CHAPTER 3

India Globalizing*

Kaushik Basu

1. Introduction

Writing in the *Financial Times* of February 23, 2005, about China and India, Martin Wolf observed, "The economic rise of Asia's giants is, therefore, the most important story of our age. It heralds the end, in the not too distant a future, of as much as five centuries of domination by the Europeans and their colonial offshoots." Optimistic predictions about China and, more recently, India, have begun appearing with a certain regularity in the media. Ted Fishman wrote in the *New York Times Magazine* (July 4, 2004, p. 27), "If any country is going to supplant the US in the world marketplace, China is it." In an interview to the *IMF Survey* (February 21, 2005, p. 40), Wanda Tseng, mission chief for India in the IMF, said, "India is one of the fastest growing economies in the world and is certainly looking to continue growing strongly." Stephen Cohen in his influential book, *India: Emerging Power* (2001),[18] writes, "India has long been counted among the have-nots. The situation is rapidly changing, which is what will make India such an interesting "great power" for the next dozen years." In Standard and Poor's *CreditWeek* (January 5, 2005, p. 12), Joydeep Mukherji credits China and India as "global success stories in reducing poverty and moving toward a prosperous market economy" and notes that "since China initiated economic reform in 1978, its national income has more than quadrupled; since India began liberalizing its economy in 1991, its per capita income has almost

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doubled." In the inaugural address to this conference, Singapore's Minister Mentor Mr. Lee Kuan Yew, in a speech crammed with statistics and deft analysis, predicted that India will be propelled into the "front ranks" of the global economy, and went on to say that "China and India will shake the world. ... In some industries, [these countries] have already leapfrogged the rest of Asia."

Several Asian economies have grown at record-breaking speeds for the last four decades, but there was no talk of a gestalt change in the world economic order, in the manner suggested by Martin Wolf or MM Lee Kuan Yew, as long as the two largest nations of Asia remained stagnant. But, starting with China in the early 1980s and India in the early 1990s this seems to have changed, certainly in the perceptions of the media. There is an increasing chorus of assertions that the global order is going to alter course, with a cluster of eight or nine Asian countries taking the lead. But before we take this "most important story of our age" as reality, we must check how well it is grounded in facts. Is it really true or one of those "truths" created by repetition?

Irked by the tedious habit of double and treble checking facts in US journalism, the British magazine, *Private Eye*, had once asserted that it relied, instead, on the "legendary British journalistic staple" that some facts are simply "too good to check".[a] It is important for us not to fall into this staple of treating some 'facts' as too newsworthy to check. My first objective in this lecture will be to critically scrutinize this "big story" of our times. China is by now more firmly on the path of rapid growth and militaristic expansion, and so the more interesting question is about India. With India's population comprising some one-sixth of the world, this is important in itself, but it acquires an even greater significance because, if the Indian (or the Chinese) economy stagnates, this will in itself vastly diminish the overall prospect of Asia and, indeed, the world.

I will begin by taking a close look at India's recent performance. It will be argued — to take away any unnecessary suspense from the matter — that the optimism is justified, though in ways that may not always be right. Moreover, it needs to be tempered by an awareness of the pitfalls. Much of the talk of

[a]Quoted from Sarah Lyall's "Recipe for Roasting the Sacred Cow, Tastelessly," New York Times, 12 November, 2001.

the rise of India refers to its geo-strategic position, its defence capability and its recent *economic* good performance. The data that has emerged over the last few years show that it is the economy that is the dominant feature of the rise of India. This — though still precarious — has happened more rapidly and in more ways than generally appreciated.

A large part of this paper will dwell on the policy options ahead of India and how these choices have to be made with care if the apple cart is not to be toppled. A sustained GDP growth rate of 8% is feasible for India. And, given that China has already been growing by approximately 10% per annum over the last two decades and shows no sign of slowing, the global economic landscape is indeed likely to change over the next three or four decades like never before.

There are of course lots of possible missteps. A war can put an end not just to growth but people. Political instability can cause any of these countries to spiral downward. And in economic life, as in life, there is always the unforeseen. A century ago most observers were sure that Argentina would be a great economic power and many were skeptical about the US. In the early years, after World War II, the Asian economies, with the exception of Japan, were presumed to be basket cases. Korea, Singapore, Hong Kong, Taiwan, and Malaysia turned these predictions on their head. The risk cannot be discounted that the current optimistic predictions about China and India will once again be turned on their head.

