Foreign Helping Hand
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India’s economic policy reforms have played a critical role in the performance of the Indian economy since 1991. Among other things, the reforms have involved opening the economy, making it more competitive, getting the government out of a huge morass of regulation, empowering states to take more responsibility for economic management and creating a kind of competition between the states for foreign investors. The gross domestic product growth rate which had collapsed to 0.8 per cent in 1991-92 rebounded to a near normal 5.3 per cent in 1992-93, and then accelerated to 6.2 per cent in 1993-94.

Subsequently, GDP grew at an average rate of 7.5 per cent in the three years from 1994-95 to 1996-97, before slowing down to 5.1 per cent in 1997-98. It is important to note that despite the slowdown, the average growth rate in the four years from 1994-95 to 1997-98 was 6.9 per cent, significantly higher than the growth rate of 5.6 per cent achieved in the Eighties. In 1998-99, the GDP is estimated to have grown at 5.9 per cent.

The positive trends being seen in most sectors had the capability to more than neutralize the debilitating effects of two general elections in two years, the east Asian currency crisis, the Kargil conflict, the nuclear explosions and the United States sanctions that followed.

In the backdrop of the east Asian crisis, growth did slow down a little bit, but India has kept growing and avoided the worst of the crisis.

From the narrow financial point of view, two things India did were quite helpful.

One, it kept some limit on short term capital inflows and did not go overboard in borrowing short term from abroad. This helped India to avoid the financial reversals of some of its neighbours.
Two, it kept the rupee flexible. The depreciation of the rupee definitely helped keep the Indian economy more competitive and kept economic growth going during this period.

In the context of the east Asian crisis, certain kinds of money fled while other kinds did not. The “hottest” money was short term loans from international banks. The reversal of short term bank lending constituted a very large proportion of the overall $ 105 billion reversal in capital flows. The banks put in $ 56 billion in net lending in 1996, and then withdrew an estimated $ 21 billion in net loans in 1997, for a swing of $ 77 billion. That amounts to 73 per cent of the overall reversal. Portfolio equity investors — in other words, country equity funds — also reversed gear, to the extent of $ 24 billion.

Foreign direct investors, by contrast, were very stable. It is estimated that net foreign direct investment remained roughly unchanged between 1996 and 1997, at around seven billion dollars in net flows each year.

It is significant to point out here that India went through a near disaster in 1991 that was, among other causes, based on short term borrowing. Of course, at that time it was short term borrowing
from nonresident Indians. But it was the same kind of phenomenon — lots of short term capital came in and then moved out, creating a severe payments crisis.

In terms of foreign investment, it is the direct investment that should be actively sought after and doors should be thrown wide open to foreign direct investment. FDI brings huge advantages like new capital, technology, managerial expertise and access to foreign markets. There is little or no downside.

There are lots of international investors who would flock to India right now, especially now that they see that India is more safe than, for example, China. But they are put off by the fact they cannot get reliable power or that the road system is so dreadful that even if they are producing effectively, they will not be able to get the goods to market or back to a port for export. Continuing fiscal difficulties that are often linked to chronic infrastructure difficulties remain a major challenge for India.

The government set itself an ambitious target of achieving $10 billion in actual FDI inflows per year. In order for this target to be met, it is essential to undertake some hard reform steps. Should the government decide to implement some of the most critical reform actions necessary for making India an attractive investment destination, then it is likely India will not only be able to meet the target but do much better than that. Of course, additionally, availability of infrastructure services, such as uninterrupted power, good roads, and adequate port and telecommunications facilities are essential.

In order to achieve the government’s goal, it is crucial to raise the 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. Actual FDI as a proportion of FDI approved was only 21.7 percent. This ratio is much higher in China, Indonesia, Korea, Malaysia, Philippines, and Thailand.

A few of the Indian states have been more reform oriented, such as Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu. But states such as Haryana, Kerala, Orissa, Madhya Pradesh, Punjab, Rajasthan and West Bengal have a lot to catch up with. Of course, Bihar and Uttar Pradesh are even further behind. States that are ahead in reform efforts right now are going to find that if they move against populist policies and set up regular markets for services, such as power and water, then they are going to be ahead of the rest in the game.

There are rather significant differences in reform interest and economic performance between a large part of north India and south India, where Karnataka, Tamil Nadu and Andhra Pradesh are quite dynamic in trying to get the infrastructure and the policy regime right to attract large scale foreign investment. In Bihar and Uttar Pradesh one does not see the same kind of reform dynamism and the economic growth results are therefore poor.

These differences will be noticed politically sooner rather than later. Inequalities will become glaring as the states that are ahead will be rewarded with better performance and the states that are behind will wait to experience domestic demand to catch up with the states that are growing.
That will spur a kind of competition among the Indian states and make the reform process go much faster.

State wise approvals of FDI in India suggest differing performances among the Indian states. States are now in competition with one another to attract private investment, domestic and foreign. State level data on FDI approvals, using 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.

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