WHAT SHOULD BE INDIA'S ECONOMIC PRIORITIES IN A GLOBALISING WORLD

Lord Meghnad Desai
Professor, London School of Economics

January 6, 1999

Indian Council for Research on
International Economic Relations
&
The Associated Chambers of
Commerce and Industry of India

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Foreword

When ICRIER and ASSOCHAM were exploring the possibility of a public lecture on the theme of globalisation and India, the question was no longer whether India should be part of the globalisation process but how. The subject that emerged from our deliberations was "What Should be India's Economic Priorities in a Globalising World?" and we could think of no better person to deliver this lecture than Prof. Lord Meghnad Desai. The session was chaired by former Finance Minister, Mr. P. Chidambaram. ICRIER is privileged to make this lecture available to a wider audience.

Lord Desai begins by suggesting that the phenomenon of "globalisation" is nothing but an aspect of capitalism in its present phase of development. After World War II, with decolonisation and the establishment of a variety of inward-looking Statist regimes, the "global" nature of capitalism had receded into the background. However, with the rapid growth of international trade and investment flows, the integration of global financial markets and the collapse of many Statist regimes, the "global" character of capitalism has once again become manifest.

Lord Desai offers a positive case for India's economic integration into the global economy, emphasising its many endowments which enable beneficial integration. According to him, India's biggest problem with globalisation, is one of attitude. Despite good endowments and the favourable inheritance of an open economy, India's policymakers have never been enthusiastic about economic openness. Hence, the real challenge is one of changing attitudes. India must liberalise its economy, Lord Desai believes, not because it has no choice but because it is the best choice. He recommends a "pro-active" stance on the part of Indian policymakers, especially in multilateral trade negotiations, rather than a reactive and defensive stance. He underscores in particular the advantages of securing long-term foreign direct investment flows over short-term portfolio flows.

In order to realise the potential offered by gloablisation, however, India will have to set its own house in order. In particular, Lord Desai emphasises the positive role the State can play in improving human development indicators like literacy, longevity and the well-being of people. If central and state governments strive to improve their peformance in these areas, India would be even better equipped to benefit from globalisation. Lord Desai's lecture is direct and his message is simple. In publishing this lecture for wider dissemination we hope to facilitate the changing of the mindsets, which Lord Desai identifies as the real challenge in India.

Isher Judge Ahluwalia
Director and Chief Executive
ICRIER

It is a great honour to give this lecture organised jointly by ICRIER and ASSOCHAM at the beginning of this new year. This is also a topic in which the two powerful interest groups – academic researchers and industrial entrepreneurs – should be actively engaged in debating policy, promoting alternatives and pushing implementation. Let me first define Globalisation as it is often argued by its detractors that it is a vague and woolly notion. It has also been demonised to such an extent that one can be forgiven for thinking that before the advent of globalisation [whenever that was supposed to be] everything was alright and the world was an equitable place with no poverty and no business cycles. I shall then argue about India's endowments, its attitudes and its opportunities in face of globalisation.

What is Globalisation?

The characteristics of Globalisation are now well known. They are:

[a] deregulated capital markets with the possibility of speedy transfer of capital;

[b] communications and information technology which makes possible "action at a distance in real time" which can be very short

[c] active forex markets with supporting financial markets with new products [e.g. derivatives, options] which allows speculators to take positions in any currency around the world where there are potential profit opportunities;

[d] greater geographical spread and increased mobility of fixed, i.e. direct, investment;

[e] rapid and linked reactions as between different financial markets which work round the world round the clock, as well as between financial markets and forex markets;

[f] the emergence of a global media network linked with a global communications network;

[g] the fashioning a of a global consumer culture and a global music/film/TV culture benefiting from all the above, especially [b] and [f];

[h] increased but as yet imperfect and legally impeded mobility of labour;

[i] greater awareness, though, as yet, not very effective redress of human rights violations, ecological disasters, famines and refugee problems, benefiting from [b] and [f];

[j] speeding up of technological change leading to increased concentration of capital via mergers and takeovers but at the same time increased competition between the surviving large companies.

