Yeah. So first, I don’t think, Salmaan (sp), that it’ll depend so much about whether it’s a UPA III or it’s an NDA II or a BJP I. I really don’t think that is going to make that much of a difference. I mean, look at – look at the last 20 years, OK? We’ve had many governments come in and go out, and they’ve all broadly supported market-based economies except the left, OK? Leave the communists, and the communists are today not that powerful.

So if it is a communist government – let’s just say that the CPI and CPM have – get 272, then I agree with you that it’s a bad government. Anybody else, actually – I think everybody’s out to – OK, this is a pie that can grow; I can get a share, and if the pie



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grows bigger, I can get it. We still haven't figured out how we make it grow, but we all gain if it grows. So unless you give the CPM 272, I don't worry that much, and I don't think that's a probabilistic scenario.

So I think whoever the government is, whatever the nature of the government, next three, four years are going to be bad, because the kind of institutional changes we need are not going to be easy to do for anybody. And my sense is that whoever it is will try to push for changes because, you know, they'll all try to get out of present situation.

[00:36:23]

MR. AZIZ: I'm not as pessimistic as she is. (Laughter.) So if you look at the way in which corporate India has been behaving – and I will take Ila's description – narrative to be very much the case that in 2007 and '08, they had nine percent growth going on forever; rupee at 40 forever, and life is wonderful forever. That didn't really materialize, and in 2008 till date, they are basically – essentially, if you look at any corporate boards or any annual reports, every project has, quote, unquote, first been delayed and then been shelved.

I think once you get some sort of a resolution on the political front, once there is some sort of belief back in Indian corporates, and mostly in EM corporate by and large – not just in Indian corporate – that G-3 growth, even though it may not be as big as it used to be back in 2008, G-3 growth is going to be far less volatile, and it's going to be low but stable for some time.

Once you get those two things ingrained in peoples' mind, I think corporate both in EM Asia – I mean, EM world, including in India, I think will start now changing their projects. It will be smaller projects. It won't be as ambitious a project, but they will start doing that. And they still haven't done that.

So if they actually do that – and those two, again, hinges on a political resolution, and political resolution I mean it doesn't matter who comes – and I agree with Ila – it doesn't really matter who comes. Somebody has to come, and much more, what really is happening to global demand?]

Q: But it could be another weak and indecisive government, and that would be fine?

MR. AZIZ: I think they will try and work around the weak and indecisive government. It was when the weak and indecisive governments tried to actively interfere in the economy as a weak and indecisive government – that's when the problems started. If the weak and indecisive government says, look, I am going to stay away from the – from the economy, that's fine. Benign neglect or – not even benign neglect – nonbenign neglect – whatever that means – (laughter) – it's perfectly fine.

I mean, it is when you actively do things, and that – which are the wrong things. So what I would be scared of is if the – let's say – whichever government comes into power – BJP or UPA says that we want to reverse everything that's happened over the last three years, and we want to target 9 percent growth rate. Life will be – India will be in serious trouble if that's what the government.

[00:38:57]

MS. PATNAIK: Jahangir, they haven't even started announcing investment projects now. So suppose you give it nine months, right? And then after that, they say, oh, wow, this government is great; we start announcing. It takes two years to start something, you know?

MR. AZIZ: True, true.



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MS. PATNAIK: So you need – you have two-and-a-half, three years at least of a lag before you can turn around.

MR. AZIZ: No, I agree, but you can get enough amount of sentiment-driven activity on consumption side and ongoing around just based on that.

[00:39:27]

MS. PATNAIK: Just capacity expansion will happen for some time.

MR. AZIZ: Some time.

MS. PATNAIK: So you could get to, what, five, five-and-a-half?

MR. AZIZ: Yeah, who's talking about anything more than that? (Laughter.) What are we talking about? (Inaudible) – accept five –

MS. PATNAIK: Yeah, if you get five, that's – so, yeah, it –

MR. AZIZ: Accept five, I think, you know, we've done – we'd be doing well if they'd just accept five.

MS. PATNAIK: Five-and-a-half, if exports pick up.

MR. AZIZ: Yeah, if the next three years – yeah

MS. PATNAIK: If the U.S. does well.

MR. LUCE: The lady on the left. Oh, sorry; you're the person – (inaudible) – I do apologize questions. (Inaudible.)

