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INDIA: THE EMERGING GIANT

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P R O C E E D I N G S

MR. BOSWORTH: Good morning. I'm Barry Bosworth of the Brookings Institution.

We're here this morning. We thought that a release of a book by Arvind Panagariya on *India: The Emerging Giant* provided a good opportunity to have a discussion of why all of a sudden India is growing so rapidly and has attracted an enormous amount of attention.

We thought we would begin by giving Arvind a chance to say something in the way of opening remarks. And Shanta Devarajan from the World Bank is going to be our discussant. And then we thought, after the two of them have had some exchanges, we'd open it up for some general comments and discussion.

So why don't we get started with Arvind Panagariya from Columbia University.

MR. PANAGARIYA: Thank you, Barry. It's a pleasure to be here. My thanks to Ann for organizing this so meticulously.

Let me see -- this is a very comprehensive book, 544 pages long. So, obviously, there's not even a small fraction of what is in the book that I can tell you about here in my presentation. So, you know -- but, by the way, those of you who haven't yet still figured out your Valentine's Day gift, I have a suggestion.

(Laughter)

Back there.

All right. So, let me kind of just tell you a little bit -- I'll speak more generally on India, but then pick up as I do that, some of the themes from the book.

So, very briefly and quickly, the book, you know, has five parts to it. The first one deals with growth and reform, second one "Poverty, Inequality and Reform." The third one is "Macro." Fourth one, then, kind of industry, trade services and (inaudible). And the final one deals with the government, where I take up the subsidies, civil service, infrastructure, all kinds of transportation, railroads, air. And then on social services, which is education, health and water supply.

So it is quite comprehensive. As I said, I can't, obviously, tell you about (inaudible) individually.

Let me just back off a little bit.

India is now on everybody's map. It was not very long ago, actually -- you know, even 20 years ago -- we used to joke that the economists who work on India are divided into two: the optimists and the pessimists. The pessimist usually says that, "Oh, gosh, things are so bad in India I can't imagine them getting any worse." And the optimist says, "But I can."

You know, but that's behind us. India is out of the Hindu rate of growth.

Going by the last four or five years, it is growing in real dollars, so it's a little different concept of growth than you usually see. But if you measure in real dollars, it has been growing at more than about 13 percent per year.

And if you project that over a 20 year period, allowing the U.S. to grow at about 2 percent a year in real dollars, in 20 years' time that will make India about two-fifths as large as the United States. So it is really going to be -- certainly, it is an emerging giant.

Things can go wrong, of course, on the way. But if the current growth really maintains in this way -- and a good case can be made that this will, it will be that way -- then it really does, within 20 years' time grows quite large actually.

And once we also, then, account for China's growth, you can see that the shape of the world economy in 20 years' time is going to be very different from what we see today.

What has happened? So -- I mentioned the growth. But, you know, foreign direct investment into India, if you go by last year, about $19 or $20 billion, and portfolio investment another $15 billion. All together, that's $35 billion.

India is also -- Indian companies are investing abroad in a big way. You have heard about Mittal Steel talking over Arcelor, Tata taking over Corus, Jaguar, et cetera. So this outward investment last year alone was about $35 billion. It's quite large.

Remittances, another $25 billion. These are overseas Indians remitting their incomes -- part of their incomes abroad. So big growth there.

And if you compare some of these like, you know, investment, foreign investment was less than $200 million in 1990. So it's a big jump from 1990, from about, you know, below $200 million to about a total of $25 billion, once you do foreign direct investment and portfolio.

Likewise, remittances were about $2 to $3 billion initially, $25 billion today.

Big, big story is telecommunications. You know, just to get an idea of what has happened there, a near revolution.

If you look at 1990 there were in India 5 million telephone lines in total. Currently the expansion itself is about 8 million lines per month. So it is really staggering. It's quite staggering.

Automobile sector, growing rapidly. The passenger vehicles are coming out on the road at the rate of about 1-1/2 million now per year, a big story. And there's a technological revolution as well, there. And, you know, one symptom of that is that at the Detroit auto show recently, the talk of the town was this little car called Nano, which was not even actually present at the show. This is the Tata poor man's car, which is supposedly about, you know, 100,000 rupees. So, this, you know, the technology front here, also it's moving.

