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from the ringside

Beyond balance: Tipping back toward growth

The Stanford Center for International Development (SCID)'s Sixth Annual Stanford Conference on Indian Economic Reform has just concluded. Stanford University commenced its India programme at the initiative of The Indus Entrepreneurs (TiE), a group of flourishing Indian entrepreneurs in Silicon Valley. Anne Krueger, the founder and former director of the Institute (now First Deputy Managing Director of the International Monetary Fund) took the lead in putting together a conference in 1999 which brought together Indian and US academics, policy makers, and the corporate sector to interact on themes of contemporary relevance to India's reform programmes.

Over the years, discussions and debates over policy recommendations have spanned concerns like the deregulation of telecom, dereservation of small-scale industry, banking and financial reforms, tax policies, power sector reforms, fiscal policies and interregional inequalities, as well as infirmities in education and health policies. Each of the conferences, which I have attended, had a tangible impact on awareness and policy formation.

This year's programme covered a wide gamut of subjects ranging from Financial and Banking Sector, Investment Climate, Health and Education, Agricultural Policy, Transportation Reform and of course, an assessment of overall Economic Performance and Reforms, particularly in the one year of the UPA government.

The participants from the academic community included Stephen Habber, Roger Noll, Nicholas Hope, and Anjini Kochar from Stanford, Abhijit Banerjee of MIT, and Pranab Bardhan of UC Berkeley. Suman Bery, Isher Ahluwalia and Arvind Virmani were among the Indian academics present. Policymakers included Vasundhara Raje, CM of Rajasthan, Montek Ahluwalia, Rakesh Mohan, Deepak Parekh, P J Nayak. Prabhu Chawla, from the media, and others from the corporate sector and consultancy organisation in India and the United States were present.

The active engagement between SCID and India is one of the significant partnerships that has been constituted following the commencement of the liberalisation policy in the 1990s. The tentative beginning of the economic liberalisation process in the 1980s and its more coherent acceleration since 1991 have generated a new fervour in the US academic community to understand the dynamics of changes in India. The discussions and papers presented at this most recent SCID conference on Indian Economic Reforms are illustrative of the "new alliances" and "understanding" between the US and Indian academic and commercial audiences.

There seems to be a view that India's international economic reforms have slowed over the past year since the UPA government took office, but that external diplomatic reforms—namely, relations with Pakistan—have accelerated. There are some qualms about India's future growth trajectory: adjusted growth rate figures suggest a trend rate of 6%, but given several constraints as well as the GDP composition from manufacturing sector remaining well below China, medium-term prospects for a significantly higher trajectory remain somewhat problematic. Similarly, the question of India's continuing large deficit and inability to set the course outlined in the Fiscal Responsibility and Budget Management Act, 2003, as well as the persistent use of all manner of inefficient subsidies and, worse, cross-subsidies was repeatedly mentioned.

While this interpretation of events over the past year is understandable, in my assessment it does not give due credit to the delicate balancing task of achieving continuity in the reform strategy despite Left detractions. There are important achievements that go inadequately recognised: tax reforms that restored the tax-GDP ratio, reversing its declining trend, should not be overshadowed by our inability to fully implement the value-added tax (VAT). India's failure to adjust tariff rates in spite of various promises has been criticised, but important advances in information technology service and business process outsourcing (BPO) are a redeeming feature of the country's relationship with the global economy. These value added activities also have broader implication for GDP growth, higher exports and employment. India has also made credible moves in infrastructure. Though power remains an endemically weak story because of an unwillingness to address fundamental distribution sector reforms, the enormous progress in civil aviation in terms of new open skies agreements, airport modernisation, and expanded scope for private sector competition, is no mean achievement.

The outcome of earlier policies have also paid results with the manufacturing sector looking forward to increasing profits and growing spillovers for the rest of the economy. The stock markets have been positive. That said, balancing is not enough. In many ways the concerns that were raised in discussions at the Stanford conference as well as more generally media coverage of India in the US are well-justified. Credit for deft political maneuvers and small steps forward in the face of political adversity does not carry as much credibility as tangible policy changes and outcomes beyond rhetoric; actions beyond intentions. Political economy constraints are a reality, but will not persuade Indian and international entrepreneurs to use their ingenuity to contribute to India's future development. India's social and economic goals will not be possible unless we move away from mere "balancing" in several important areas that the conference honed in on. The need to make credible progress on labour reforms, similarly, was a common theme in the discussions over the two days. Current labour laws were called "draconian" and there was widespread agreement that they were choking private initiative and thus, in the long run, harming the very workers who they nominally protect by limiting the prospects for expanded employment.

Many of the papers also emphasised the need to improve the quality of public expenditure, both to improve macroeconomic balance and to better achieve development goals of programmes such as Bharat Nirman and Rural Employment Guarantee schemes.

This will require a two-pronged effort. First, more data needs to be gathered with which we can evaluate the costs and benefits of existing programmes, as well as the impact of recent policies. It is difficult to even decipher trends in poverty over time with existing data!

Second, financial sector reform occupied a central place in the discussion of priorities. The financial system is the main mechanism for matching resources with high-return investments, but it does not seem to be performing this function. Nearly half of household savings are direct savings that do not use the range of financial intermediation available. The current account balance is positive, implying that Indians are investing their savings abroad.

Debate over the various reasons behind India's inability to attract foreign investment was perhaps the broadest discussion at the Stanford conference, as well as the policy area with the biggest implications for India's future. Many at the conference (including the paper written by Jessica Wallack and myself on Transport Infrastructure) emphasised that an appropriate improvement in policy environment would make investments more attractive. The proposal to expand Special Economic Zones (SEZs) was debated, but the consensus seemed to be caution that these will be no panacea. There is no substitute for broader policies to improve the investment climate, complete unfinished agendas, accelerate clearances, and create a credible regulatory framework. Reduce red tape, accelerate clearances, and clarify the regulatory environment. Only then can we move "Beyond Balance to Tip Back Towards Growth."