The Indian EXPRESS COLUMNISTS

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Saturday , January 24, 2004

Asia's two emerging giants will compete, but they will also complement. Concluding a two-part series

India-China, the great Asian JV

India's primary tasks are to address rising budget deficits and pare down continuing constraints on the market economy. Total public debt (including state-owned enterprises) stood at 95 per cent of GDP as of March 2003 and primary deficits were over three per cent of GDP.

The Tenth Plan target of increasing tax revenues to 10.3 per cent of GDP by 2006-07 must be actively pursued. Attention should be given to reducing agricultural and power sector subsidies that drain state and federal budgets.

The new federal Fiscal Responsibility and Budget Management Bill, as well as the matching state-level legislation, are important steps in the direction of fiscal discipline. This trend must be continued.

With regard to removing the key constraints on the Indian economy, several bottlenecks have been identified, both by external observers and government reports. Among the most important challenges are to complete infrastructure reforms, dismantle remaining trade barriers, both internal and external, introduce flexibility in labour laws and complete tax reforms through the early introduction of a value-added system of taxation.

Future growth also depends on further financial liberalisation, streamlining of industrial policy and reduction of distortionary subsidies in the agriculture. The continued reforms carried out by this government are laying the macro-policy foundations for further growth. But it is important this ‘‘reform accelerator’’ continue.

China, like India, faces growing fiscal deficit. At 5.3 per cent of GDP this year, according to the IMF, it is lower than India's, but similar in that a large part is due to sub-national overspending. China also has the task of evolving an independent private sector, even as it faces an inevitable transition to a more open polity.

The past few decades of growth have been built on a hybrid economic structure of partnerships between government and private enterprise. While this has been quite successful in the past and state-owned enterprises' (SOEs') production steadily rose over the past decades — output increased 13-fold from 1978 to 1997 — the state-led model has inevitable limitations.

Enterprises involving the private sector now account for much of China's growth. This growth of the private sector raises the important challenge of improving corporate governance and regulation.

China also faces the political challenge of restructuring the extensive network of less-efficient SOEs, many of which currently provide social safety nets for workers.

China’s deepening reforms in the financial sector are also essential to its sustained growth. The financial sector, the key to efficient capital allocation, is currently under-developed. Many private businesses, especially the potentially dynamic small and medium enterprises, are forced to resort to high-interest loans from the black market.

They have difficulty obtaining credit from the largely state-owned banks. Transaction cost barriers to stock listings are too high for all but the largest enterprises.

The financial system is also burdened by an accumulation of bad loans. This will need to be resolved before the planned privatisation in the financial sector.

India's long history of democracy is an important advantage in the coming decades. Politically sensitive distributional questions have no doubt held India back from some earlier reforms, keeping in place economically inefficient policies in industrial policy — small scale reservations, Sick Companies Act — and other areas.

But the advantage of moving slowly has been to build consensus among stakeholders. India has spent many decades learning how to function as a society where power is not centralised, where there are many voices and conflicting interests are handled in a spirit of negotiation and consensus building.

The politico-economic foundations for the kinds of reforms mentioned above are firmly in place in India. We have strong support for the current reform-minded government, and a growing middle class anxious for change that bring further opportunities.

The recent elections in several states demonstrated the growing importance of economic issues in the electoral psyche of the people. In this sense, the upcoming general election is more than ever before likely to be a referendum on this government’s development policies — maintaining high growth rates, continuing reform initiatives, and creating gainful employment opportunities.

China, on the other hand, faces distributional questions that are augmented by its economic transition, without the same kind of experience with building consensus as India has developed.

The ongoing economic transition has created new political tensions — both in the form of newly economically empowered groups in society as well as unrest over the dismantling of SOEs. The process of integrating the much poorer, slower-growing inland provinces with their surging coastal counterparts also requires sensitive handling of issues such as labour migration.

Managing these kinds of transitions can be taxing. Fortunately, the Chinese leadership has shown sagacity and practical wisdom.

The answer to the question, ‘‘Will India or China become Asia’s economic power?’’ is, however, not clear. But the question itself is somewhat limited.

Both countries are likely to play a significant role in the region. There will be inevitable competition. Both will vie for FDI, BPO, market share in exports of manufacturing and services, and supply of skilled workers to the global labour force.

More important are the complementarities. There are already numerous opportunities for productive partnerships between Indian software and Chinese hardware, Indian R&D and Chinese manufacturing.

India-China trade is likely to be a dynamic regional source of growth, as both are large, fast-growing markets. This flow of goods and services will increase even more rapidly with concerted efforts at deeper integration, or harmonisation of standards, streamlining of customs processes, etc. Bilateral investment, similarly, will augment regional growth.

The greatest complementarity, however, is potential for learning from each other’s experiences in the transition from state-led economies to the ever more open markets of today and tomorrow. As an old Hindu saying goes, ‘‘There is nothing noble in being superior to someone else. The true nobility is being superior to your previous self.’’

Concluded

The author is member, Planning Commission. This is an edited version of his speech at the meeting of the World Economic Forum, Davos, January 22

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