I do not wish to argue that Globalisation is a natural phenomenon in the sense of an earthquake or typhoon. But even natural phenomena can be studied and mapped and forecast. We can take steps to minimise their effects so even if I did regard Globalisation as a natural phenomenon, it does not imply that we are helpless in its face. Globalisation is, however, a supranational or global force to which all countries - North and South, Rich and Poor- have to adjust. It is a result of action by millions of investors and traders and many large global corporations and governments and international institutions and NGOs and workers and farmers and refugees and migrants etc. Globalisation or what is sometimes called the Market is just all of us acting in our own interests and responding to opportunities and adjusting to constraints. Globalisation is Us. It is not some mysterious other.

The big debate about Globalisation has been about the power of governments, the State if you like, to counter the effects of Globalisation. There is much controversy here as between the views that the State is helpless against outside forces and that if only we had the will the State could do anything whatsoever, like it used to be able to [or thought it was able to] do. All governments find that their capacity to shape their economies are limited in the late twentieth century. This is difficult for many to recognise and they refuse to admit the validity of the limits. This is because throughout much of the twentieth century we have been accustomed to the idea of the State - the territorial State - as capable of running the economy. This idea is totally absent on the Left or on the Right in the nineteenth century. Neither Marx nor Gladstone thought the government could or should run the economy.

It is only during the First World War and after that the idea of the State running the economy became popular. Keynes then gave us the tools for running the economy not only in war time but also on an ongoing basis in peacetime for the advanced capitalist economies. But this was conditional on strict control over capital movements. So while trade was liberalised during the 1950's and 1960's capital movements were regulated. It was only when, in the 1970's after the oil shock and the long continuous full employment, inflation became an insoluble problem for Keynesian policymakers that capital immobility was abandoned. This was really a crisis of profitability but it put pressures to liberalise capital movements and this was done by USA, Germany and UK during the 1970's. After that it was difficult to pursue Keynesian policies.

For developing countries independence meant an opportunity to launch development plans. Given the high prestige of the USSR in the post war period many - India especially - followed the autarchic policies of Soviet style planning with minimal reliance on trade, import substitution and protection to public and private sectors. With hardly any exceptions this model proved to be a recipe for slow growth. Countries which went on to an export growth path grew faster. Many developing countries got caught in the global financial nexus during the 1970's when they borrowed petrodollars and failed to repay. India came late on to this problem yet the end result was the same. It borrowed abroad but failed to reorient its economy in an export oriented way and got caught in 1991 in a debt crisis.

But although India started on the path of economic reform in June 1991, there is still a great deal of reluctance to pursue that path in an enthusiastic way. The case for India to liberalise has to be argued again and again. India's political leaders have given the impression that Economic reform has happened because someone [IMF] has told us so, or because it is fashionable, or because we wish to attract foreign investment to build up reserves etc. There has been no positive platform built up for reforms nor a pro-reform coalition among the people. This is not because reform is not in people's interest; indeed, it is and more so than a continuation of the old policies which consigned India to be a laggard in Asia for the first forty years after Independence. The case for India's economic integration into the global economy has to be argued positively and boldly and I hope to do so in this lecture.

Inheritance:

The Indian independence struggle got caught in a xenophobic dislike of foreign trade and foreign capital as marks of India's loss of freedom. But in the history of India, it has always been a trading nation from times immemorial. The Ancient Indian economy was well integrated with its trading partners in Europe – Greece, Rome, and the Arab countries, as well as East Africa and South East Asia. There was overland trade with Russia and China and typically India enjoyed a balance of trade surplus which drained its trading partners of gold. India has never been totally self-sufficient and does not need to be. The export pessimism which became fashionable in the late 1950's and 1960's had a fragile support in actual data and much more in dogma.

In fact India was, among the colonised countries, the one with the largest industrial sector. It had a native entrepreneurial class which had started modern manufacturing in mid nineteenth century and by 1947 had built up a world class textile industry. In terms of volume of industrial output, India was the seventh largest industrial country on the eve of Independence. It had a trained industrial workforce in the larger cities, a good infrastructure of rail, roads and ports, a higher education establishment which though small was of high quality. India was well poised for rapid industrial development.

