

Salon Speakers Series

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“On the Rise of India”

I'll talk about India tonight, and maybe make a short comparison with China at the end.

For years, India was, in fact, in many ways a basket case, until 1991 when we had a balance of payments crisis. The government was close to default, our central bank had refused new credit and India could hardly finance three week's worth of imports.

This led to reforms being initiated, of course. If you see that the population grew at 2% and the share of trade and GNP had fallen to 2%, well you know that with that kind of growth rate you can barely make an impact on poverty. The regional strategy was to grow fast and put people into gainful employment, because there was a huge amount of poverty, just like in China. One of my Marxist friends said that the trouble with India is you have too many exploited and too few exploiters -- by which he meant that you couldn't redistribute your way out. You could just get one more chapati per person and that's the end. So that's not a solution for a country with huge amounts of

unemployment.

So our original strategy -- and this is something I participated in when I went back from study abroad into the Indian Planning Commission -- was to figure out how to bring up the bottom 30% to above the poverty line. That was our objective. So growth was a strategy; what the economist's jargon call an instrumental variable. And the target was actually reducing poverty. So all of the people today, whom you might call poverty-lovers, they somehow think we never thought of poverty. In fact, that was our central concern and growth was not an objective in itself. But it didn't work. The reason it didn't work was we didn't get the growth in the first place. And why did we not get the growth? We didn't get it because we had a very counter-productive policy.

I'll just single some of the elements out for you -- including for the Indians who are young and probably don't know how ingenious we were at shooting ourselves in the foot, extremely ingenious. We had first of all a very inward-looking policy. We were a large country with the attitude of a small country in the sense of psychology. We basically were preventing any kind of trade from happening.

So again, 1991 was when we had the balance of payments crisis which led to the reforms being initiated. Back then we had deep controls over our imports which in turn affected also India's export

performance. Then in terms of actual investment coming in, we were scared. We thought that this would lead to disruption of the market, of the entire economy. The common phrase at that time was "integration of the world economy leads to disintegration of the national economy."

It's sort of come back now but it's an old-fashioned view now in our part of the world here, in the West rather than the rest. Unions are fearful of trade; a whole lot of corporations sometimes act in the same way, particularly during a recession. All of these attitudes which you recognize in your own countries during difficult times were thriving in India – and in many other poor countries -- in abundant form.

Now, in America you can't just have ideas, you've got to have magnitudes and proportions. For five years after I immigrated here I was still living in terror of my colleagues saying, what's the dimension of that problem, because that's not the way Indians think. They think, they don't do numbers; except they invented them. But you have to look at numbers -- how much equity investment do we have? And I saw 100 million dollars and I thought at least one zero must be missing, right? It wasn't. That was, in fact, the value of the investment. So this illustrates how deeply inward-looking we were on investment and on trade, as well.

At the same time, we had massive interventions of the Kafkaesque type. I'm just telling you how bad it was. You could not

diversify your production; if you were licensed to produce forks you could not produce knives. And so on. These were called restrictions on product diversification, or restrictions on investment or restrictions on importing materials. There were restrictions on everything. It was unbelievable. Many of the young Indians don't have a clue about any of this. The result, of course, was massive inefficiency. Once at an after dinner speech I said that the problem with India was that Adam Smith's invisible hand was nowhere to be seen. I mean, there was massive intervention everywhere. It's not natural. It is common sense that you would stifle all initiatives with such a system and that such a system would operate very inefficiently. It is not even economics. It's just common sense.

So when we had the 1991 crisis a lot of us had already been writing about this. Because I am in the public domain I can afford to write -- I don't risk losing my job or anything like that so I can be brave without really being brave. Well, those of us who were writing about this were really in a very isolated position because the whole system had that same mentality. What we were expressing was very alien to India.

Once I was talking with the present prime minister who is a very old friend of mine from Cambridge days, from 1955. When he became the finance minister he was chosen by the coalition prime minister at

that time and he provided him with political cover because he's a technician basically, or what we call a techno-pol nowadays, which is a technician who's become a politician. So he got the chance to implement all of these changes; his university thesis had actually been about how India could export more. And he succeeded.

Now, many people said this was Washington's consensus or that Washington imposed it meaning the International Monetary Fund (IMF) and the World Bank, those two institutions. But it just wasn't true.

A lot of us had realized that the whole model wasn't working and poverty was increasing, growth rates were low. It just could not go on like that. My wife had written a book about that and said as much. She is now a Russian expert, getting away from my orbit, and so she documented these same things for Gorbachev. Gorbachev brought about changes not because Washington told him to introduce *perestroika* and *glasnost*; he did it because of internal compulsions.

And the same thing is true about China. The Chinese didn't really take instructions from the IMF or the World Bank about their reforms. They just did it because their old model wasn't working.