Q: I can think of good and bad scenarios. I like your view on a bad scenario, which is, I think, in which we're not so much blaming the politicians. And this is if any political party (given ?) India cannot avoid responding or being – having a narrative of responding to the emerging aspirations. And if you like, one of the other institutional failures was that because of the booming revenues, they were able to get away with highly inefficient, quote, populist policies, but ones that had to be delivered somewhere or the other. That's one. (Sorry ?).

[00:40:45]

Also, in this booming period, there was a, to pick up on Ila's point, a kind of half-baked deal between the government and the corporate sector. It's a kind of somewhat legal, somewhat shady, and now that can't happen now. So given that, it's almost like you could paint a scenario where there's a systemic shift. The old ways of business aren't going to work. Still have to meet these aspirations. And in the meantime, there is this – there is this debt overhang, a corporate debt overhang and driven by a combination of the rising expectations and the –

MR. LUCE: Is there a question at the end of that?



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Q: – and the (time ?) – this is – sorry – (inaudible).

MR. LUCE: (Inaudible.)

Q: Is this feasible?

(Cross talk, laughter.)

MS. PATNAIK: Is what feasible? (Laughter.)

[00:41:37]

Q: Is this a likely scenario?

MS. PATNAIK: I mean, you have – you'll take some time to clean up the balance sheets. It's going to take time. It's – in the meanwhile we're in this deep slowdown of – so the tax collection has really plunged, and this time it's looking like it's going to be worse than last year. It's not going to be easy to clean that out, get access back. I think that they're going to try and make subsidy delivery far more efficient. So even though they've – you know, they've set up this whole welfare scheme and that welfare scheme and so on, I think the infrastructure that is being put in place through – (inaudible) – and bank accounts, and it's, like, OK, we have to somehow get money to people who are excluded from growth, but we can't afford to do it with a 50 percent leakage. So we now need to still get the money to them, but do it more efficiently. So –

MR. LUCE: Do you have anything?

[00:42:43]

MR. AZIZ: I mean, if you look at any of these, you know, Freedom House, Heritage measures of transparency, governance, et cetera, all of them are procyclical. Sentiments about how great your government is doing depends entirely on how you are feeling. If you're feeling bad, government is doing really, really badly; if you're doing well, government is doing extremely well. So to your point, that why can't a muddled scenario where you're really not sure what is the relationship between the states and the private sector, why can't that keep on working as long as the other middle class does not – is given some amount of, you know, side payments, so to speak. You know, you allow wages to grow a little bit, you allow asset prices to grow a little bit, you allow real estate prices to grow a little bit. And, you know, every aspirational parent, OK, fine, so you don't get into IIM Ahmedabad, but you get into some – your son gets into some sort of management school. I think middle class will tolerate that environment and that – (inaudible) – for quite some time. I don't see urban middle class basically saying I'm turning Latin American without an actual Latin American-style crisis. And these group – these politicians, I mean, the economic policymakers in India, both in UPA and in the NDA, are extremely good at avoiding any kind of a Latin American-style crisis. You need three, four, five years, that kind of a crisis for the



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urban middle class to create a new consensus and push that consensus on the government. That's not going to happen. You get a 5 percent growth in (Ila's and my ?) framework? That is bad? Not that bad.

[00:44:31]

MR. LUCE: Mmm hmm. Mmm hmm.

Yeah. Ilan (ph).

Q: So Jahangir, let me pick up on that last point. Would you go so far as to say that the urban middle class has not only not come up with a consensus, they've actually perverted the old consensus, they contributed to corruption, they've exited the public system, they haven't invested in institutions, they've benefited from subsidies they didn't deserve, from corruption that accrued to their interests? So do they have an – everyone talks as if the middle class will be the savior, but is there a way in which they've been just as complicit as everyone else?

MR. AZIZ: Yeah. I mean, I would agree with that. I mean, I mean, there isn't – there is – I mean – I mean, there was a sort of an emerging social consensus, social compact that was being – that was working, which was that the urban middle class and rural middle class in the sense of those who were benefiting from the acquisition of land, for example – as long – they were being – they would be allowed to make money, and in exchange for that, they'll be asked for 2 percent of GDP of fiscal subsidies to keep social stability through the – you know, the unemployment programs and this and that and the other.

And as, you know – (inaudible) – pointing out and even both of us were talking about, I think the fact that the economy's slowed and revenue started to collapse made both sides of the equation the ability to deliver the 2 percent subsidy and the ability to keep on allowing urban middle class to keep on – have the incomes grow at 15, 16 percent – both of them came to a head – crashed. And I think that's what the urban middle class is really mad at, that yes, we are willing, you know, to go along with this social compact as long as we're getting from there 15, 16 percent of annual income growth. And we were used to it from 2003 to 2009, '10; suddenly it's disappearing. And I think that's what's really, really bothering them.

