

## There's More to Growth than China . . .

By Martin Feldstein

When President Bush visits India next month, he will see a country that is making remarkable economic progress despite enormous structural problems. That progress will, however, be far less visible than it is in China. In India he will not see the modern high-rises or the general level of prosperity that he has seen in urban China. But the progress in India is nevertheless real.

India started its reforms later than China and has been handicapped by political opposition to much that needs to be done. And yet in a visit there last month, what I saw and what I heard in conversations with officials, businessmen and others persuaded me that the strong recent pace of economic growth is likely to continue. India's real GDP has nearly doubled in the 10 years since I first started going there. Last year's growth of about 8% is a plausible estimate of what India can achieve for at least the next few years. While some pessimists predict a decline to a 6% annual growth rate, the optimists believe that plausible reforms, particularly of infrastructure, could raise the growth rate to 10%.

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India is handicapped by a socialist past, enormously powerful labor unions, and influential entrenched business interests. The tradition of state ownership that goes back to Nehru and Indira Gandhi is hard to reverse in a country where trade unions dominate employment in the public sector and in private industry. The Congress Party that leads the current coalition government is dominated by unions whose misperceived self-interest prevents reforms that would actually lead to higher employment and faster economic growth. To make matters worse, the current government needs the parliamentary support of the Communist Party of India.

The current government is headed by Dr. Monmohm Singh, the reform-minded economist who started India's economic reforms in 1991, when he was finance minister. There should be no doubt about his commitment to reform and about the commitment of those around him. But the political constraints mean that the reforms are less than they should be. Ironically, though, they are actually greater than they appear to be. In contrast to the previous BJP government that wanted to assure its supporters that it was achieving the privatization and tariff reductions that it had promised, the current government makes reforms in a quiet way to avoid attracting a backlash from its own political supporters.

There has been a wide range of significant /macroeconomic reforms. Sound monetary policy by the central bank has reduced inflation to less than 5% despite the jump in energy costs. A floating exchange rate and the accumulation of more than \$130 billion in foreign exchange reserves reduce the risk of the kind of currency crisis that hit Asia at the end of the 1990s. A

complex system of state and federal taxes that has been a burden on business activity is being replaced by a unified national VAT. The budget deficit, although still too high, has been reduced despite the revenue loss that resulted from cutting import tariffs. Even with these fiscal deficits, the high rates of household and business saving mean that India's gross national saving rate is a relatively robust 32% of GDP.

The government's microeconomic policies have been less successful than its macroeconomic reforms. Energy remains a major weakness, with too little building of electricity generating capacity and a distribution system that wastes much of the electricity that is generated

### *India has awakened from its socialist slumber.*

by a combination of free electricity for poor and agricultural households and the outright theft of electricity that is permitted by low-level bureaucrats in state energy companies. The results are electricity shortages, brownouts and the ubiquitous small generators in shops and homes because the state electricity supply is so unreliable.

In contrast, telecommunications is working well because of widespread use of privately supplied cellphones, now at 75 million users and rising at 3.5 million per month. It is ironic that cellphone service is widely available at low cost because it was regarded as a luxury and therefore left to the market, while electricity is hard to obtain because it has been regarded as a necessity and therefore managed by the government.

Transportation is beginning to improve. A new "open skies" agreement with Washington allows U.S. airlines to fly to any city in India and grants Indian airlines a similar access in the U.S. American travelers have already benefited from new nonstops to Delhi from Chicago and Newark. Within India, privately owned airlines are providing low-cost service among a large number of cities. Although there is still wrangling over details, it now looks like there will be new private airports in Bangalore and Hyderabad and public-private partnerships to rebuild the major airports in New Delhi and Mumbai. Road travel is still difficult in India but a national network of divided highways, begun under the previous BJP government, is cutting time for passenger and truck traffic among major cities. The excessive dependence on trucks for long-distance shipping may be reduced by a recent rule change allowing private rail containers.

The system of primary and secondary public education is a terrible failure, especially for girls and low-income and rural households, with a resulting high level of illiteracy. In contrast, elite institutions of higher education produce world-class graduates among those who have been able to buy quality secondary school education. Although the explosive demand for technically

qualified engineers and computer programmers is being met in part by private post-secondary schools, there is a shortage of teachers that may limit the future growth of such schools.

Despite this, high-tech industries are growing rapidly because of the combination of wages that are low even by Chinese standards, an absolutely large educated labor force and widespread knowledge of English. Information technology is only the most visible of these. The pharmaceutical industry is growing rapidly, helped by well-educated chemists and by India's new intellectual property protection legislation that is bringing foreign pharmaceutical companies to supplement what Indian firms are doing.

But industrial activity in general, particularly employment-intensive manufacturing, is much less developed than in China. Industrial development is hampered by labor market rules that apply to firms in the "organized sector" and by the continued government ownership in a wide range of industries. The result is that less than 5% of the population works in the organized sector, the rest remaining in agriculture, retailing, and various small-scale services.

The growth of firms and the establishment of new firms is also hampered by the weakness of the banking system. The commercial banks are still largely state-owned, a relic of their nationalization by Indira Gandhi. They devote much of their lending to the purchase of government bonds. Although new private banks are expanding, there is political resistance to selling the state banks or allowing foreign banks to enter the Indian market despite the contribution that could make to economic growth.

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The success of China in raising the living standard of its people is causing Indian policy officials to think about what India should be able to achieve. A few years ago, whenever I spoke to Indian officials about China's economic performance I was likely to hear that such comparisons were irrelevant because China was a dictatorship and India a democracy. I no longer hear that excuse. It is now common for officials to compare their own performance and policies to those of China and to look at Chinese experience for guidance on what might be done in India.

The optimistic mood in India's business community, the desire for reforms by the top leadership of the government, and the growing number of relatively middle-class households provide a force for change and a source of support for new entrepreneurial activities. If the political leaders can now persuade the traditional opponents of reform that growth can benefit their constituents and that better new jobs will re-place the old, India will see decades of remarkable achievement.

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