Civil aviation, rising very rapidly if you go by either the passengers carried or freight. Large software story. We all know it's a big story.

So -- and then, you know, the last figures, the latest report by the Forbes on the number of billionaires. There are now in India 54 billionaires. That is dollar terms, not rupees, which, you know, if you looked at five years ago, it was less than 10 -- well below 10, actually.

So, big things are happening. There's no question that the Indian economy is doing well. Now, it has helped poverty, as well. So, contrary to a lot of the claims out there in the press, and particularly by the NGOs, also in India the leftists, always omnipresent -- which claims to the contrary but, you know, you can look at virtually any study. It is quite undeniable, actually, that the poverty ratio, the proportion of the people living below the poverty line has come down dramatically.

Official figures are that the decline is now 45 percent in 1983, to about 27 percent in 2004 -- which is based on the official poverty line, of course.

I think future prospects do look very good. Two or three different reasons.

One -- the biggest one, of course -- is that an enormous amount of liberalization has actually happened. It has slowed down under the current government but, nevertheless, enough has happened actually that entrepreneurs are free in a variety of dimensions that they were not, even 15 or 20 years ago.

Demographically, India is getting much younger. Even China, actually, the competitor, is going to get older. Dependency ratios in China are going to rise. And so, you know, in effect actually, India is going to be supplying population around, actually, to the globe. You'll see many more people like me around you in 20 years' time, I suspect.

Savings rate is already about 33 percent -- and rising. And I have no doubt that this is going to hit 40 percent in four to five years' time for sure, if not faster. One reason being that corporate savings in India are still about 8 percent, compared to something like 29, 30 percent in China. So there's enormous scope for corporate savings to grow still. They are growing rapidly, and enormous scope for them to grow.

India's entrepreneurs -- top class. You know, I think, it is a very interesting story actually we used to tell. This was Manny Palchiavali, a lawyer, actually. He used to say that, you know, India's entrepreneurs are the best, not easy to suppress. But, unfortunately, our bureaucrats have got the talent to do so.

And so, you know, for a long time they were kept down. But that hand of the bureaucrat has now been lifted off and, I think, you know the results of those are visible now, and we continue to go that way.

So, briefly let me turn back. So I think things are happening. The future I predict as looking quite good, actually, quite bright. Something fully will have to go wrong for this growth (inaudible).

And also the attitudes are changed. You know, when growth rate this year is expected to decline from 9-1/2 percent to 8-1/2 percent, you know, this is seen as a big kind of bad news that, gee, you know, there is a slowdown in the economy. So, you know, for an economy at 8-1/2 you call it a slowdown. But that's the kind of (inaudible) attitude, you know. So, sort of fatalism that existed in the past has been now replaced by very robust optimism which, again, is important, as well.

Now, what went wrong? You know, what happened? You know, if you look at the Indian history, which the book does in great detail, actually, in the first part of the book, through the 1950s, 1960s and 1970s, India suffered from, you know, what has come to be called the "Hindu rate of growth," which was a growth rate of the GDP between 3 and 4 percent, and the population growing at about 2-1/2 percent; per capita income still growing extremely slowly.

And there was virtually no reduction in poverty. If you look at the trend, poverty ratio, it was completely flat during those three decades.

So this was a period actually when the entrepreneurs were very much controlled through a large variety of instruments. The economy was very autarchic. You know, one way to think of it is Korea, and India both had about, you know, exports to GDP ration in the range of about 5 percent in the 1950s.

India more or less stayed there, actually may have even declined, by 1980. Korea by 1980 had an exports to GDP ratio of about 30 percent. So big change -- big change in Korea, not in India.

And this autarchic set of policies, reinforced by the domestic investment licensing -- also by restrictions on the large firms to invest in any of the labor-intensive sectors. The labor-intensive sectors were all reserved for the small-scale enterprises, and large-scale firms were actually confined to investments in the most capital intensive industries.

Now, you know, you'd think that in a country where you want to generate employment this was precisely the wrong policy. But that's what was done.

And so, you know, there's this huge kind of restriction, both on competition from outside, as well as from within -- led to a huge decline in productivity, a very low productivity, which reflected itself, you know, in very poor quality of the products, as well.