Endowments:

India is well endowed for competing in global markets. First and foremost it has a large pool of educated personnel. It is true that the overall literacy rate is low and should be increased, but as far as higher education is concerned India has built on its earlier foundations. Thus while many bad universities have proliferated and politics has ruined much higher education, there has been a growth of the IIMs and the IITs which have maintained a high quality.

India has also a system of laws and courts which though slow and cumbersome guarantees due process. Thus the attempt some years ago to shut down KFC in Delhi was soon put right by recourse to the courts. There is a financial system, one of the oldest Stock Exchanges in the world and a habit of trading in sophisticated instruments. Here again reform is needed but it is also in hand. Banking is also an old established industry and there are formal as well as informal linkages in financial markets.

Attitudes:

India's biggest problem with globalisation is one of attitude. Despite the good endowments and the sound inheritance of being an open trading economy through much of its history, Indian policymakers have never been enthusiastic about globalisation. This comes from a variety of sources. As a fledgling independent country, India identified all foreign capital and trade with imperial dependence. Thus independence meant autonomy as well as autarchy. This tendency was deepened after the resources crisis of the Second Five Year Plan in 1958 when an anti trade philosophy began to take hold. A slight relaxation in the early years of Mrs Gandhi's Prime Ministership, when India devalued and relaxed controls, was soon reversed because of US hostility to India which led to the World Bank reneging on the post devaluation package which India had been promised. From then on till the early 1980's, it was the Soviet model which had the appeal to India's planners. India did not liberalise when many other Asian countries – Sri Lanka for instance - did.

Opening out the economy to foreign borrowing on official account in the 1980's was the beginning of an admission that self reliance was not a successful strategy, that the Indian economy was trapped in a low growth equilibrium [3.5% total and 1.3 % per capita income growth per annum 1950-1979]. But while capital imports accelerated growth [upto 5% plus] there was no restructuring of the economy and no reorientation towards exports. Thus when the foreign exchange crisis hit India in 1991, the planners were, as if, caught unawares. An economy which had successfully raised its rate of growth from 3.5 to 5.5 % was caught in a debt trap. There was much resentment that a stabilisation programme was forced on India.

The radical change of economic policy inaugurated by Manmohan Singh in 1991 was seen to be an emergency package. Without any change in personnel, the planners of yesteryear became the liberalisers of tomorrow, but there was no searching analysis of the causes of the crisis nor any internalisation of the need for a drastic restructuring of the economy. The lack of change in personnel also meant that old vested interests which had done well out of the old dirigiste regime and who never admitted that the old model had failed, were still in commanding positions waiting for their time to restore the old status quo. Thus India became a reluctant liberaliser. A strong anti capitalist, anti profit ideology permeates the elite including, unfortunately, the business elite. A lifetime of living off tariffs and subsidised interest rates has inured the Big Business classes against the virtues of competition. The establishment of the Bombay Club soon after 1991 shows this. India's socialists [virtually everyone in politics] as well as its capitalists are hostile to liberalisation.

Yet it is quite clear that India must liberalise. This is for several reasons. First because it is in India's long term interests. The old Nehruvian strategy had lost usefulness by about 1970. India should have switched to an export oriented path having established an industrial base and solved its agricultural surplus problem thanks to the Green Revolution [itself a combination of foreign technology and Indian private sector, i.e., farmers' responsiveness]. This is what the countries of East Asia and South East Asia did. They used the State to transform their economies to be globally competitive. Korea whose per capita income was the same as India's in 1960 went on to achieve an income level twenty five times India by following that path [and the recent crisis will hardly dent that advantage]. Liberalisation is the only way left for India to gear its economy upto a high growth path, 7 to 8 % per annum.

Secondly, although it is argued that liberalisation leads to inequitable outcomes, there is little evidence for this. It is true that any restructuring will have losers and gainers, in India's case the losers are those who have benefited enormously from the old structures and who have contributed to the low performance of the economy. They enjoy subsidies of various sorts - tariffs for big business, water/electricity/fertiliser subsidies for farmers, guaranteed jobs at indexed and rising salaries for government employees, comforts of non competitive behaviour for bankers and the corrupt gains from the business - politics tie up for the politicians. These forces resist change. But the change will help reduce poverty at an accelerated pace if higher growth is achieved. India's past record in poverty reduction shows this. There was no reduction of poverty in the years upto 1980 but rapid progress afterwards thanks to the acceleration of growth. Although growth alone need not necessarily lead to poverty reduction, it is a necessary condition. What is more the pattern of growth in the old regime was hostile to poverty reduction.