We must therefore tread with caution, trying to evaluate the policy options with as much objectivity as possible. In a globalized world many of the policy choices involve intricate inter-country coordination and so we must discuss these as well. The rapid growth of such large countries bring with it responsibilities not just within the boundary of each nation but for the global economy and polity. And lots of open questions remain about how these responsibilities will be shouldered.

Globalization can cut two ways with countries. It will be argued here that, in the case of India, globalization has been a boon. India has made critical use of it — maybe more so even than China — to restructure its economy and leverage growth. But globalization can also cause large segments of the population to be marginalized. This is not only politically destabilizing but is morally unacceptable. So in crafting the next generation of reforms one has to keep in mind the importance of policies for better distribution of income and for countering some of the negative fallouts of globalization.

2. The Triggers

In his book on Singapore's trajectory from poverty to a developed state MM Lee Kuan Yew spoke of India's unfulfilled potential. "India is a nation of unfulfilled greatness," he wrote[1]; but he also noted that changes were afoot that could launch the economy. He wrote about when Manmohan Singh, the then Finance Minister and P. Chidambaram, the then Commerce Minister, visited Singapore in the early 1990s. "Both ministers were clear on how to improve India's economic growth and knew what had to be done" (p. 409) and that "the impetus to the Indian economy came from Manmohan Singh [Prime Minister Rao's] Finance Minister."

This kind of mixed feeling about the Indian economy was pervasive in the 1990s. What happened over the last 10 or 12 years was beyond what anybody had expected and led to the dramatic optimistic turn in global opinion that I discussed in the last section. Actually, India's growth performance had improved from the late 1970s but there was no indication that this would be sustainable, let alone rise to the point where it raised hopes of India lifting itself out of poverty. But the growth continued and picked up steam; and from 1994 the GDP growth rate broke the 7% mark for three consecutive years and over the last decade averaged over 6% per annum. India's foreign exchange balance, which hovered at a precariously low level for decades began to rise from the early 1990s. India's savings rate that had hovered around 12% in the late 1960s had risen to 23% by the end 1970s. But none of these much-repeated facts is reason enough to merit the optimism of India becoming a major economic power. The reasons for optimism lie in facts that exist beyond these broad aggregates.

First, not only has India's growth been very high over the last decade but, more importantly, this has been the best decade in terms of two *social* indicators. It has been the decade of faster growth in literacy than witnessed in any previous decade since India's independence more than half a century ago. And this last decade is also the one in which poverty seems finally to be on the wane. This is not to gloss over the undisputed fact of worsening inequality, but I will return to this topic later.

Second, for the first time — and this has happened only in the last 2 or 3 years, and could not have been predicted even 5 or 6 years ago, Indian firms have made a small but sure-footed appearance in the global scene and are getting to be known for their good corporate governance (see Ref. 2). The impetus for this came from many sources. Initially, there were the software companies, Infosys, Wipro, and others, which burst onto the global scene as major success stories and had a large advertisement effect for India Inc., in general.[b] These companies were known for their quality products and also for "clean business" — two particularly scarce resources in Indian business. India's large foreign exchange reserves played a role in the internationalization of Indian companies. In the Forbes list of best under-$1 billion companies there were 10 Indian companies in 2001, 13 in 2002, and 18 in 2003.

Third, there has been a windfall in India's outsourcing business, related, somewhat surprisingly, to the US presidential race. Early in his election campaign, candidate John Kerry had criticized US companies that outsourced back-office work to developing countries. He later back-tracked on this, realizing that it was neither good economics nor commendable ethics to propagate protectionism against poor nations. But once this subject made its appearance in the media, it refused to go away. A host of writers and commentators on US television, such as Lou Dobbs on CNN, went out of their way to vilify American companies that outsourced jobs for greed of profit.

This was a clarion call for a host of small American companies that had the greed of profit but did not know of this great opportunity. Company managers employing as few as five or six secretaries realized that, barring the two or three persons they needed on call, they could have the rest of their secretarial staff located in poor English-speaking countries and make huge profits. For the Third World the advertisement effect of the repeat attacks on outsourcing was an unexpected boon. Since advertising on US television is so expensive, they would never have done it on their own. Several countries have gained and India, which already had an organizational structure in place and a ready-supply of English-speaking workers, has done exceedingly well. All statistical indicators show that India has had a sharp rise in outsourcing work over the last year; and, more interestingly, there is now a sudden rise in cubby-hole operations, with three or four persons sitting in a room, glued to computers, and working for American and European companies.