A very interesting story there, actually -- you know, Jagdish Bhagwati, in whose name I chair at Columbia -- after whom my chair at Columbia is named -- he in 1961 returned to India and, actually, you know, he also shared these nationalistic sentiments of his generation, which has participated in the national movement. So he wrote to his professor, Harry

Johnson -- Harry Johnson was also a (inaudible) economist at the time -- and so he wrote to Harry that, you know, “I’m very disturbed by the craze for the foreign goods that exists in India.”

And Harry Johnson, who was really a quick wit, kind of wrote back saying that, “Look, you know, if the quality of the paper on which your letter is written is any indication of the quality of the products in India, the craze for the foreign goods seems quite rational to me.”

(Laughter)

And, you know, those of us who grew actually during that period know exactly how poor the products were. Again, the joke among us was that, you know, the fountain pens we were using were mostly fountains but not really pens.

So, you know, anyway the quality really suffered, and that’s correlated with very low productivity in general. This began to change in the 1980s. A small bit of liberalization in a piecemeal fashion began, accelerated a little bit during Rajiv Gandhi’s era, which is 1985, 1986, (inaudible) until ‘87.

Then there was a slowdown again. About 1991, there was a macroeconomic crisis, and the liberalization then became much more systematic. It picked up.

Big liberalization in investment licensing went off during 1992 reform. Licensing on imports also went off, except on the consumer goods, which went out ultimately in 2001.

Tariff scheme tumbling down. You know, the top tariff rate, for instance, of about 350 percent in 1991 came down to -- today it is 10 percent on the industrial goods. Now, agriculture is still very protected. Industrial goods tariff, top tariff is 10 percent. Given some peaks, actually, the average tariff on industrial goods is about 12 percent -- which compares with 9 percent in China.

Foreign direct investment obviously has liberalized dramatically, as well, which means that there has also been a great deal of liberalization in the services sectors -- which, again, have picked up, as well.

So I think a good bit of liberalization happened. Then there was a slowdown in the mid-1990s. There was very unstable kind of coalition governments which tried to carry forward some, but not very successfully.

Then came Vajpayee government, which stayed in office for six years, and there was major, major reforms again -- at pretty much the way early 1990s reforms were. And these went into also, you know, taxation macro reforms. Telecommunications was a big thing. Electricity. Big, big time reforms. And I really attribute, in the book, the recent acceleration that happened starting from the year 2003-04 from about the 6 percent rates, to now between 8 to 9 percent, to these reforms that happened in the late 1990s and early 2000s.

Looking ahead -- let me just, you know, I'll take just two or three more minutes to see, you know, where I see the big problems of transformation in India.

Now, the big problem of transformation in India currently is that on the one hand you've got about 55 percent of the work force in agriculture. On the other, agriculture by itself generates only 16 percent of the GDP. So, a large number of people, large proportion of the work force, is dependent on income which is really a small proportion of the GDP.

So you've got this problem of, you know, getting people out of agriculture into gainful employment, which has to be either in industry or services. What has happened in India still, because of two or three major bottlenecks. One is the power, electricity. It remains a big bottleneck. That reform is still incomplete -- again, slowed down under the present government.

Then you've got infrastructure, in general -- transportation. Improvements are happening. There I am much more hopeful. I'm quite optimistic. Electricity, I'm less optimistic, actually. That will take much longer. But roads, ports and airports, I think, you know, right now there is a bottleneck in each of those sectors, but that's something that can be -- that the government knows it can handle.

So I'm less pessimistic there. Then the third very, very important reform is in the area of labor markets. If you are a firm with 100 workers on more in India, you have no rights to fire the workers. And that actually has hurt -- that, along with the bottlenecks in the power sector -- have hurt incredibly the labor-intensive sectors.

You know, so if you look at apparel, footwear, toys, light manufacturing also of the consumer goods, which really grew very rapidly in China in the 1990s, have done very poorly in India. And that's where you have to bring in the bulk of the workers, actually, out of agriculture into gainful employment.

So that is a big bottleneck. I think, you know, down the road it will be, ultimately, you know, from a distributional point, but particularly also from the poverty reduction point if you want to accelerate that, labor-intensive industry has to grow much faster and these bottlenecks have to be resolved.