MR. LUCE: (Inaudible) – question I meant to ask but forgot. Since you both seem to be agreed that there isn't a premium attached to –

[00:46:41]

MR. AZIZ: That's not a good thing, by the way.

MR. LUCE: Yeah – (inaudible) –



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MR. AZIZ: Two economists agreeing.

MR. LUCE: Yes. (Laughter.) You weren't – you weren't going to – (inaudible).

MR. AZIZ: Yeah. Yeah.

MR. LUCE: Since you both agree on the fact that Modi wouldn't be an economic premium for India, that a Modi prime ministership wouldn't be any different – (inaudible) –

MR. AZIZ: No, no, no, but no, both of us agree that there will be a massive premium in the asset side.

MR. LUCE: On the asset side.

MR. AZIZ: Stocks are going to go through the roof.

MS. PATNAIK: Zoom. Zoom.

[00:47:05]

MR. LUCE: Yeah. Sentimentwise. But that might not necessarily be long-lived. But in terms of what you said on the structure – (inaudible) – you seemed skeptical. So could you enumerate what you think the downside of a Modi prime ministership would be? Would there be a communal dimension here? Would there be a Pakistan relations dimension here? Or is he, Modi, a kind of Sharon figure who's put that behind him?

MS. PATNAIK: So I'm not – I'm not sure what he stands for today. I'm not sure what his foreign policy is. I'm not sure what his vision is. I'm not – I've not even heard him talk about – so whatever limited speeches I've heard have been mainly against the Congress. So it's not clear to me what he stands for. So I'm not sure now to – if he stands for nothing, which is that if he hasn't made these speeches, I know – I do know that there are many groups getting around all over India, certainly becoming very proactive, saying we'll give him a vision. You know, let's write down what he needs to do.

[00:48:09]

MR. LUCE: Is this a case of him keeping vision quiet –

MS. PATNAIK: I don't know that he has a vision.

MR. LUCE: – or (that he's ?) lost his vision?



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MS. PATNAIK: No, I don't know that he has a vision. So for example, one did not expect him to support the food security bill, OK? Business did not expect him to support the land acquisition bill because he was supposed to be pro-government, and the land acquisition bill that has been – brought in changes increases the cost of acquiring land. So I would say that if he does not have a vision, because I've not heard what that vision is, and if we get a leader who does not have a vision to take to – you know, making India a modern, vibrant, liberal democracy, then that is the biggest answer. I have no idea what's (gone on?).

MR. LUCE: You'd agree with that?

[00:49:01]

MR. AZIZ: I'm not too worried about the vision thing. He can create a vision thing. I mean, you're going to get a bunch of people to create a vision.

MS. PATNAIK: No, Jahangir, I'm not – my vision is not like as superficial as your sense of a vision. (Laughter.)

MR. AZIZ: Oh, OK. I'm not too worried, by the way.

MR. LUCE: Supposition on my question.

MS. PATNAIK: (Chuckles.)

MR. LUCE: Vision that we never – has exhibited in the past is not exactly reassuring.

MR. AZIZ: Yeah, but, you know –

MR. LUCE: (Inaudible.)

[00:49:24]

MR. AZIZ: But people – but look, I mean, he was chief minister of Gujarat in 2008, when that event took place, just become a chief minister. I –

MR. LUCE: 2002.

MR. AZIZ: 2002. Today he is going to be the prime minister of India. It's like, you know, somebody being in the opposition and saying I'm going to do all these things, and then the person is actually going into government. The responsibility of – the constitutional responsibility will have – will force narrow down what he can do, what he can't do, what his vision can be and will be. So I'm –



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MR. LUCE: He's not going to be – (inaudible) –

MR. AZIZ: No – yeah, but difficult it was for a few days.

[00:49:59]

MR. LUCE: (Inaudible.)

MR. AZIZ: No –

(Cross talk.)

MR. AZIZ: Yeah, but Deve Gowda was a few days. We –

(Cross talk.)

MR. AZIZ: No, no, no he was for a few days, Deve. We don't know what Deve Gowda would have become in three years' time or four years' time if he was allowed to – (inaudible).

