Reforms and growth prospects

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INDIA'S REFORM programme is similar in many ways to the reforms undertaken in other developing countries, but it has been implemented at a much more gradual pace than elsewhere. This gradualism, which is usually explained in terms of the compulsions of India's democratic polity, has been criticised in many quarters for producing a frustratingly slow pace of change.

A slow moving reform process in the Indian States, lack of decentralisation in terms of economic policy-making at the State-level, stringent labour laws; product reservation for small scale industry and poor infrastructure - in terms of power, ports, roads, and telecom - are some of the crucial reasons why India is unable to attract large sums of foreign direct investment (FDI). India's neighbors that are relying heavily on FDI, such as China, Indonesia, Malaysia, and Thailand, have been pulling far ahead of India in economic growth, income levels, and productivity, while also increasing their security and geopolitical influence. India's continuing ambivalence to FDI, as a result, exacts a heavy toll on its economy.

In the current global scenario, it is possible for India to achieve very dynamic growth based upon labour-intensive manufacturing, that combines the vast supply of labour, including skilled managers and engineers, with foreign capital, technology and markets. There are lots of international investors who would flock to India right now, especially now that they see that it has a lot of safety for them compared to China, for example. But, they are put off by the fact that they cannot get reliable power or that the roads system is so dreadful that even if they are producing effectively, they will not be able to get the goods to the market or to the port for exports in time. Continuing fiscal difficulties that are often linked to the chronic infrastructure problems remain a major challenge for India. The Government has set for itself an ambitious target of achieving $10 billion in actual FDI inflows a year. For this, some hard reform steps are essential.

To achieve the Government's goal, it is crucial to raise FDI approvals to actual ratio. On a cumulative basis, FDI approvals between April 1991 and September 1998 were of the order of $54,268 million, whereas, actual FDI during the same period was a mere $11,806 million. The same ratio is much higher in China, Indonesia, Korea, Malaysia, Philippines, and Thailand. State-level data on FDI approvals (aggregate FDI approvals between 1991-97) suggest that the relatively fast moving reformers have tended to attract higher investments, both from foreign and domestic investors.

From the long-term development point of view, we are of the view that India has tremendous growth prospects through export-led growth in a broad range of sectors, both traditional and new. The most interesting by far of the new sectors is software and information technology. This sector is the fastest-growing foreign exchange earner for India. Several U.S. and European companies have located their back-office operations in Bangalore, Chennai, and Pune. Abundant supply of labour, low wages, cheap satellite communications and the internet have been instrumental in this decision of foreign firms. Such operations create job opportunities in Indian cities and help lower costs for the foreign companies.
Export-led growth in services is one of the most interesting developments, and export-led growth in manufactures, the more traditional textiles and apparel, in electronics and other labour-intensive operations remains an area where India could do a lot more than in the past. China has achieved a lot more in manufactured export production than India and for no particular reason. India has the resource base, it has the entrepreneurship, has the access to the sea coast, a vast labour force, it has everything that coastal China has had except the interest of the Government which neglected this for a long time and which even today underemphasises the role of industrial facilities, underemphasises the role of infrastructure, of land area, of effective port facilities. But it is, we believe, a place where one could find tens of millions of jobs over the next few years in real, significant foreign exchange earning private sector activity. This would require a change of attitude, a real promotion of these sectors both at the State and Central Government levels. We must mention here that the recent decision of the Government to de-reserve the garments sector, till now the exclusive preserve of the small scale sector, is a bold and a very welcome step. Product reservation for the small-scale industry has had, and continues to have, a negative impact on India's exports. 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, garments being one of them. This is the kiss of death to effective international competitiveness in labour-intensive exports.

We believe that substantial impetus can be imparted to the growth process should the Central Government decentralise economic policy-making and allow the States to make crucial decisions on their own. Greater decentralisation of decision-making in India is likely to lead to greater competition among the States and therefore to higher efficiency and productivity in these regions. In India, key fiscal, infrastructure, and regulatory decisions on economic management remain at the Central Government level. Essentially what this centralised system of governance implies is that the States have very little jurisdiction in, or control over, policy and regulatory decisions that would make them more attractive to prospective investors. A gradual decentralisation has begun in India as a result of the fact that regional political parties have been lending support in the formation and running of the Government at the Centre. This is a healthy development.

While it is true that the record of the coalition Governments so far as stability at the Centre is concerned is poor, it is also important to recognise that coalition politics is rather new to the country, and with the passage of time is likely to mature, signs of which are being seen already. Regional parties having representation in the Central Government can play a critical role and negotiate for greater decision-making authority to be transferred to the State-level. Policy-making at the sub-national level is essential for State Governments to be able to follow development strategies suitable to their socio-economic, cultural, and geographic characteristics.

To conclude, there are several reasons for being optimistic about India's future growth prospects - a decade of opening of the economy has produced new dynamism, most dramatically in the IT sector, but in others as well. The new technologies especially IT and biotechnology give new opportunities for economic and social development. Demographic trends, especially a slowing population growth rate and a rising share of the population of working age, contribute to rising per capita income.
While rapid economic growth is certainly possible, it could flounder for several reasons. First, large and persistent fiscal deficits can endanger sustainability of growth over time. Second, despite its excellence in high technology, much of India remains mired in illiteracy and exclusion. Unless society, and the Government at all levels, truly prioritise improvements in the access of all Indians to education and health services, millions of will have little practical prospect of improvement in life conditions in the coming years. Third, India must not rest on the laurels of a successful decade of economic reforms. Much was accomplished in the 1990s, especially when viewed from the perspective of the opening years of crisis of that decade. But much remains to be done: improved infrastructure, in part through privatisation and completion of reforms in key sectors; attraction of much greater flows of FDI; liberalisation of labour, land, and other factor markets; fiscal reform and consolidation; and finally meeting the great social challenges among India's poor and excluded groups.

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