Finally, on the formal sector services, financial sectors, you've got software industry and so forth, you've also got to deal with the higher education system. That is -- India's higher education system is in really dire straits. It really needs to be completely kind of transformed.

Unfortunately, there is no thinking -- as in the area of the labor markets, there is no thinking going on.

Still -- well, thinking may be going on, but there is no intention of any policy action. Successively, the HRD Minister that has been appointed has had no interest, actually. Even under the Vajpayee government, where actually reforms penetrated virtually every area, education -- higher education -- was an area in which not enough, nothing actually was done.

The current education minister also is not doing anything on higher education. That is a big bottleneck, as well. And you can see that, you know, in the tightness of the labor market for skilled workers. Skilled wages—and they are rising currently at the rate of 14 to 15 percent a year, which is, you know, is not observed in any other country, actually.

Turnover rates in the IT industry are very high. If you look purely at the call centers, 50 percent of the labor force turns over every year. So big bottlenecks there. That's another area which is in dire need of reforms. There's also issues in health sector, which I'm not going to touch on right now. But there are issues dealt with also in the book.

So that's roughly the road map of what I present in the book.

Thank you.

(Applause)

MR. DEVARAJAN: Okay.

Let me start by saying when I was asked to review this book, my first reaction was, you know, why do we need yet another book about India?

I mean, the Indian story is now widely known: increasing globalization, faster growth, poverty reduction. And, I think, to paraphrase Amartya Sen, you know, we have about 1.1 billion argumentative Indians, and a few argumentative non-Indians like myself, who are engaged in a sort of a huge debate and controversy about India's recent growth.

And I'm going to try to orient my remarks around what I have called "the four inconvenient truths" about India's economic growth.

But I think this book makes a tremendous contribution, because it addresses, actually, each of those four inconvenient truths. But it addresses them in such a dispassionate, careful way that you really come out with something much greater than what we had before I read this book.

The first inconvenient truth -- and Arvind alluded to that in his presentation -- is that some people have claimed that India's growth started 10 years before the policy reforms, before the liberalization actually occurred. And it's true that there was an acceleration of growth in the 1980s, whereas the big-bang reforms, if you like, were in the early 1990s. And, you know, this is not only an inconvenient truth, but it's perhaps embarrassing to those of us who believe that policy reforms have something to do with economic growth.

I think what this book does -- and it makes a really valuable contribution -- is to really dispel that myth. And in a very careful way, by going back historically to the -- really, after independence, and breaking India's economic history into these four phases. And one of the things it shows is that, actually, the first phase, which was the 1950 to '65 -- is it? Yes -- was a phase where India was relatively open, and actually had relatively high growth. And then, actually, the growth deceleration started in '65, when they clamped down on trade.

And then, actually, this business about the 1980s and 1990s is very nicely clarified here by showing that it's actually the second half of the 1980s where the growth took off, rather than the first half. And if you change the cutoff dates, rather than just looking at it in terms of decades, that you actually align the cutoff dates with the reforms, you actually get a very clear pattern of reforms' triggering the growth.

So I think this book really lays to rest that first inconvenient truth. And I would say that just the description of those four phases is, in itself, a valuable contribution. And I think -- you know, there's a remark in the book about how Arvind's father, just before he died, told him "Write the definitive book about India." And I would say that you've fulfilled his wish -- just based on that part of the book.

The second inconvenient truth -- and, again, it's mentioned here -- has to do with the fact that, you know, we have certain rules of thumb about macroeconomic stability. You know, IMF saying, well, if a country has a fiscal deficit to GDP ratio of about 6 percent or above, that's a problem. You know, and usually, when the deficit gets to about 6 percent of GDP, you'll be sure that an IMF mission will be there in the capital city in a few weeks.

India has had a fiscal deficit of over 6 percent of GDP for 20 years. Right? It goes back to the late 1980s. And managed to -- that's the period when it actually accelerated its growth. Again, profoundly embarrassing to people.

And, you know, when I became Chief Economist of South Asia I sort of decided to go back and read all the earlier economic reports that the Bank and the Fund had done about India. And, sure enough, you know, every one of those reports sort of said, "Yeah, you know, they've managed to grow this year, but wait till next year. You know, that deficit cannot be sustained at 8 percent, 9 percent, 10 percent."

