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| **Flexible economies**- India has to cross several more hurdles to be industrialized  |
| CommentaraoS.L. Rao |
| China in 2016 is estimated to grow at 6.6 per cent, the United States of America at 1.6 and India at 7.6. The only similarity that most see between the US and India is that India is the world's largest democracy and the US is the second. Going further, they are perhaps the two most diverse nations in the world, in the number of races, religions, and languages. The US got that way by immigration and then by birth. China is an autocracy with a more homogeneous population. We like to think of our youthful population as a potential for economic dividends in future years but are investing little for its development. The corporate sector in all three countries is overleveraged with debt, as is the household sector in the US, but not so far in India and China. Inequalities in income and wealth in all three populations are high and rising.India is more dissimilar to the others. The International Monetary Fund estimated the 2016 gross domestic product of the US to be 18,558,129 in international dollars, that of India to be 8,642,758 and that of China to be 20,853,331. India's GDP is much smaller, and even smaller in per capita GDP than the US, with its much smaller population, and China, which has a relatively static population.In the last two years, India's growth has outstripped that of most other countries, including the US, and is higher than China's recent declining growth rate.The composition of the GDP is also different. Industrial production in 2014 was 24.2 per cent of GDP in India, and 43.9 in China. Industrial production grew at 6.3 per cent in China, the US 1.1, and India at minus 2.4. We are far from being an industrial economy and getting there very slowly. This structural difference between India and the other two is likely to limit general prosperity till more Indians move from occupation in agriculture to industry and services. Services as a percentage of GDP were 43.8 in China and 56.9 in India, but more people in India are in services that need few skills and are therefore poorly paid. Agriculture in the US contributed 1.12 per cent, China 9.1 and India 25.8, with most people dependent on it, leading to poor per capita incomes. Indian agriculture is also inefficient, with yields of most crops lower than that of most Asian countries. The shares in GDP are not reflective of relative outputs.The US is highly indebted overseas at 114 per cent of GDP, while China has 16.2 and India 6 per cent. The US also has enormous public debt at 104.17 per cent of GDP, while China has 31.7 and India 49.6 per cent. It seems that prosperity requires high borrowing by governments and their enterprises. However, if we look at total external debt, counting public and private debt, the US as percentage of GDP has 114 per cent, China 16.2 and India 6 per cent. The US is highly leveraged and India and China are far less so. The status of the American dollar as a reserve currency helps the US. It is thus that the resources of other countries are valued in dollars, in which most trade is conducted. This will soon be the case with China, which has a huge foreign exchange reserve, booming international trade and has taken the first steps to attain an international currency.The domestic savings rate in China was 48 per cent of GDP, India 31.1 per cent, and the US 16.9 per cent. The corporate sector is a big and growing borrower, and the US savings rate might fall further. In China, corporate debt was 125 per cent of GDP; in India, the corporate debt was 52.7; while in the US, it was 190.4. Both government and corporate debt have fuelled American growth. India and China are following the same route. Savings are high because of high household savings rates, but will fall in the US with the use of credit cards and housing loans. This may not be the best route to take, since it places the economy at the mercy of a volatile financial system. But societies like India and China that model themselves after Western lifestyles will go the way of the US.Thus growth seems to be fuelled by government, corporate and household borrowings and spendings. As these rise, savings decline and the economy depends on debt - domestic and external. This puts a huge pressure on the lending agencies to vet borrowers and get the debts serviced. In countries like China and India, where banks are largely government-owned and borrowers are either government enterprises or private ones with enormous influence over the government, many of these loans are weakly backed by assets or prospects. The lenders end up with huge non-performing assets and the banks become fragile. In the US, which is the home of private enterprise, there is a similar result for other reasons. Managers of lending agencies are paid bonuses on the growth of their portfolios of loans and tend to lend with significant hope in some cases of being repaid. The problem is magnified by the very high levels of household borrowings. These are stimulated by very low interest rates, which make borrowing preferred.What is needed is much greater discipline among lenders, whose managers should be rewarded for stable portfolios over a period of years and not just over one year. Loans must be backed by adequate security and not just by personal guarantees. If enforced, this might reduce the level of economic activity. Public enterprises (in India and China) must also be subjected to the same rigorous tests about their present and future prospects. An independent investigation agency must watch to ensure that loans are given to all on honest appraisals and not bribery or nepotism.The US has similar problems, although borrowings are mostly private unlike in India and China, where they are mostly by public enterprises. However, India has developed a private enterprise system that exercises undue influence on State-owned banks through illegal favours and commissions.India has another set of problems that prevent rapid industrialization. These are the residues of the system of rigid licensing and controls and public interference in corporate decisions by government officials. This has become part of our industrial culture in relation to government. We have a heavy-handed bureaucracy at all levels, and complex rules and procedures. Adeptness at these rules marks the successful (and many times also prosperous) bureaucrats. These rules and procedures have to go or be simplified if industry is to grow. "Ease of doing business" means this, but the dismantling of these regulations demands expert knowledge that only the bureaucracy possesses. There is dilatoriness in this effort, especially now at state government, municipal and *taluk* levels.Industrialization in India faces the new obstacle of rapid changes in technology. These have to do with scale, automation, and robotics. Reproducing cars through 3-D printing may be possible soon. Such a technology calls on new education and skills. It will lead to smaller scales of production and considerable decentralization.India has yet to become industrialized with much large-scale production. We must plan our financial sector to ensure that we keep high savings rates. We must plan as a society for the next stage of industrialization with smaller-scale production capacities and wider dispersal of manufacturing. We will need far more flexibility in land acquisition and in licences and rules for starting and running factories. It will need much deeper equity and debt markets. Our investments in improving the people through education and skills development must go up substantially. They must be of good quality. We must spend enough so that all benefit and we do not create a small privileged class and a large class of poorly educated and unskilled peopale.If the rate of present capital investment in demographic improvement is a guide, we will continue to be as we have been for decades, a middling industrial society with a few bright spots.**The author is former director-general, National Council of Applied Economic Research** |