[b]For accounts of what spurred this sector see Refs. 3–5.

Fourth, and this has been barely noticed. There is new synergy between India and China. This has no doubt been aided by China's joining of the WTO and the removal of quantity restrictions on imports; but also by the greater maturity of the Indian economy. Trade between India and China has been growing very rapidly over the last three years, the Himalayas not being as big a hindrance to modern trade as they were historically.[c] In 2003 the total trade between China and India was of the value of $7.6 billion; this year it is expected to cross $17 billion. It has been felt in India that this whopping increase is of some strategic value, since it is in the interest of the US to maintain better economic and political balance by bolstering its trade and concomitant political ties with India and China individually, and since the ties with China are already at a high, the main focus will be on India.

Finally, these strong economic developments come with a fortuitous political change. No matter what moral position one takes on this, the fact is that, with the rise of global terror, US political interests have come into alignment with India's. As Thomas Simons, ex-US Ambassador to Pakistan, had noted, the Soviets left Afghanistan in February 1989 and insurgency in Kashmir rose from the summer of that year. This was no coincidence. Some of the same fundamentalist forces that were engaging the Soviets were clearly settling into a new job.

This is today a common problem for the US and India. And, combined with the fact that India and the US share similar political systems, this makes India a natural strategic partner for the US. Moreover, especially with Condoleezza Rice as Secretary of State, the US is likely to embark on a policy of trying to use India as a balancing force against China's inevitable rise to world power, a source of considerable apprehension for the US

The Straits of Malacca, through which more than 60,000 ships pass each year, is a vital artery for Western trade with Asia and, for that very reason, is a potential flash-point in a future US–China conflict. The Indian navy has been a growing presence in the straits. This is clearly happening with US approval, since the Indian flotilla keeps an eye on terrorist activity and at the same time allays the risk of the region coming under exclusive Chinese control. Even for China, it is better to have a third-country presence in the South China seas, than a face off with the US, one on one.

[c]Although, even historically, Indo-Chinese interaction was greater than is popularly supposed.[5]

For India to nurture these economic and political advantages will involve a pragmatic assessment of its self-interest but also, I like to believe, a commitment to certain values. It will entail cooperation with China and the US, but also the strength to retain moral independence in matters of global politics and internal economic policy. This may entail giving up some short-term gains, but would command greater respect in the long-run.

Unless India makes a major blunder or gets inadvertently drawn into some costly war or generates so much inequality as to cause political instability, the growth should continue. And to aim for a sustained growth rate of 8% and a rapid decline in poverty is entirely within the realm of the feasible.

3. The Foundations

However, I have moved on too quick. To understand what the major factors were behind the quickening growth rate of India and the recent changing structure of the Indian economy, it is necessary to go back a few decades. It is important also to keep in mind that the cause of as large a phenomenon as a country's overall growth will invariably be diverse. Geography, culture, leadership and the global situation, all play their roles and the absence of one critical factor can stall an otherwise booming economy. Even so, one can try to locate what were the salient factors behind an economy's buoyancy. In trying to answer this, it is however important to determine when the growth spurt first began. In the case of India, there are two possible candidates — the late 1970s and the early 1990s.

A cursory look at the growth rates data and graphs (see Table 1 and Fig. 1) does not reveal very much. The reason is that India's growth rate *peaks* have remained more or less unchanged. Careful examination of the data reveals, however, that the downturns of the economy have become less severe over the years — and that is really the crux of India's recent better performance. In fact, since 1980 independent India has not had any year with a negative growth rate, while, before that, there were four such episodes.

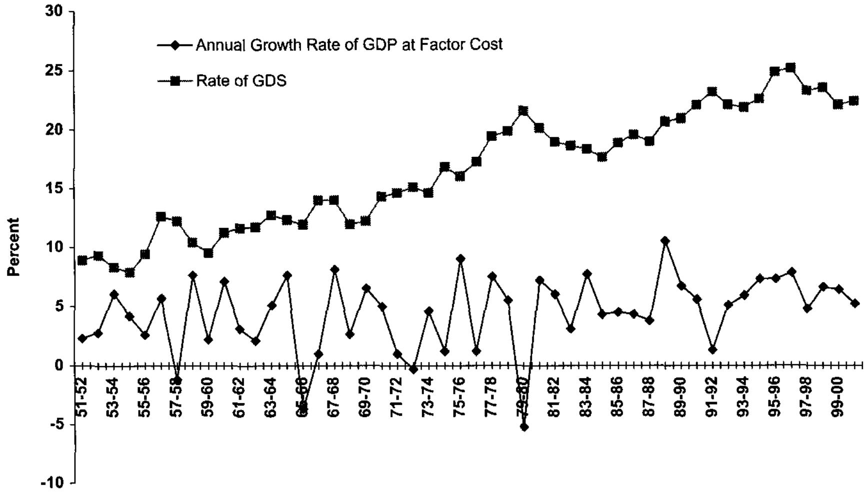
A clever way of seeing this is to construct a moving average. If in each year we plot the average growth rate of the previous 10 years we get the graph shown in the ***Economic Survey 2003–2004*** of the Ministry of Finance, reproduced in Fig. 2. Once one does this averaging of the growth rates, the changes begin to show quite clearly. The graph begins to move up in the early 1980s.