This is because resources went into industrial growth which was capital intensive and low employment generating. The average tariff protection for industry was 45 % with subsidised capital inputs. Agriculture was on the other hand subjected to a 22 % tax which held back rural development. Since poverty is in rural areas, the sectoral pattern of growth in the first six five year plans was anti poor despite the rhetoric.

Thus it was the old model which was a hindrance to poverty reduction. Its insistence on import substitution industrialisation without regard to price or profit considerations meant inefficient allocation of resources and slow growth as well as stagnant employment. When the insistence of an exclusive reliance on domestic resources was dropped, growth picked up and poverty began to go down. But there was yet a need for restructuring as well as for foreign investment, it is this phase that is now being reluctantly undertaken.

India has adopted a victim mentality when it really needs to adopt a winner mentality. It appears that our policy makers think as if the entire outside world has nothing better to do than to conspire against India. But in fact, our slow growth has marginalised India to the extent that a country which was in 1947 the leader of Asia, is now thought to be no part of the dynamic Asian experience. The approach to GATT negotiations exaggerated the harm that could be done to India by signing the Dunkel draft. But no one explained the advantages of the MFN status which could only be had by being in the GATT process, that India like many other developing but industrialised countries, had a lot to gain from access to developed country markets and that withdrawing from GATT was never ever an option. But the Rao government did nothing to counter populist rhetoric until one fine day it went ahead and signed the Treaty. Thus an opportunity to argue the advantages of freer trade was lost. India has a lot to gain from being a dynamic export economy. Our record in software shows that we can do it.

The same is true of FDI. One of the cardinal errors of the 1980's was that India borrowed from abroad in form of loans and debt rather than equity. This meant that the risk of failure was borne by India while with equity investment it would have been borne by the lender. India has also wasted a lot of resources chasing the chimera of national technology as in the Sam Pitroda affair. The smart thing is to let FDI bring in the latest technology and combine it with India's skilled labour pool to export. This is the lesson of Bangalore; borrow the hardware and inject the software. It is no longer possible today to borrow the money and buy the technology off the shelf. Technology comes embodied in the FDI along with the latest management techniques. It is better to import and adapt and benefit that way than insist on having local technology which may fuel national pride but is a waste of resources.

India has indeed gone about foreign capital the wrong way around. Portfolio capital has been imported and now forms the bulk of the $ 30 billion reserves. But this is short term capital while what is more stable and growth enhancing is FDI. So India has put obstacles in the path of beneficial FDI and welcomed the volatile short term capital. China has done much better in this respect and got a large inflow of FDI. It is India's reluctance to adopt liberalisation in whole hearted way which prevents FDI from coming to India.

This is not to say that there are no problems with liberalisation. But the correct comparison is not with some ideal world in which liberalisation is combined with equity but the alternative India has been pursuing which yielded neither growth nor equity. There are attempts nowadays to portray all problems as arising out of globalisation as if India was a paradise before 1991 or 1981. The truth is that poverty has come down faster since 1981 and growth has accelerated since 1991, with seven percent plus growth being registered for the first time in Indian economic history since records began. The difficulty is to sustain the growth and if that has not been possible the reason is not too much, but too little liberalisation.

Indian resistance to liberalisation has deep roots not only in the ideology of anti imperialism [which after fifty years can hardly be more than nostalgia] but also by material interests. But these are elite interests not those of the poor. At the forefront are the organised sector industrialists who have benefited from tariffs and subsidies. It is clear that they fear opening out of the economy because they fear competition. They speak of level playing field as a prerequisite before liberalisation. But they have enjoyed tariffs, subsidised low interest loans and quotas. Even the SMEs who should really be competitive, have been given reservation quotas for exports. India has a lot to gain by unleashing competition and cutting tariffs down. This will make Indian products competitive unlike now. When the Multi Fibre Agreement comes to an end, India could be in the forefront using its long run lead in textiles at every level but only if they are competitive.

