

Zones And Phones

The Telegraph, Calcutta, May 22, 2000

Jeffrey D. Sachs & Nirupam Bajpai

Among the key economic areas that New Delhi needs to address to maintain the pace of economic reforms is promoting exports and information technology.

The government needs to promote exports by stressing export processing zones, eliminating product reservation for small scale industry, encouraging the information technology sector, eliminating administrative barriers to foreign direct investment, and abolishing tax and tariff structures that are biased against exports. India could have achieved what China has achieved in export growth. However, India failed in basic policy strategy.

At the centre of China's strategy were the special economic zones in which favourable export conditions were assured. SEZs were designed to give foreign investors and domestic enterprises favourable conditions for rapid export promotion. All aspects of the export environment were secured. Exporters were allowed to import intermediate products and capital goods duty free. They were given generous tax holidays and assured decent physical infrastructure. This was done by providing land, power, physical security and transport to ports within special industrial parks.

India too has experimented with similar zones, but India's approach has been one of relative neglect. China's five main SEZs have been successful in exports, attracting FDI and creating large scale employment opportunities. By contrast, India's main export processing zones have not succeeded in any of these areas.

India's EPZs have not performed as well as China's SEZs for many reasons. They have been of limited scale and are overcrowded. India has built insufficient logistical links with ports. Infrastructure near the zones has been poor with unpaved roads and poor physical security. There is still much government ambivalence and red tape regarding inward FDI, as well as unclear incentive packages about inward investment. State and local governments, even the private sector, lack sufficient authority and interest in the design, setup and functioning of the zones.

In China, the major responsibility for In SEZs rests with local and provincial governments. In India, the responsibilities lie heavily with New Delhi. Under these circumstances, many state governments are actually averse to locating EPZs in their state. Some of the initiatives announced by the government in the export-import policy 2000-01, such as establishing SEZs in different parts of the country and fully involving the state governments in the export efforts, are welcome. While these measures will undoubtedly provide great impetus to India's export efforts, it is critical to abolish product reservation for small scale industry and to liberalize labour laws if India is to attain and sustain high rates of export growth.

India's labour laws make it costly to dismiss workers in enterprises of more than 100 workers. The result is that formal sector firms are loath to take on new employees. The vast majority of India's employees remains informal, in small, tax evading, inefficient enterprises.

Remarkably India's legislation continues to restrict the entry of large firms, or the growth of small firms into large firms, in several areas of potential comparative advantage. Thus garments, toys, shoes and leather products continue to be reserved for small scale producers. India's high overall tariff rates, especially tariffs on intermediate products used by exporters, impose a heavy indirect tax on export competitiveness.

Furthermore, the budget for 2000-01 proposes phasing out exemptions from income tax for export earnings. The regulatory attitude to foreign direct investors, potential engines for India's export drive, continues to be ambivalent. The government promotes FDI on the one hand, but then regulates against full foreign ownership and maintains lengthy approval processes, on the other hand.

Service sector export based on info tech is another area where government policy could do much more to spur export growth. India is becoming one of the world's most important infotech players. It is the fastest growing foreign exchange earner. The government could do more for this industry, not through direct subsidies, but through the liberalization of telecommunications, allowing for lower priced telecom services and the entry of major international players.

These companies could lay down a tremendous fibre optic network in India and increase the bandwidth available for business. This would push India even closer to the international scene. New Delhi should find some resources to support basic science and research and development in this sector. India has world class engineers and scientists who have already brought India up in an important way in this sector and could keep India in the forefront of this new technology.

The continuing state monopoly of Videsh Sanchar Nigam in international telephony as well as in internet provision within the Indian market seriously raise the costs of telephone and infotech services in India. It is doing considerable damage to India's international competitiveness in the infotech sector. In addition, India's telephone density is abysmally low, at around 1.3 lines per hundred persons in 1995.

International telephone calls originating in India are among the most expensive in the world, largely due to lack of competition. Physical infrastructure for data transmission within India-for example, fibre optic cables -remains underdeveloped despite some recent progress. Restrictive policies on FDI have kept international chipmakers out of India, and have indirectly raised the prices of personal computers in the Indian market. The lack of enforcement of intellectual property laws most likely inhibits inward investments in info tech sectors.

All of these problems are remediable through further deregulation of telecom and FDI, as well as effective law enforcement in a more liberalized and competitive environment.

The engine of growth of the booming info tech sector is the software industry which has grown at an average annual rate of 60 per cent between 1992 and 1999. The turnover of the Indian software industry, which employs 160,000 professionals, has zoomed from a mere \$ 20 million 10 years ago to four billion dollars in 1998-99, of which \$ 2.6 billion was exported.

This industry has clearly emerged as a major export earner for the country, contributing eight per cent of total merchandise exports. It has also achieved worldwide reputation for providing excellent quality. Many local software firms have earned International Standards Organization 9000 certificates. They have also gotten the Software Engineering Institute's capability maturity model certification, with five of them having reached level five. Only nine firms worldwide have reached this level. India has achieved this feat by leveraging its most valuable resource: highly skilled manpower.

Improvements in infrastructure through liberalization combined with regulation are needed. In telecom this should be done through privatization and competition. In power, reforming the state electricity boards is extremely crucial. Liberalizing telecom would allow for lower priced services and letting in more major international players could raise Indian infrastructure to international levels.