The Other Side November 8, 2012

A Prosperous New Year for India?

In recent weeks, there have occurred two major developments in the economic sphere: some policy changes announced by the Government and, even more important, an attempt by both government and party leaders to explain the need for the changes, the latter perhaps for the first time. Both are to be welcomed as far as they go.

Will the changes be enough to spur growth and create jobs? The policy changes, particularly in foreign direct investment, are all in the services sector (retail, insurance, aviation and, of all things, pension fund management!). As for cooking gas prices, the new Minister's announcement of a price rise, and its withdrawal later the same day, reminded me of one episode from the extremely popular "*Yes, Minister*" serial of yesteryear on BBC. On one particular issue, Sir Humphrey, the quintessential civil servant, tells the Minister that his decision would doubtless be considered as "bold". This petrifies the Minister who hastily withdraws the step taken – as Mr. Moily did the other day.

More seriously, looking back over the last two decades, one finds that the share of manufacturing in the economy has remained stable; that of agriculture has fallen dramatically; the only growth sector has been services. (No wonder, the most successful new entrepreneurs in India have come from the services sector – IT, telecom, etc.) Will this model create the needed output and jobs growth? Services growth has not done the trick in any country in post war Asia. Korea, Taiwan, the tiger cubs in South East Asia, China, have all depended on labour intensive manufacturing. For us, this is perhaps all the more necessary in order to move millions of people, today dependent on agriculture, to more gainful employment. In the process this will also improve the standards of living of those remaining in agriculture (particularly if productivity goes to even Chinese levels, roughly double ours), far more effectively than the various schemes of rural development; much of the outlays on such schemes, often launched without putting effective delivery systems in place, is eaten up by middle-men who can "manage the system".

Instead of encouraging labour intensive manufacturing, we are deliberately closing down existing manufacturing activities for breaches of complex, archaic, environmental or other regulations -- the Shah Commission enquiring into the infringements in Goa has fallen back upon a Portuguese era law of 1906 vintage! In the process, we are hurting a very large number of innocent stakeholders, whose livelihood depends on the functioning of the units. One result: iron ore output will fall from 76 MMT is 2010-11 to an estimated 50/55 MMT in the current fiscal year! And, we will be importing increasing amounts of steel, even while keeping POSCO waiting for 12 years! This is just one example of the most stultifying constraint on manufacturing (and infrastructure): the delays in getting the necessary approvals

There are other major hurdles in the growth of labour intensive manufacturing, quite apart from the labour laws which many comment upon. One is the cost of land – labour intensive manufacturing would employ far more people on an acre of land, than the same acre devoted to agriculture: but, costlier the land, less competitive the economics of labour intensive manufacturing. In sharp contrast, labour intensive manufacturing is at the heart of China's growth, job creation, and improvements in living standards. The Special Economic Zones in China were the foundation of such labour intensive, export oriented manufacturing. The fate of our SEZs is too well-known to need any comment.

Another sharp contrast with China is, of course, our exchange rate policy of the last several years. A competitive exchange rate matters far more to labour intensive industry, garments or leather goods for example, as compared to say Reliance's export oriented refinery. I desist from the temptation to comment on the issue since I have done this time and again in the past.

Then, of course, there is the "holy cow" of the concern for environment. In fact, environmental regulation seems to have taken the place of good hold industrial licensing. The status quo is assumed to be benign, and any change to be resisted: the attempt to make an omelet without breaking eggs would be amusing were the consequences to the economy not so adverse! Under the current regulatory regime, even the tiger has become a holy cow!

To come back to where I started, policy changes and speeches need to be accompanied by a revolution in governance culture, if we are not to have social instability. The three re-reshuffles, within one week, of the cabinet reshuffle of October 28th, are a representative example of the present quality and meticulousness of our administrative culture, the *“Chalta Hai”* attitude.

One of the books short listed for the Financial Times Business Book of the Year Award 2012 is *Why Nations Fail* by Daron Acermoglu and James Robinson. Apparently it seeks to answer the question: “Why are some societies democratic, prosperous and stable and others autocratic, poor and unstable?” Equally relevant is why some societies are democratic, poor and non-performing, while others are autocratic, consistently fast growing and stable!

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