Now the book, the chapter -- and this is one sort of minor quibble I have with the book -- is that the chapter on macroeconomics addresses this question, but it addresses it from the point of view of how and whether India has managed to avoid crises, looking at it from the point of view -- I mean, 1991 was a crisis, but whether another crisis would emerge after that. And I think that's valuable.

But I think it could have benefited from asking the question in the other direction: How did they manage to grow so fast, with such a high fiscal deficit? And I think there's some work that Brian Pinto, who is here, has done that sheds some light on that.

And I would say that it might benefit -- maybe not in this book, obviously. The book is already published -- but the next paper -- doing a kind of comparison between India and some of the, say, a Latin American country which has had equally high deficits but not as much growth, and seeing what was different between India and those other countries.

The third inconvenient truth -- and, again, Arvind alluded to this -- is the fact that there's no question that during this period of rapid economic growth, inequality has increased. I mean, the way I put it in my blog, the inconvenient truth is that India is not growing. It's Maharashtra, Gujarat, Haryana, Tamil Nadu, Andhra Pradesh and Karnataka that are growing. There are states like Bihar and Uttar Pradesh -- in fact, the poorer northern states of India, which has a combined population of 500 million, have been growing 3 percentage points slower than the richer southern and western states.

So there's huge divergence going on alongside this growth.

Now, what the anti-globalizers would say is, “I told you so.” Right? This confirms the worst suspicions of the anti-globalizers. “See, you globalize, you liberalize, and the rich get richer and the poor -- ” -- they don’t get poorer, but they don’t really get richer. States like Bihar and Uttar Pradesh have really languished during this period.

What this book shows is that that reasoning is precisely wrong. It is not because of globalization or liberalization that those southern states -- I mean, the northern states or the poorer areas, the lagging regions of India, have failed to grow. Indeed, it is because they have not reformed the policies of those lagging regions that affect those lagging regions -- and various other policies.

So it is really a policy failure, or the lack of globalization, a lack of liberalization, rather than the cause of liberalization that is driving it.

And the book very systematically goes through that. It looks at agriculture. You know, one of the reasons why these states are languishing, the lagging regions, is because of slow agricultural growth, slow agricultural productivity growth. Arvind already alluded to that.

Well, then you say: Why is agricultural growth so slow? Well, there’s a complex web of taxes and subsidies that are really sort of squeezing Indian farmers. Some of these subsidies are well-intentioned, such as the original free power -- giving free power to farmers -- that have led to all sorts of distortions, including depleting the water table, that has led to really very slow agricultural growth.

The other is employment. Again, Arvind mentioned this. You know, this growth has not been accompanied by rapid employment growth. And India is remarkable -- unlike China, has not been able to maintain a large growth in manufactured exports.

Well, what's going on there? The other factors that -- the other inconvenient truth is that 93 percent of the labor force is informal. And when you say, "Why is that?" Well, that's because these labor regulations that actually prevent you from firing people that you've hired, or having to pay exorbitant severance pay, and it's very difficult then to get employers to actually hire people at large scales. And so you find that very small firms which can avoid those regulations is the name of the game.

Now, so, this is on the one hand quite troubling, that you've having this inequality. But it does give you a little bit of hope, or a little promise, that if you can liberalize or make more flexible the labor regulations, and if you can do something with that complex web of agricultural taxes and subsidies, India can grow even faster. You can really take off.

And I think that brings me to the fourth inconvenient truth that this book also addresses, which is that while India has been growing during this period, many of the public services, like health, education, water and sanitation, have actually been deteriorating. Immunization rates in India are actually -- during this period of 8 percent growth, immunization rates have been flat. And India's average immunization rate is actually lower than Kenya's. Right?

So these are fundamental failures in the delivery of public services -- something on which I've written too much, probably. And Arvind actually addresses some of them.

But, again, think about it. Most of it really is a government failure, the failure of the government to deliver these services. And he proposes some solutions, such as moving to systems of vouchers and cash transfers, which might be a way of actually strengthening the delivery of services.

But I come back to my final point, which is that the way this book has addressed these four inconvenient truths -- the first one, it demolishes. I don't think it's an inconvenient truth anymore. And the latter two -- the one about inequality and about public services -- it really shows, it drills down to the source of the problem, which is really a government failure. It shows that we can actually do something about it.