In all of these cases there were internal realizations by the people themselves who were running the country. It couldn't go on like this. It was an engine that couldn't. That's how the reforms started in a very substantial way.

One test of the strength of this argument, of the change, was that after two years we could have borrowed the money from the IMF and the World Bank to get over the crisis and we could have gone back to the old ways, but we didn't. In fact, we intensified the reforms. Successive governments went ahead and broadened and deepened the reforms.

Now, many people have said, gosh, it's moving so slowly; but if you are aware of what system these people inherited in 1991 it was like cleaning up after a tsunami. You can't possibly do it quickly. Almost all the old aspects of the system had to be changed and reformed and on top of it in a democratic set-up that slows you down because you have to deal with interest groups, lobbies, politicians, all of which have grown up around the old system. You have to get around them and in a democratic system it's like walking a minefield.

The Chinese can just do it right away. They don't have democracy. Of course, they can do crazy things, too. They eliminated all of the sparrows in one fell swoop and it has upset the ecological balance. So dictatorships can do the wrong things and there are no constraints and there is no feedback from the system, no blowback, which would slow you down.

On reforms which are reasonably obvious to both countries on the economic side, however, the Chinese could go much faster. They

got a head start in the early 1980s and they intensified their reforms and changed things much faster than a democracy could. So in that sense they've moved ahead of us, so there's a little bit of an India/China comparison. That's where we fell behind.

But still we were steadily improving our growth rates and some reforms did intensify as the Indian economy opened up in many ways. We had 115% average tariff on manufactured imports -- now it's about 12%. It's still high compared to many other countries but imagine the difference from the past. It went down gradually. There was no shock therapy, of the kind which my colleague Jeffrey Sachs now pretends he never recommended.

You know, you can't deny history. It was bad advice from an economic and political standpoint to do everything at once. I mean, Adam Smith never wanted shock therapy, Keynes never wanted shock therapy. The best economists have never wanted shock therapy because it may work in certain other contexts but not in economics. In terms of making massive changes it upsets the system in a dramatic way. So I think we, apart from escalating our growth rate, we still have a long way to go because we still haven't adjusted our labour laws. This is the hardest thing to do in most countries. France is never going to do it probably -- we have a lot in common with them, actually.

To me it seems the world economy is in a state of flux now, for example. And when it's like that, if you start an investment or put up a factory, suddenly the comparative advantage or competitive advantage -- to put it in less of an economist's jargon -- may shift to another country. Everybody's cheek-by-jowl in competition today in the world economy. Suddenly you can lose the ability to compete with some other country. You have to be able to wind up that firm, right? But if you have laws that say that once you hire somebody you can't fire them then you don't have an advantage anymore. So those decisions and reforms are linked.

Some French and German firms are fantastically good but they don't invest in their own countries because of the laws making it so difficult. In a state-of-flux economy you have to have a flexibility to be able to fire people or you have to have a system which enables you to do that without imposing a cost on you as the investor or the employer.

We have a problem like that in India. We have something called sick units. As soon as you call yourself sick you can easily get a subsidy to continue being sick forever. There are all kinds of things like that and you can't get good labour as a result. So that is a problem.

Privatization is also very difficult in a country like India. You could even say that we have been somewhat ingenious in the sense

that there is so much monopoly in the public sector – and such a large public sector -- that we've opened it up to private investment which was not possible before. We also said you can not have any more subsidies. You can keep the existing subsidies but you can't have more. So there is some movement when new firms come in which are private and efficient, because they crowd the old public sector firms and those firms have to shape up.

We've been getting increasing efficiency that way without actually having privatization which is a politically difficult hot potato in India. So the Indians have been as ingenious in getting out of the old problems as they were in creating them in the first place. And I think we will continue to see change but we have a long ways to go.

I think these are what I sometimes call stage one reforms; cleaning up the system, opening it up and increasing competition and increasing imports, encouraging participation in the world economy, not fearing it but actually trying to exploit it.

Now we've also got what I call stage two reforms because the fact of a growing economy finally -- it's now around 8 to 9% -- has been to generate more revenues. When you have more revenues you can spend them on health and education and for the poor. What you're getting is a whole lot of new sets of reforms, which are made possible by the first set of reforms, because as long as the economy is

stagnant, well, everything stagnates.

In the past, the finance minister was the last portfolio anyone wanted to hold in India because there wasn't any action, there was nothing coming in. But now a lot of money has been coming in because of the growth; so now that's a portfolio people would like to have because you could ingeniously try and help the poor more directly. But this is social engineering -- like what size classes should we have, how do we get teachers who are interested in actually teaching, how do we get children to actually go to school. These are all difficult problems.