[00:50:08]

But that's not what I'm afraid of. What I'm afraid of is that if you look at the Gujarat, the narrative that goes with the Gujarat model: Here is Narendra Modi and here are technocracies. There is no one in the middle. And he is delivering this huge growth, working with the technocracy, technocrats, to deliver the growth rate. You can do that in Gujarat. You can't do that in the central government.

So my usual question is, to those who believe in the Gujarat state model, name me one minister of his cabinet – anyone.

MR. LUCE: Even the one who was in prison? (Laughter.)

MR. AZIZ: Name him. Just name one person from his cabinet other than him.

MR. LUCE: Ila, that's for you, not for me.

MS. PATNAIK: Name –

MR. AZIZ: One person in his cabinet.



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MS. PATNAIK: The minister who went – (laughter) –

MR. AZIZ: Right, some guy with something. Name it. Name it.

(Cross talk, laughter.)

MR. LUCE: Next question? I think we've got time for a couple – a couple more. Yes, the gentleman at the back. Oh, no, you're a mic distributor. (Laughter.) Sorry. The gentleman sitting over there.

[00:51:17]

Q: So my question is very simple. I am – (inaudible). Name one member of the cabinet of Nitish Kumar's government in Bihar.

MR. AZIZ: Oh, Modi – Sushil Modi.

Q: No, he's not there yet. He's not there.

MR. AZIZ: Yeah, but – no, but he was a key part in the part of Nitish Kumar's government that delivered that growth rate. So –

Q: I'm saying a current government.

MR. AZIZ: But I don't need to know because the current government hasn't done anything. (Laughter.) The part of the government that did deliver, I'm just saying Sushil Modi was a critical part of that government.

MR. LUCE: More questions? Yes, sir. Please – sorry, I should have said this at the beginning – state your name and affiliation.

[00:51:57]

Q: Sure. Brian Beary, Washington correspondent for Europolitics Newspaper. And I just had a question about trade policy, because I cover a lot of the trade agreements and I don't know the situation in India as regards – it's on the radar but there's a lot of changes with, you know, the WTO. Things have come to a standstill and a lot of people pointed the finger, blame at India when that happened several years ago.



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And now you have the two giant regional trade agreements between Europe and the United States, and then you have the Trans-Pacific. And I know that China is sort of waking up to, you know, the implications of that. I'm just wondering if this issue features on the radar in Indian politics and if there's any viewpoint on international trade policy.

MR. LUCE: That's a good question. Ila?

MS. PATNAIK: I'm not sure that it's – I mean, if it's a question of does it feature on the radar of Indian politics, then not particularly, no. No. So it's – when there is a WTO meeting and India has to go in and disrupt it for a few days, we see it – you know, it makes headlines that, you know, India stopped everything from happening. (Laughter.)

[00:53:08]

MR. AZIZ: And by the way, and in India – and during those days there was a consensus within India that what the government's approach is, is the right thing.

MS. PATNAIK: So, you know, everybody is kind of –

(Cross talk.)

MR. AZIZ: But it doesn't matter which side of the spectrum you are on. There's complete consensus that nothing should be given up, for example, in agriculture. There's complete consensus.

MR. LUCE: Is there any angst that groups like the TPP obviously weren't included in India's –

MS. PATNAIK: No, but the –

MR. LUCE: It's not a Pacific nation.

MR. AZIZ: No.

MS. PATNAIK: No, no, no, and there is very little appetite for an Indo-U.S. FTA now, at the moment at least.

MR. AZIZ: Yeah. Yeah. And the only thing that has been talked about, the FTA with Pakistan. Well, that's much more political.

MS. PATNAIK: Yeah, but that's because – first they have to give us the MFN status.

MR. AZIZ: Yeah.



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[00:53:47]

MS. PATNAIK: That's where it starts. The only thing you talk about is Pakistan has not given India the MFN status. They need to get their politics right. But that's about, OK, we gave it to them 10 years ago, so that's about –

MR. LUCE: Since there aren't any hands up I'm going to smuggle another quick question in.

Nawaz Sherif is here this week, and I think on Wednesday he's going to the White House. Is Pakistan going to play – and they're having their \$1.6 billion whatever it is, U.S. civilian aid restored, quietly. Is Pakistan going to play any role in this – in this election?

MS. PATNAIK: I don't see Pakistan playing a role in this election.

MR. LUCE: What will be the issues in this election, other than corruption and governance?

MS. PATNAIK: So there seem to be – corruption and governance seem to be the issues of this election.

MR. LUCE: All right. All right. I think, though – I keep saying I think we've got time for one more. Does anybody have any idea what the time is? I'm just guessing.