Table 1. Growth rate and gross domestic savings rate in India, 1950–2001.

	Rate of gross domestic saving	Annual growth rate of GDP at factor cost		Rate of gross domestic saving	Annual growth rate of GDP at factor cost
50–51	8.9	—	76–77	19.4	1.2
51–52	9.3	2.3	77–78	19.8	7.5
52–53	8.3	2.8	78–79	21.5	5.5
53–54	7.9	6.1	79–80	20.1	−5.2
54–55	9.4	4.2	80–81	18.9	7.2
55–56	12.6	2.6	81–82	18.6	6
56–57	12.2	5.7	82–83	18.3	3.1
57–58	10.4	−1.2	83–84	17.6	7.7
58–59	9.5	7.6	84–85	18.8	4.3
59–60	11.2	2.2	85–86	19.5	4.5
60–61	11.6	7.1	86–87	18.9	4.3
61–62	11.7	3.1	87–88	20.6	3.8
62–63	12.7	2.1	88–89	20.9	10.5
63–64	12.3	5.1	89–90	22	6.7
64–65	11.9	7.6	90–91	23.1	5.6
65–66	14	−3.7	91–92	22	1.3
66–67	14	1	92–93	21.8	5.1
67–68	11.9	8.1	93–94	22.5	5.9
68–69	12.2	2.6	94–95	24.8	7.3
69–70	14.3	6.5	95–96	25.1	7.3
70–71	14.6	5	96–97	23.2	7.8
71–72	15.1	1	97–98	23.5	4.8
72–73	14.6	−0.3	98–99	22	6.6
73–74	16.8	4.6	99–00	22.3	6.4
74–75	16	1.2	00–01	—	5.2
75–76	17.2	9			

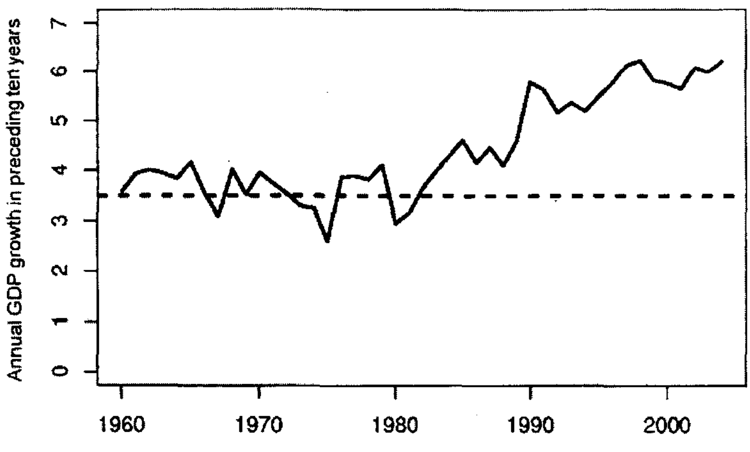
Source: Handbook of Statistics on Indian Economy, Reserve Bank of India, 2001.

Another way of looking at this is to examine the average growth rate for each plan period — typically 5 years. This is shown in Table 2. It is immediately clear that there is a break from the late 1970s. Indian economists find it uncomfortable to talk of the emergency years, 1975–1977, when Indira Gandhi took dictatorial control of the country. But there is no denying that, despite the trauma, or maybe because of that, the emergency years mark a break in India's performance. The economy grew by an astonishing 9% in 1975–1976 and the Fifth Plan, 1974–1979, was the first five-year plan period during which the per capita income of the economy grew by over 5% and it would never fall below that again. Hence, the late 1970s break is undeniable.



Source: Table 1.

Fig. 1. Gross domestic saving (GDS) and growth rate in India, 1950–2001.