And I think books like this will give ammunition to those of us who are trying to get the political forces to actually adopt some of these reforms, because it gives the evidence on which those reforms can be based.

So, just to conclude, I think I have to switch political slogans, that I'm no longer going to be talking about "inconvenient truths." I think what this book gives us is the audacity of hope.

(Applause.)

MR. BOSWORTH: Well, thank you for those remarks, Shanta, on the book.

I must say, I just had one word. I sort of felt a bit like Shanta that my knowledge of India is limited, and extends just back a couple of years, but I've been now involved in going there more frequently. But when I read, not just Arvind's books but other books, that's a long list of problems. And the list of difficulties just seems sort of overwhelming.

So my reaction on reading this was, "This country can't grow. It can't work." Yet, when you go there, it does work. I think it's a real surprise.

And I agree with the reforms. I don't mean there hasn't been reforms. But the list of problems that India faces is so incredible, yet the country's just having this amazing growth in the last two decades.

I still sort of puzzle: is this just a temporary accident? A bubble that will burst? Because it doesn't look like the country has a lot of inherent advantages -- other than inexpensive labor. And I think I'm still troubled a little bit, because there seem to be a lot of inconvenient truths to deal with, and the country just seems to manage to overcome them to an extent. I'm sort of puzzled about that yet.

But I thought I'd give you a change to respond to some of the remarks that Shanta made before we open it up more generally.

MR. PANAGARIYA: Well, I think, you know -- no quibbles to take with Shanta. Maybe the only one I could respond to is on why, despite fiscal deficits, India managed to grow during this period.

The book does go into some of the details why actually -- you know, whereas there was crisis in 1991, with similar expansionary policies during the 1980s, the crisis did not happen in 1990s and 2000s.

There are two facts. One is that the economy is now far more open. Trade to GDP ratio, for instance, was about 15 percent in 1991. It's now 45 percent or higher. So it's a much more open economy, which means that, you know, any foreign exchange difficulties can be dealt with.

But that is then combined with, also, openness on the foreign direct investment, portfolio investment, which has created this very large pool of foreign exchange reserves, which is now about, you know, inching towards $300 billion.

And on top of that, whereas in the 1980s India financed the deficit by borrowing abroad, which led to, by 1990, very large debt servicing ratios -- you know, about 30, 35 percent of the exports, which were small to begin with anyway -- were being used to service the debts that had been accumulated in the 1980s.

1990s onward, the fiscal deficit has been financed largely by borrowing domestically. And what that has meant is that, you know, on the external front we are covered, because the foreign exchange reserve is much higher, trade to GDP ratio -- and so, and much less borrowing abroad.

So all those factors have lent the country a certain macroeconomic stability which, when combined with all the other microeconomic reforms have helped the growth process.

So, I mean, that's how I explain that.

Now, to your puzzle, Barry -- I think, you know, when the economy suffers from such large inefficiencies as the Indian economy did for about three-and-a-half decades, and you begin to actually address at least some of the bottlenecks that were behind those inefficiencies, they are also very large. And the distortion is large. Removing those distortions is also very large.

And, I mean, you really have to read carefully part one of the book, you will see how incredible the policy regime was in the '60s and '70s; how, particularly by the 1970s, this was like -- you know, if you were a firm with investment, total investment, or total value of assets of $27 million, you were classified as a large firm, and then you were not allowed to invest outside of about 19 or 20 core sectors, and these core sectors were highly capital-intensive sectors.

I mean, this is -- so you had complete exclusion. And even within those sectors, when you went to invest, you have to get the license. And then, all the labor-intensive sectors, you know, from apparel to toys to whatever consumer goods, what have you, they were all put on this list which was for small-scale industries. Now, small-scale enterprises, these were investments of less than a million dollars.

So, you know, you will never turn into an exporter if you are a -- you know, with an investment of a million dollars. And even if you become successful, you can't become bigger. So, you know, a lot of the entrepreneurs basically just were kept down, they were just held down.

So I think once you got rid of the Trade Authority, you got rid of the licensing and now also the small-scale industry reservation, I think you have really released this incredible entrepreneurial energy.

