

Faster Growth at Low-cost – Is It Feasible?

Despite fractious politics and short-term populism, Indian growth rate at about 7% per annum, is next only to China's among major economies. This reflects the underlying strength of our economy. However, comparisons with China are inevitable, given our comparable sizes, length of history and civilization, and somewhat parallel developments after the Second World War.

Many objective observers believe that China is destined to be the next economic superpower. By contrast, India is believed to be under-performing. Not surprisingly, many analysts are tempted to attribute our woes to democracy, and Chinese progress to dictatorial policies. What is the truth?

A careful analysis shows that dictatorship has been an obstacle to China's growth for decades. The infamous Great Leap Forward and Cultural Revolution led to enormous grief and vandalism. The successes of Mao's era – accessible school education, effective healthcare delivery, and transfer of technology to rural areas had nothing to do with dictatorship; they were products of sound and sensible policies.

Similarly, the Deng era successes are not a consequence of authoritarianism, but greater liberalization and democratization. Choice and competition in economic arena, removal of entry and exit barriers, highly decentralized economic decision making, effective local governments enjoying functional autonomy, and in recent days the experiment of deliberative democracy at local level – all these are symptoms of greater democratization, not totalitarian control and arbitrary decision-making.

Clearly, the difference in growth rates and current GDP levels between the two countries cannot be attributed to Chinese totalitarianism and Indian democracy. Instead, sound policies and enhancement of liberty are the two key determinants of economic success. Despite our democratic system, decision-making is highly centralized in India. It is said that the United States has the largest number of final decision-making authorities relative to any other society. India possibly has the smallest number of final decision makers for any large society, let alone a democracy.

Not too long ago, China's spectacular advances in the field of telecommunications was a source of global wonder and admiration. But once Indian policy makers got their act together, and allowed choice, competition, technology and investment, we are now witnessing a comparable growth in this sector. The difference between the two countries is largely on account of the delayed liberalization in India. As China, under the redoubtable Deng, changed course in 1978, we waited until the 1991 crisis to allow freedom and choice.

Even now several states and regions in India are showing great dynamism and fast growth. All we need to match China's growth is for the rest of India to do as well as these regions. China's long-term growth rate since the 80's has been about 9 percent on an average, as opposed to about 6 percent in our case. Can we match, or surpass, China's growth? Much of the debate has centered round three issues: foreign direct investment, privatization of public sector enterprises, and flexible labour markets. True, the current political climate does not permit privatization and labour reforms, and FDI cannot grow spectacularly overnight. Our continued fiscal deficits and the government's incapacity to invest in infrastructure and improve the management of power sector are significantly retarding growth.

However, can something be done to accelerate growth within these fiscal and political constraints? In other words, are there painless, low-cost solutions? Happily, there are at least four areas improvements in which will raise growth rates spectacularly. All these are politically feasible, win-win solutions, which can be implemented within the present or projected budgetary allocations.

First, delivery of education – at both school and university level. Allocations for schools have gone up, and the recent education cess is universally accepted. But even in this day and age, our focus is merely on enrolment and retention, and not on quality. As a result, much of our education is futile. Functional literacy, communication skills, conceptual clarity, skill promotion, and creation of meaningful knowledge and its application form the essence of education.

Except for a few elite schools and colleges, and a small proportion of gifted children, most of our education is unproductive. As a result, millions of unemployable school and college graduates are churned out every year. Happily, there is phenomenal demand for quality education. Even the poor are willing to spend considerable sums for education, in the hope of a better future for their children. Sensible policies and non-monetary inputs based on best practices will improve the quality of human power, and enhance growth rate by at least one percent.

Second, our healthcare system is in shambles. The government's record in public health is appalling. A few correctives are being applied in recent years, and the Prime Minister launched the Health Mission in April, 2005. But more allocations and better infrastructure alone are not sufficient. Avoidable hospital costs and sickness are the chief causes of poverty, indebtedness and low productivity. Decentralized management, accountability to the community, integration of various health programmes and nutrition, water supply and sanitation at the grassroots level, and most of all, choice, competition and altered incentives in hospital management are the critical changes in trajectory in healthcare delivery. If there is a genuine change of course, even the projected modest enhancements in allocations for public health will ease the suffering of

the bulk of our people, raise their productivity and incomes, and substantially accelerate growth.

Third, rule of law is the bedrock of market economy and growth. Proper land surveys, assured property titles, speedy and fair adjudication of disputes, swift punishments for violation of law, quick and effective enforcement of contracts and non-discriminatory treatment are all critical requirements to ensure predictability and encourage investment, risk-taking and hardwork. While normatively we have an independent judiciary and institutions of rule of law, in reality they are moribund and ineffective. As a result, there is a growing market demand for criminals in society, and mafia and musclemen have become the undeclared judges dispensing rough and ready justice by brutal means for a price. There are reports of even a few foreign banks in India hiring musclemen to enforce recovery of overdues. Clearly such a climate inhibits economic activity and retards growth. There are many low cost, politically acceptable, popular mechanisms to improve justice delivery and rule of law. This alone will enhance growth by at least one percent per annum.

Fourth, extortionary corruption and arbitrariness in tax departments are sapping the energies of small and medium enterprises and seriously eroding the competitiveness of our manufacturing sector. The direct taxes have witnessed some measurable improvements. But the administration of central excise, service tax, customs and state-level sales-tax are still largely discretionary, unpredictable and arbitrary. Rent-seeking behaviour is therefore exceedingly common, seriously undermining the competitiveness of honest tax payers, and diverting the precious time and energy of the entrepreneurs. Transparent, industry-friendly procedures will not only help the economy, but will also enhance revenues. It costs no money, and yet boosts growth.

Improvements in these four sectors cost little, make the government popular, accelerate economic growth by 3-4 percent, promote investment and employment generation, and create several virtuous cycles of growth, savings and investment. All these are eminently feasible, but require bureaucratic accountability and delivery of services, sound, self-correcting, sustainable policies, and display of minimum level of political skills to build consensus and mobilize public opinion in favour of these improvements. These are the elements which constitute good governance, and that is what is lacking now. Freedom is not a liability; it is a glorious asset for growth. Sound politics is about making democracy and growth compatible, not finding alibis for non-performance. We can, and should, overtake China in long-term growth. But we need to set our house in order first.

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