

What India Can Do To Catch Up With China

Gary S. Becker. Business Week. New York: Feb 16, 2004 , Iss. 3870; pg. 26.

Many are predicting that China will be the dominant economic force in the 21st century, at least in Asia, but I would not sell India short. That giant nation began to turn around its economy a little more than a decade ago -- and with further free-market reforms, it can give China a run for being the most dynamic big developing country.

India became a vibrant democracy after independence from Britain in 1947, despite 15 major languages and sharp conflicts among castes and religious and ethnic groups. But its economy grew slowly for four decades, and it played a minor role in the world economy.

India's economic policies were influenced by leaders such as Jawaharlal Nehru, its first Prime Minister, who admired both democratic socialism and central planning. This led to a highly regulated economy with sharp controls over private investment by Indian companies, many license requirements for even the smallest economic steps, high tariffs and other import barriers, and little interest in exports. Foreign direct investment was negligible, while government-owned enterprises proliferated. As a result, Indian per capita income grew at only a little over 1% per year until the mid-1980s.

TWO DEVELOPMENTS CREATED a much more favorable climate for radical economic reform. In 1991, a balance-of-payments and fiscal crisis erupted. And India became concerned about the economic success of its giant neighbor and rival, China. That country's per capita income began to exceed India's, even though 40 years earlier India's was above that of China. India had avoided the economic disasters of the Great Leap Forward and the Cultural Revolution. But once China changed policies, abandoning collective farming in 1978 in favor of private plots and opening the economy to foreign investment, its growth accelerated rapidly.

In 1991 the Indian government, still controlled by Nehru's socialist Congress Party, changed direction under the leadership of a bold finance minister, Manmohan Singh, and began to dismantle the old system. India moved toward a market-oriented economy by allowing private Indian companies to enter most industries without prior government approval, eased the high tariffs and quotas that kept out foreign goods, and loosened the tight curbs on direct foreign investment. The result was an acceleration of gross domestic product growth to about 6% a year since 1991, among the fastest of any nation, but considerably lower than China's 8% to 10% pace. The present government, under the leadership of the Hindu nationalist Bharatiya Janata Party, extended these reforms by privatizing several major government companies and reducing tariff barriers further. Taking advantage of India's excellent system of engineering and scientific schools and its tradition of using English in business and in much of higher education, U.S. companies began outsourcing jobs to the country, including software, back-office clerical tasks, pharmaceutical testing, and other white-collar jobs. This is making India into a global high-tech powerhouse.

Still, India cannot eliminate its dreadful poverty simply by developing its high-tech sectors, since the vast majority of Indians has no more than six to eight years of schooling. India must emulate China by taking advantage of its cheap, hard-working, and low-skilled workers to compete better in world markets in labor-intensive products such as textiles and electronic goods. This requires simplifying the time-consuming procedures still needed to build plants and start businesses. Direct foreign investment in India is far below China's, so India must make it easier for foreign companies to operate there.

To compete effectively in world markets, India needs to expand its secondary school education. It also has to vastly improve its health services. There is abundant evidence that returns on such investments in India's human capital would be high.

During a recent trip to India, I found little interest in returning to the old system and a yearning among younger persons for further reforms to propel India forward faster. There's growing confidence in the country that with the right economic and human capital policies, this complicated democracy can lift the terrible burden of poverty and disease from its masses. Indians have been highly successful business people and professionals all over the globe. The path of reform chosen in 1991 may mean that talented Indians no longer have to go abroad to find economic success.