Now, don't forget, I mean, China was similar actually. I mean, I know -- I remember accounts which were written -- take, you know, I mean obviously the most visible bottleneck or problems that you see like, you know, the transportation sector. You arrive at the airport and you see a mass of people in this very small little airport. And then you go on the roads and you again see the incredible condition on the roads, especially in Bombay. I mean, Delhi has done a lot better, actually, of streamlining its transportation side, including building up the train system and so forth. But Bombay, if you go, small stretches could easily take you two hours to travel through.

But I remember accounts, reading accounts, of China, actually, the late 1980s and early 1990s, there were these entrepreneurs who came in and finally managed to get out, and then never returning to China again, reacting to the kind of infrastructure. But, you know, today nobody -- even people who think that China, interested in this country, think China is paradise, or at least moving at the rate of paradise.

And, you know, so these bottlenecks, I think -- again, if I think of India like 15 or 20 years ago, I had a very pessimistic view, also. I mean this came, for example, from a trip I had to make once from Delhi to Jaipur, my hometown. And the trip normally should take four hours. It took eight hours because the road was all broken and, you know, you got an entrepreneurial driver who actually took you around from behind, all kinds of back roads and so forth. And eight hours, took us there, even though there was no road, actually. The direct road has washed off in large chunks.

And I felt that, you know, we'll never -- these roads will have to be always built by the government. It's a (inaudible) by the government they can't solve, and we'll never get these roads which will really be all-weather.

But it turns out, you know, the formula got discovered. Eventually Vajpayee government went in with private-public partnerships, and brought in these large builders, both domestic and foreign, and basically gave the charge of building the roads to these large multinational companies. And, lo and behold, you know, you got this Golden Quadrilateral, which is several thousand kilometers long. All of it is now four lanes, and substantial chunks of it are six lanes. And, you know, in the past we road actually on the -- one of the highways was six lanes and I said, "Oh, this is America. This is not India."

(Laughter.)

I mean, it's just incredible.

So, I think things are happening. And it is precisely -- I mean, I really think that one of the things that's going for India, which is in some ways, actually, better than China is the entrepreneurial spirit. I mean, the entrepreneurs in India (inaudible). And they're more creative, I think. They're not good at, perhaps, reproducing the same thing, so therefore manufacturing has not done as well. But, you know, in terms of other sectors, like financial sector, India's financial sector is way ahead of China's actually, in terms of reforms, in terms of the growth of the financial sector. IT, of course.

So anything that requires skills, India seems to have been doing quite well.

So, you know, lots of problems. But that, of course, is the reason for hope actually that 8 percent can easily be turned into 12 percent. You know, if you can do 8 percent with what you are doing now, you can easily push it to 12 percent. Whether the government is actually going to deliver on this or not, this remains to be seen. But I see enough energy.

And even on the government side, at least, you know, in some of the areas, like -- again, this trip I just took. Actually I just came, end of January I came, actually, from India. And so we drove, actually, from Jaipur to Delhi. And this incredible highway that has been built that connects now (inaudible) to the airport, and (inaudible) to New Delhi -- it's just, again, like America, you know. (Inaudible) out on the highways, you know, which I have never heard of in India. It's there.

So, I think Bombay has a lot more problems, but even that is being now, beginning to be addressed at least. You know, there's a big public transportation that's now being built up, actually, over ground. It will take a couple of years to really happen.

So, I mean, I think there's a lot of reason to be optimistic.

MR. BOSWORTH: The one thing I think we can both -- I very much agree with, you don't see written enough about is the entrepreneurial energy. That's the common thing you see in China and in India when you're there. All these people, so interested in trying to build businesses and stuff. Maybe the Chinese government unleashed those energies -- perhaps. But it's a remarkable turnaround for what would normally be an awfully long list of problems, it seems to me.

But why don't we open it up more generally, to see what people have got comments and questions.

Way back there in the back. I think there's -- yeah, there's microphones.

SPEAKER: Thank you. My name is Sheshido Tomaluri. I work for a micro-finance institution. I worked in India, and here I'm working for the same sector.

I have two quick comments that would lead to some questions, I guess.