Source: Economic Survey, 2003–2004, Ministry of Finance, Government of India.

Fig. 2. Moving average of growth rate.

Table 2. Annual average growth rate in India across plan periods.

		GNP at factor cost, 1993–1994 prices
First plan	1951–1956	3.7
Second plan	1956–1961	4.2
Third plan	1961–1966	2.8
Fourth plan	1969–1974	3.4
Fifth plan	1974–1979	5.0
Sixth plan	1980–1985	5.5
Seventh plan	1985–1990	5.8
Eighth plan	1992–1997	6.8
Ninth plan	1997–2002	5.6
Average	**1951–2000**	4.4

Source: National Accounts Statistics 2001, Ministry of Statistics, Government of India; and Economic Survey, 2003–2004, Ministry of Finance, Government of India.

The next break occurs in the early 1990s, as is evident from Fig. 2 and Table 2; and there has been much discussion about which of these two was the serious break from the past, representing some underlying change rather than a temporary and superficial shift.[5,7,8] I believe that there was *some* genuine change in the late 1970s and early 1980s, but the serious take off of the Indian economy occurred in the early 1990s.[d] A part of the higher growth in the 1980s was made possible by heavy government borrowing, large fiscal deficit and also a substantial international debt. The crisis in the early nineties, while triggered by the Gulf War, was inevitable sooner or later.

Moreover, much of what was achieved in the early 1980s was an outcome of a small coterie of entrepreneurs, close to the government, breaking out of the bureaucratic stranglehold that was India. This did give a boost to growth but could be detrimental for the economy and polity in the long run with the risk of sliding into crony capitalism, a risk that is by no means zero even now. The only fundamental change in the late 1970s and the early 1980s was that India's savings and investment rates had risen over the previous decade like in no decade before that (and, for that matter, since) (see Table 1; also Ref. 9).

The sustainable change occurred — I would argue — with the reforms of the early 1990s. These were reforms that, with the removal of industrial

[d]This was outperformed only once in independent India's history, in 1988–1989.

licensing, lowering of tariff rates and greater freedom to the state governments to pursue global investment, for the first time attempted allowing freer competition and greater play of anonymous market incentives. For a newly growing economy there is always the risk of anonymity breaking down and a few industrial houses gaining control of the market, thereby causing long-run harm to the economy. And India is in no way immune to this. But from the 1990s, there was hope of genuine competitive markets to come into play. And indeed the 1990s have seen faster growth than any previous period.

The growth would have been even faster but for the slowdown after 1997. But this slowdown, it is arguable, was beyond the country's control. From July 1997 Thailand went into its biggest crisis and this spread from one country to another with alacrity, engulfing most Asian economies and subsequently carrying over to other parts of the world. India, which had very little global exposure at that time — its capital account convertibility was minimal and trade as a fraction of GNP was small — did not get hit directly by a flight of capital or collapse of the rupee, but nevertheless had to cope with the cooling down of the global economy. As a consequence its growth rate fell.

With the Asian crisis behind us, India has bounced back once again, marking a (per capita income) growth rate of 8.5% in 2003–2004 and 6.9% in 2004–2005. That the changes in the 1990s are deeper is also suggested by changes in social indicators, like the literacy rate and poverty. As mentioned earlier, Indian literacy rose rapidly, from 52 to 65%, during 1991–2001. Poverty, as measured by the percentage of people living below the poverty line, also declined in the late 1990s. By some estimates, the decline was sufficiently large that not only did the percentage fall but the absolute number of people below the poverty line declined as well.[10,11] Even though there may be some controversy about the absolute numbers,[12,e] the decline in the head-count ratio of poverty now seems certain.

[e]The controversy was caused by the decision of the National Sample Survey (NSS) of India to change the reference period of consumption for most items from 30 days to 7 days. To make this transition smooth it was decided that, in the 55th round of the NSS, data would be collected for consumption in both "the last 30 days" and the "last 7 days." The remarkable consistency that emerged between these two sets of data made it clear that one of those questions may have "contaminated" the other, thereby providing an ideal brew for controversy and confusion. However, while on poverty there is controversy, regarding inequality there is almost total consensus that, no matter how one looks at it — across regions or across individuals, there has been a steady increase.

If the early 1990s mark the take-off of the Indian economy, what are the main causes? I would argue that the most important causes are related to India's international sector. It was a crisis in India's international sector that started the reforms and it is the international sector that has been the engine of growth. The aggregate economy of India has benefited enormously from globalization and there is still scope for huge gains in the future.