MR. : Four minutes.

MR. AZIZ: Four minutes.

MR. LUCE: Four minutes. That's four questions, in my book. (Laughter.) So let's see at least one of them. Oh, two of them. I'm starting with you.

[00:54:50]

Q: So it might not actually be a question. But, Ila, like, you brought up why BJP didn't want – voted against land acquisition and food bill. At this point of time elections are so near no one is going to antagonize local population for that matter.

My point is whether, with Modi being elected or Gandhi being elected, is there going to be patchwork, which will – as you said, which will lead to super economic growth – subeconomic (ph) growth rather, or will there be a visionary move towards economic growth in the long term? So that is – that is what – whether Modi is capable of doing that or not?

MS. PATNAIK: So-so.



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MR. LUCE: A chance to change your views on Modi. Last chance. (Laughter.)

MS. PATNAIK: I mean, that's –

(Cross talk, laughter.)

MS. PATNAIK: So why would – so suppose I stood against handouts. Then why would my supporters be upset if I continued to stand against handouts? So I don't see why you would argue that not supporting the food security bill was against – would upset voters.

If my – if my ideology – look at what the communists have been – I mean, OK, in my past life I was one but now I'm not. (Laughter.) But look at what the communists say. If they say that they're opposing India's friendship with the U.S., let's say, you know, or any other issue which is not really something that the bulk of the population supports, or they would – or various voters support but they have their own supporters, then those supporters are finally the view they pick.

[00:56:30]

So the point I'm trying to make – I was trying to make was that if Modi stands for minimal government, if Modi does not support handouts and a welfare state like the food security bill, then his supporters support him because he stands for that, because he does not support those things.

Now, suddenly if I was to say, because elections are near so I change my stand, that's a very odd thing to say. That means I don't really have that ideology. I never actually was supporting reducing the state or not having a welfare state. Am I just opportunist that today I'll do whatever the voters feel?

MR. LUCE: But you've heard of bait and switch, right? I mean, it's a common – (laughter) – it's a common practice in politics.

[00:57:15]

MS. PATNAIK: So that – again, for the –

MR. LUCE: It's a rhetorical question because we have one – actually one left. So there was a gentleman in the same row as you who had their hand up. Yes.

Q: I'm wondering, while all these political dynamics are continuing, as they have done for very, very many years, I'm interested to know the extent to which the Indian diaspora is able to make any difference to the kind of – the economic dynamics, given the fact that you have now about \$70 billion a year coming in through remittances and an enormous return



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of Indian capital and Indian entrepreneurial skills from the U.S. and other countries. And I'm interested to know the extent to which this is a dynamic which can actually, you know, make a difference vis-à-vis the kind of traditional, if you like, difficulties or, if you like, gridlock of Indian politics.

[0058:11]

MR. AZIZ: I think, you know – want me to go ahead? OK, I think that the – I mean, the kind of role let's say the Chinese diaspora played in the initial years of China's development, where they were the ones who established the beginnings of the supply chain which would originate in the West Coast of the United States of America and go to China, I don't think that the Indian diaspora ever intends to play that role or even wants to play that role.

So in terms of what is it that they can do to change, my guess is it's very limited in terms of – apart from bringing in \$70 billion of remittances, and let's say another \$10 billion of – you know, in non-resident Indian deposits, they really do not have that much of a role to play either in other portfolio (?) influences or in FDI. That's not the way in which the Chinese diaspora worked.

So it's much more in terms of influencing politics perhaps, but not in really going and setting up, let's say, a complete new supply chain for pharmaceuticals – I'm just making this up – or textiles or something like that, the way in which the Chinese diaspora did. They established the supply chain, but way before the multinationals, way before Walmart had come into the supply chain, (this thing ?) of China, they were the ones who were – who were creating the supply chain.

MR. LUCE: Has there been a Miss USA from China? (Laughter.) Sorry, that wasn't a question either.

MR. AZIZ: Let me think. (Laughter.)

MR. LUCE: Do you want to respond to that or – because I think we are at the end of the time.

[00:59:56]

MS. PATNAIK: No, I agree pretty much, except I would like to see them play a role in – you know, go from Silicon Valley and play a similar role in India.

MR. LUCE: Sure, but –

MS. PATNAIK: Is that something that's happening? Not that much, no. Not likely.

MR. AZIZ: No.

MR. LUCE: Well, thank you to both of you – some very illuminating answers – and for your patience.



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MS. PATNAIK: Thank you. (Applause.)

(END)