

Don't Mimic China's Economic Model

Emphasising education & trust, India should aim to be a champion in global service delivery

Raghuram Rajan & Rohit Lamba

The recent Budget was pragmatic. It laudably continued to push in areas like transportation infrastructure, and tap water and broadband connectivity for all. But the lack of an economic vision is now palpable. With little help for those recovering from the pandemic, especially the poor and their children, the growing jobs crisis, the continuing tariff increases, and the lack of serious structural reforms, we must ask whether the government's proposals hang together.

Perhaps the timidity on reforms stems from the government's experience with the recent farm laws that were muscled through Parliament, only to be rolled back. The problem here, though, is not with the healthy Indian tradition of public protest but with the absence of democratic dialogue in passing the laws.

Recall India's most important economic reforms were carried out by a minority government in the early 1990s. Benefiting from a generation of leaders that were willing to work through coalitional politics, we built on these reforms till the early 2000s. The economic pie grew substantially. Conversely, we have examples of decisions taken by charismatic leaders without much public (or even intra-government) debate or protest. These include the 1969 bank nationalisations, the 1975 Emergency, and the 2016 demonetisation. Few would argue these turned out well for India.

What has worked for India is a clear economic vision, followed by a rollout of well-thought-through frameworks that harness the energy of our people to achieve it. The vision since the early 1990s was to steadily separate the government from the economy by allowing more private entry, competition and innovation, including opening up to the world through trade and investment.

The government would focus its limited capabilities on providing regulatory frameworks, infrastructure and safety nets, while private operators entered sectors ranging from telecom to air transport. Civil society's role in governance was enhanced through measures like the Right to Information Act. Technological frameworks such as the Aadhaar stack

played an enabling role, allowing the state, private sector and citizens to do more.

The easy gains from the initial liberalisation have, unfortunately, played out. After a decade of lost dynamism, India desperately needs to update its vision, to raise the grossly inadequate pace of current growth.

The vision that can be gleaned from this Budget is of India becoming a manufacturing export powerhouse that will replicate China's success. This is no small vision. But is the China path even feasible for India?

Rapid Chinese growth was initially achieved by suppressing wages and consumption, and keeping borrowing costs in check by lowering interest paid to households. Over time, China also created a more educated workforce and decent infrastructure, and reduced tariffs. Our starting point is different.

It is impossible, as also undesirable, for a democracy like India to directly suppress worker wages and household saving rates. So the government has been trying to promote manufacturing, partly through better logistics as promised in this Budget too, but primarily through higher tariffs and production subsidies.

India tried this before and failed, for straightforward reasons. A tariff on inputs is a tax on exports. Indeed, a recent study of mobile phone manufacturing in India suggests the production cost increase from tariffs on inputs completely offsets any subsidies, reducing the effectiveness of the PLI scheme in encouraging exports.

Furthermore, constant rejigging of tariffs, as in this Budget, discourages investment. Global manufacturers will fear any export-oriented investment could be disrupted by some domestic lobby wrangling a tariff on an input. Also, which industries get subsidies is nontransparent, leading to the possibility that taxpayer money goes to subsidise the well-connected rather than sectors where India may have natural advantages.

Finally, any manufacturing-exports-led growth strategy today faces protectionism from developed countries, reluctant to accept another China storming its way into their domestic markets and decimating the small-town manufacturers that still survive. There is an alternative path, building on the old vision of increasing openness and liberalisation. It draws on India's people, their minds, and their creativity. To follow this path, we should certainly continue to build out infrastructure and encourage our manufacturers to seek out new global markets. But we should particularly increase our presence in global services by strengthening our human capital.

Two recent developments give India an opening. First, the pandemic has made it easy to provide high value added services at a distance. If a consultant can work from home in Chicago to service clients in Austin, can't she do the same from Hyderabad? The markets for services like consulting, legal and financial advisory, education and telemedicine are ripe for globalisation. And services delivered online, unlike goods, do not cross a physical border where they can be stopped.

Second, a key element in providing these services is shared values and trust, especially around the data harvested. This automatically puts a number of authoritarian countries, like China and Russia, at a disadvantage. No customer cares where they are buying a vacuum cleaner from, so long as it works well. But if they are asked to share their medical or financial data, or their firm's strategy, they care very much. Will the provider protect their data? It helps if the provider comes from a transparent and tolerant democracy that is driven by the rule of law.

To pursue such services-led growth, India requires a different emphasis. The push on physical infrastructure will offer meagre returns if we do not recognise and remedy the damage done to our children's schooling, which has suffered so much in the pandemic.

Similarly, our democracy should not be seen as a constraint to be sidestepped but as something to build on – for instance, by protecting the privacy of data, and limiting the government's ability to intrude on it. India's image of being respectful towards its own minorities should be restored so that the world wants to trade with, and invest in, us, without hesitation; and people everywhere want to visit, study, or work, here.

Put simply, rather than attempting to mimic the Chinese path, India needs a truly Indian vision.

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This is the second article in an occasional series by the two authors