In June 1991, India came close to defaulting on its international debt commitments, with balance of payments deficit running high, foreign exchange balance precariously low (enough for 13 days of normal imports) and fiscal deficit high. This prompted major reforms in 1991 and, more so, in 1992. Import tariffs, which had climbed sky high, were brought down; convertibility on the current account was increased; industrial licensing removed; and a variety of incentives to attract foreign capital both as foreign direct investment and as portfolio investment were instituted. These changes, coming on top of the higher savings rate (then hovering at around 23%), that had been achieved by the early 1980s, led to a robust boost to the economy.

If one dissects the overall growth, it becomes clear that the biggest affect has been in the international sector. India's foreign exchange balance grew, steadily and is now at a comfortable level of over 130 billion dollars (see Table 3 and Fig. 3). The information technology (IT) sector had its celebrated take off in this decade.[3,4] India has gained enormously from globalization. If one looks at where the output from the IT sector is going, one will find that 60% of it is being exported. Once this sector made a global name for itself, this

Table 3. Foreign exchange reserves.

Year	Foreign exchange reserves, US$ millions	Aggregate export of goods and services US$ millions	Short-term debt, as % of forex reserves	Debt-service ratio
1977	5824			
1990	5834	18,477	129	35
1994	25,186	26,855	14	26
1998	32,490	34,298	16	18
2002	75,428	52,512	10	14
2005	130,000	68,000		

Source: Economic Survey (various), Ministry of Finance, Government of India; and Press Releases of the Ministry of Commerce.

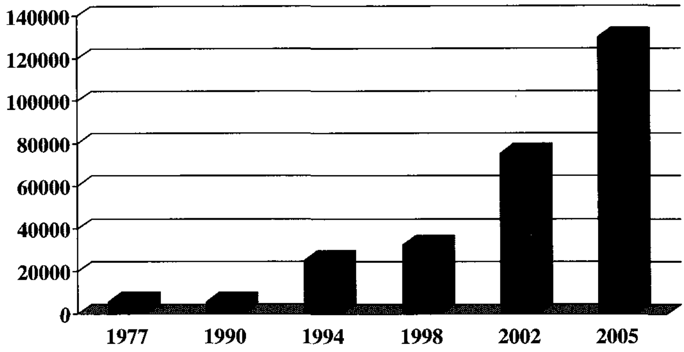


Fig. 3. Foreign exchange reserves.

had a promotional effect for India as a whole and soon there were other sectors, such as bio-technology and even steel, that began to do well. And now with quotas under the Multifiber Agreement (MFA) having been terminated, textile exports of India are expected to go up from the current annual value of 14 billion dollars to 50 billion dollars by 2010.

4. The Next Round of Reforms

Despite all the good portents, much remains to be done. The country continues to be crushingly poor. Even though poverty has fallen, inequality is on the rise and can reach destabilizing levels. India needs to push on several policy fronts to make a big dent on poverty and for the bottom quintile of the population to feel the prosperity. Turning from this general pronouncement to details, I would emphasize five essential policy thrusts for the next round.

First, governments worry about big things, like money supply, the balance of trade and budgetary deficits. These are of course important but, often, an economy fails not because of these but because of the malfunction of what I have elsewhere[f] called "the nuts and bolts" of the economy. A number of studies have shown that India trails behind other countries when it comes to the enforcement of contracts, the effort spent by citizens on overcoming bureaucratic hurdles, and the time taken to start a business and, more so, to close one. We now have hard statistics to evaluate where India stands on these

[f] In BBC News Online column: http://news.bbc.co.uk/1/hi/world/south_asia/3819315.htm.

matters of nuts and bolts. These are summarized in Table 4. If you want to start a business in India, it will take you on average 88 days to get the requisite clearance. In China this takes 46 days, in Malaysia 31 and in Singapore and the US an astonishing 8 and 4 days, respectively. If your business runs into the problem of someone violating a contract, in India it will take you 1 year to solve the problem, in China 180 days and in Singapore 50 days.[g] But even if you can enter and have contracts enforced the real catch in India is in getting out of a business. To resolve an insolvency case takes 8 months in Singapore, 26 months in Malaysia and 136 months in India.