This is not an issue of the State against the Market. South Korea was able via state aid to build up a competitive car industry while India fostered an uncompetitive technologically stagnant one. It is not that India has to give up State intervention because of ideological reasons. It is because State intervention in India is of a low quality and merely an excuse for rent seeking that India has to give up State intervention. After all in a country blessed with an active native entrepreneurship as of 1947, how has India managed to lose that edge and failed to build up truly global competitive industries? The blame must be laid at the door of the economic strategy chosen in the 1950's and the bad implementation of the strategy.

The modern need is of a state that can swim with the tide and take advantage of globalisation. Rather than govern the market, the need is to benefit from the market. Defying the market is no longer the answer but learning to play the market for what it is worth is the real need of the hour. It is not laissez faire since there is need for competition as well as regulation. What must be junked is state ownership as it has proven to be wasteful and growth retarding and shift over to state regulation of privatised industries or services. Surplus needs to be generated by the industrial sector whereas now it is surplus absorbing. India needs to abandon anti profit policies and ideologies and take up the challenge of building productive profitable industries. This lesson has been learned in agriculture during the Green Revolution. It has also been learned in many service industries such as software and privatised tourist industry.

The siren sounds of protectionism come from two angles. First are the people who will never admit that the Nehru model failed to work especially after 1975 and would like to get back to old style planning. They dress up their demands with complaints about the inequities of globalisation. But as I have already said above the first twenty-five years of Nehruvian planning did not lower poverty nor did they lead to greater equality of income or wealth. Top down elitist planning which retards employment growth cannot tackle poverty; nor does it make industries competitive.

The other strand is much more short term and that is caused by the recession which has plagued Indian economy since 1996. The roots of this recession are however domestic not foreign. It was the insistence of the Rao government facing an election that the RBI squeeze out demand to bring the headline figures on inflation down. This was overdone and while inflation came down [Congress however lost the election!] but the industrial sector received a nasty shock from which it has not as yet recovered. Frequent changes of government have not helped nor have irresponsible fiscal policies. But protectionism is not the answer to the recession. The answer is a drastic retrenchment of budget deficit which will ensure an easier monetary policy. Tight fiscal policy allows the pursuit of an easier monetary policy.

The logic of the global economy as well India's interests dictate that India become proactive in its liberalisation policies. There is a big market out there and India has all the advantages to be able to expand its exports. If the developed countries are resorting to Non Tariff barriers, it is because they are afraid of competition from countries like India. If India is to fight this tide of NTBs, it can only do so by adopting an active open economy trade stance. After fifty years of industrialisation, India surely cannot insist on eternal infant status.

But a bold open stance will also help at the next Ministerial meeting of the WTO later this year. India should take the lead in denying the developed world any grounds of expanding NTBs under dubious grounds of labour or environmental conditions. It should take the lead in insisting on an open global economy in which cost effective labour intensive exports will have unhindered access. If India tries to hide behind some protectionist covers, it will strengthen the developed countries' ability to arm themselves with super non tariff weapons. Then there will be no hiding place.

Conclusion:

India must liberalise - not because it has no choice - but because it is the best choice. India must liberalise because that way alone can it become a rich and prosperous nation, that way alone is there any hope of conquering poverty. Globalisation requires a well-educated healthy population. Education and health, long neglected under the old regime [though it called itself socialist] will get their proper place in the new order of things. The State will stop wasting resources owning old unprofitable industries, subsidising an aristocracy of workers, and put the money saved thereby in the education and health of the poor people. India must globalise because it is the path of human development as well as material prosperity.

About the Author

Lord Meghnad Desai

Meghnad Desai, Professor of Economics at the London School of Economics and Political Science, is currently the Director of the Centre for the Study of Global Governance, LSE. Born in July 1940, he was educated at the University of Bombay. He secured his PhD. from the University of Pennsylvania, USA. He has written extensively on a wide range of subjects. From 1984 - 1991, he was co-editor of the Journal of Applied Econometrics. He has been both Chair and President of Islington South and Finsbury Constituency Labour Party in London and was made a peer in April 1991. He is currently Chairman of the Trustee's Board for Training for Life, Chairman of the Management Board of City Roads and on the Board of Tribune magazine.