It's not like slashing a tire. That's a political problem, a first stage problem, right? How do you reduce trade barriers with all those lobbies against you doing it? You just slash a tire -- politics enables you to do it. Here we have social engineering problems. This is what Indians are engaged in right now. It's a very exciting stage when you've got both sets of reforms you want to intensify, broaden and deepen. As I said, it's like cleaning up after a tsunami.

So I think that's where we are at, sort of walking on two legs as it were, and none of it would have been possible before 1991. There is a sense of excitement in the country as a result.

How does it compare with China? I have just a couple of thoughts. We are behind the curve because we can't go as fast, as I

said, as a dictatorship can. On the other hand, let me mention a couple of factors where India is at an advantage over the Chinese model.

I think The Economist magazine said that India was likely to overtake China by 2013, which sounded ridiculous when you first saw it. The Economist magazine was very tough on India, and always compared it to a tiger. If you look up tiger and Economist and India you'll see on Google large numbers of articles always saying India's like a tiger crouched to leap but not leaping. So the fear of rigor mortis was setting in. But now the tiger has leapt forward and now The Economist says it is overtaking China.

At first, it actually sounds a bit odd but it's not that odd when you think about it. Let me take the economic reasons first, and then the political ones. While the Chinese don't go slowly on reforms, because there is no dissent possible in that system, they can also make mistakes. On the political side also, it's a very unstable system, because it's top heavy. Everything depends on who succeeds whom. There's nothing like public opinion as a moderating force in China. If Ignatieff succeeds Harper it's not going to make much difference in Canada. But with Stalin's succession we had to worry about whether it was Malenkov or Beria or Molotov – in other words, you could move from one end to another.

My wife was once asked --years ago – which way China would go. Would it go with Mao or Zhou Enlai? Mao was a great revolutionary and Zhou Enlai was a French-trained, polished guy with silk suits. She was asked which way China would go and she said it depends on whether Mao dies first or Zhou Enlai dies first. This is not the way we think about India because India is democratic. Public opinion matters.

It's the same issue about software. China is afraid of software, because it's a communist system. They are trying to stop Google; they are trying to censor everything in sight. There's a line I used in my globalization book, that the pc and the CP are incompatible. A lot of change takes place around software -- in fact the retail sector is the most productive today in the world because it has implemented the IT revolution. It's no longer mom and pop shops, and inefficient little sectors. It's the most dynamic one. Now, if that is not available in China to the same degree as it is in India -- where everything is possible – then China has a genuine disadvantage.

So one could go on to say that political democracy can be a help to India and a lack of it harmful to China. That lack of democracy and their egregious violation of human rights, these things are going to create problems for China's exports. Human rights groups are out to get them in a big way because it's an abomination to have such a regime, in my opinion, in the 21st century. I work for Human Rights

Watch and I think these violations should not be acceptable. Of course I just recommend an open mouth policy, meaning criticize those guys; because dictators don't like to be criticized.

But as I said, this is going to create problems for China's exports and China being able to sustain things, unless they wind up actually changing their system but that's a big open question. How will they react to the aspiration of their people to have more political freedom? Will they react like they did in Tiananmen Square where they just rolled the tanks, or will they be accommodating? Nobody knows. I have consulted many Chinese experts. They are divided; it's anybody's guess what's going to happen. So I think the Chinese line in the political sphere is not sustainable.

And one economic area where China is at a disadvantage has to do with the fact that India has its own army of labourers. You've got -- as capital accumulates -- any number of labourers available. So you reinvest and you grow very fast. When you have an upward rising supply curve, meaning labour's getting scarce, then you are like the rest of the world and that is what China is becoming now.

It first started with a slack supply of labour but the very rapid growth and the associated demand for labour combined with the one-child policy means that labour is getting scarce. That demographic is very important. And they haven't been able to get as many people into

the hinterland, into the Guangdong provinces which is where their export platforms are. There they are beginning to build infrastructure but it's a slow process and they don't have housing to accommodate people.

Their whole planning is based on keeping people out and not getting them into the cities. Now they're going to have to change everything to be able to ease the supply of labour. They are now more like a modern economy. So that is going to bring down their growth rate.

India has very different demographics. There are lots of young people in the population -- I forget the exact numbers. As I said Indians are not into numbers. But I think about a third of the population is under 25. It's a very different kind of profile, more traditional. The Chinese profile is more like the Western one where women are not making babies anymore the way they used to. So I think this is where you have the possibility of more and more labour being available as India accelerates its investments.

So while India will be about two decades behind China on the supply of labour, it will accelerate a great deal and it will be able to use the supply of labour. China starts ahead but will go down, I think.

I think these are some of the arguments we can use to say that maybe The Economist's prediction will work out, but nobody has a

crystal ball. India's in the game, however, very definitely right now.

So that is my broad outline and I think it's better now to shift to questions, because I could go on forever. Ken Galbraith called Americans the affluent society; we Indians call ourselves the fluent society because once we start we can go on forever.