To me, these are the crucial ingredients of an economy's success. If the state can provide these functions efficaciously, the market can take care of much of the rest. To achieve this needs widespread reform of governance. Many mainstream economists believe that all governments have to do is be scarce. It would be nice if life were as simple. In reality governments have to perform certain functions if an economy is to prosper. One can see this somewhat from Table 4. There is little systematic difference in the *number* of government procedures that one has to go through to start a business or to have a contract enforced between more and less successful countries. In fact in India the number of procedures for enforcing a contract is much less than in Singapore, USA or Malaysia. So the problem is not resolved by governments removing the procedures and regulations — a modern economy cannot do without these. There is no getting away from the fact that the government of a modern economy has to have lots of regulations and procedures; it just has to learn to get these jobs done quickly and efficiently.

One specific facility that governments need to provide urgently is that of patenting inventions. Establishing property rights on one's ideas is not a very generous thing to do, but when the industrial world is doing so, one does not have much choice in the matter. According to the latest comparable statistics available,[12] the number of patents filed by Indians in India in 2002 was 220. Of course this will be less than in industrialized nations. What is surprising is how big the gap is. The figure for the US for the same year is 198,339 and for Japan it is 371,495. And it is not as if there is not enough scientific work going on in India. By Third World standards India does fairly well on this.

[g]In litigious United States it seems to take as long as in India, though I have some skepticism about this figure.

Table 4. Nuts and bolts of the economy, 2003.

	No. of procedures to start business	Time to start business (days)	Cost to register business (% of per capita income)	No. of procedures to enforce contract	Time to enforce contracts (days)	Time to resolve insolvency of firms (months)	Index of labor regulation most flexible (0) – most rigid (100)
India	10	88	50	11	365	136	51
China	11	46	14	20	180	31	47
Hong Kong	5	11	2	17	180	12	27
Malaysia	8	31	27	22	270	26	25
USA	5	4	1	17	365	36	22
Singapore	7	8	1	23	50	8	20

Source: World Development Indicators, 2004, World Bank, 2004.

In 2001, the number of scientific and technical journal articles published in India was 11,076. The figures for the US and Japan are, respectively, 200,870 and 57,420.

In the US, every university and large institute provides facilities for filing patent protection on ideas. India needs, as do most Third World countries, to move toward this. And this is a task that cannot be left entirely to the market; governments have to shoulder much of the responsibility.

Second, there will have to be important labor market reforms. A legacy of India's Industrial Disputes Act, 1947[h] is that it is exceedingly difficult to layoff or retrench workers. This law was enacted in the belief that this will help employment. But of course a potential employer who knows that he will not be able to retrench his workers may decide not to employ workers in the first place. During a recent visit to some textile factories, outside Delhi, the CEO of Orientcrafts — a major supplier of fashion garments to American department stores — told me that, since in the fashion industry demand has huge seasonalities and in India it is difficult to layoff workers during the lean season, he simply employs, all year round, the number of workers needed during the lean season.

But the problem now goes beyond labor laws. These laws have spawned a *culture* of job guarantee, irrespective of performance, which has — and this is my main concern — hurt labor by keeping labor demand low. While the laws do need reform (see Ref. 14, for discussion), much that happens in the labor market depends on more amorphous factors, like norms and polity. So there will have to be a broad thrust on this front. And it has to begin by educating the trade unions that these changes are needed not for other sectors of the economy but for reasons of the welfare of the workers themselves.

The liberalization of labor laws should be introduced in tandem with the implementation of a basic social security and welfare system. It is possible for India to have a minimal social welfare system which will provide a floor for workers who find themselves temporarily out of work. I return to the topic of direct welfare interventions below.

Third, infrastructure continues to be a bottleneck for further progress. Poor roads, poor ports, uninterrupted electricity and inadequate airport facilities are strangling opportunities in many sectors, especially ones where the

[h]Interestingly, this act became effective in April — that is, before India's Independence.

timing of sales is important, such as garments and apparels. From a factory in India to a department store in New York a garment takes on average 32 days. It takes half this time from several East Asian countries. Bureaucracy is a big factor in this but also, the Indian ports being outdated and small, large liners do not come here. So garments have to travel by feeder vessels to be transferred to mother vessels in other ports, before they can set out on their long journey to Europe and the US.

Governments have to spend money on making a big thrust on infrastructure in several dimensions. Investment in infrastructure can boost private sector employment in a big way and this is the best way to create jobs without causing fiscal strain. But, of course, the investment itself will require money. Where will this come from? Governments should use a combination of borrowed money and some of its foreign exchange reserves.

Some analysts, including some IMF economists, have cautioned governments not to do so for reasons of fiscal prudence. The concern — namely, that we must not make the mistake of treating forex reserves of the government as free money — is correct but the conclusion wrong. Suppose Mr. X earns 100 dollars in New York and, on returning to Delhi, changes it to rupees. India's forex reserves would have risen by 100 dollars. If now the government spends this, then, given that X will also be spending his 100-dollars-equivalent in rupees, we will end up spending 200 dollars worth of money as a consequence of having earned 100 dollars. Hence, this will amount to a rise in our fiscal deficit.

But, if this money is spent not on consumption (like paying wages or subsidising products) but on investment, then the pressure on the deficit is not necessarily bad. In fact, *at this juncture of the Indian economy*, that is what I would recommend — the lid has to be firm on the *revenue* deficit, not the entire deficit. It is like a person who has Rs. 1000, but decides to start a new factory by spending Rs. 2000. Of course, he will run up a deficit. Whether this is a good idea or not depends critically on how much faith we have in his ability to run the factory.

With all investments there is what may be called "the risk of Gander." In 1938 the world's largest airport was Gander International. It was an essential refueling stop for planes crossing the Atlantic. The local government calculated that as air traffic grew, the demand for Gander International would inevitably rise and invested heavily in enlarging the airport. But planes became fuel

About this kind of risk — that comes with sudden technology changes or unexpected political shifts — there is nothing we can do. The only mistake would be to allow the fear of this to paralyze us into doing nothing. Since India is on the upswing, it is worth the risk of expanding our infrastructure. Of course this should be done judiciously and with our eyes open. In using some of its dollar reserves India will be exposing itself to the risk of a liquidity crisis. On the other hand, using dollars has the advantage that this will not immediately cause a rise in demand for Indian goods (which could cause inflation). The trick is to use the right combination of borrowed rupees and dollar reserves.

The above policy will also have the desirable byproduct of raising India's investment rate (total investment as a percentage of national income). India may never reach China's investment rate of over 40%, but it is time to break the 30% barrier. India's investment rate has not had any secular rise since the late seventies, when it reached 20%, and in fact had a slight decline in the late 1990s (though it shows signs of an upward movement even as I write this). This is the fourth policy thrust that India needs — to boost its stagnant savings and investment rates. India's savings rate has in fact not had any secular rise since the early 1980s (see Table 1), a slight decline in the late 1990s and a slight upturn in recent months. A part of this stagnation is caused by the large revenue deficit of the government. It is time to think of policy interventions to correct this.

Fifth, the country needs to plan a variety of more imaginative direct interventions to improve the standard of living of the poorer sections. This involves properly targeted government interventions to combat illiteracy, morbidity and inequality. Spending on education, health and social security will cost money. But if we add up the huge subsidies that are given in indirect ways to the rich and the powerful (just consider how well a city is maintained where the rich live), we will find little excuse to skimp on the poor. Moreover, the total revenue (from taxes and other sources) collected by the Indian government is 13% of the national income. This is much below the potential. The figure for most Scandinavian nations is around 40%, for Singapore 25%, and the US 21%. If governments work on correcting this as it raises its spending on the poor, it can keep budgetary pressures under control. It is of course important to design interventions that will not damage market efficiency too much and will result in positive net gain. The scope for action here is immense. It is primarily a matter of resolve on the part of governments.

The problem of inequality is somewhat different from that of poverty. There is more that governments can and should do but, at the same time, there is no getting away from the fact there are severe limits to how much can be done about inequality by a single country in today's globalized world.[15] Inequality needs *global* policy coordination. I have elaborated on this in Ref. 16. The essential idea is this. With globalization, one segment of the labor market that is acquiring greater international mobility is the professional and technically qualified workers. Hence, top-end salaries in Third World nations are being driven up.[i] Unless there is some global coordination in keeping the spread of incomes within limits, a single country's attempt to compress the variance in incomes too much will cause flights of professional labor and capital. This could in turn impede growth and, beyond a point, even increase poverty. When a single country tries to combat inequality, this consequence of unilateral policy action has to be kept in mind.

In Ref. 16 I have tried to develop the principle that inequality should be controlled as long as it does not make poverty worse. My expectation is that this constraint will bind quite quickly in developing countries unless there is coordination of equity policies across nations. The trouble is that, while we currently have international organizations for coordinating trade policies (WTO), labor policies (ILO) and many others, there is no institution or organization for coordinating equity-policies across nations. There is clearly need for some global institution building in this area.

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[i]Some indirect evidence for this is provided in Ref. 17.

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