I think, while being an Indian and being in this debate of growth and inequality feel great that it's doing well, we are growing fast. But there are two major, I think, issues which we read sometimes, but I didn't hear in today's talk is: entrepreneurship has been dealt well with, but employability -- I guess reading some numbers, compared to the new emerging economies in Eastern Europe, Latin America, India is falling very, very behind. (Inaudible) report says that not more than 25 percent of

Indian graduates are employable to the new or growing sectors, or the globalizing economy.

So I would like to hear the comments of Arvind to see what this thing would imply for India in the future -- which also addresses the question of inequality, from rural-urban inequality.

And that leads to another point of manufacturing versus service sector issue. India seems to have missed the big manufacturing mark to China, in ‘70s and ‘80s. And everybody said that, oh, India missed the mark, and somehow we got the knowledge and service economy, we took off.

But it seems that more of skilled and educated class gained really remarkably and left the unskilled and rural and poorer class, or illiterate class, behind, because of manufacturing gap. And of course that leads to the issue of infrastructure, transportation, power.

But having had these big two issues in hand, which might pull us back a little bit from all the euphoria we have, is there anything which you think the government, or the policy advisors, should be looking at to address these gaps?

Thank you.

MR. PANAGARIYA: Okay. I said a few things about each of those things, on the employability of graduates. Of course the higher education system is in collapse, actually.

The argument I make here is that, you know, what is really carrying on the universities, and particularly institutions like the IITs and IANs is not their faculty or the value-added -- the value that they add to the graduates. But it is the sheer brilliance of the students.

You know, you are looking at a large population. And when you select out a few, even, you know, top 3 or 4 percent, you've got a very large number of very bright individuals there.

And at the university level, what is carrying it on is the fact that there is a reasonably okay curriculum in place. And the university has still managed to give reasonably good examinations. So, you know, the examination system, which is what we could call "quality control system," that works all right.

So the students know that if that if they really master the curriculum, if they really do well on the exams, the degree would have some value. So those who do in the top 5 to 10 percent of the institutions, they do fine.

But then there is no signaling value once you get beyond, maybe, the bottom 80 or 85 percent of the graduates, there is no signaling value. And that's where your unemployability issue comes in.

There's a whole set of higher education reforms that need to be done. I discuss that in great detail in the last section of the back.

On manufacturing versus services -- again, this is an issue. You know, there were lots of hurdles in the way of labor-intensive manufacturing taking off. Many of those hurdles, including one important one -- the small-scale industry reservation -- has been now more or less lifted off. But you've still got the labor market regulation, which I think is the final remaining barrier to the growth of the labor-intensive industries.

You see, what happens is that when 80 or 90 percent of your costs are labor costs, as is true in industries like apparel, footwear, et cetera, then this kind of labor regulation becomes very important. You pay much higher wages.

Now, India has an opportunity right here, because now the wages in China are beginning to rise, and even a unskilled level or semi-skilled level. Wages in China are now rising, and they have caught up -- actually, more than caught up with -- I mean, one study I recently saw apparently says that in 1980, late 1980s, Indian wages were higher than the Chinese wages, but that has now been overturned now.

So India has a big opportunity here. But whether it can rise to it and undertake the labor reform necessary remains to be seen. I think, you know, the present government has no -- I mean, the present government actually has completely the reverse commitment, that it is not going to undertake that reform. It's there, written out in the Common Minimum Program that they worked out at the beginning of June 2004.

Finally, on (inaudible) in on the rural folks, I mean there are a agricultural area reforms which I discuss in the book. But the one single thing that I would do, which is doable -- I mean, two things I would like to do, but the second one is not as doable.

But the one that is completely doable is the building of the rural roads. If the government can build, actually, these highways, the Golden Quadrilateral four-lane and in a lot of places six lanes, there is no reason why they cannot build reliable rural roads.

The problem is that because, you know, the whole system is driven by equality, rural roads are built under contract of 15 million -- 10 to 15 million rupees. No company of any repute is going to bid for those contracts.

What they have to do is take entire district, or maybe take five districts, have a single contract for rural roads in that set of districts, let the big guys come in and build the rural roads. And then the government can also actually do the quality control. They can oversee.

But when you've got this tiny little kind of contractors building rural roads all over, you know what kind of outcome you're going to get. The guys are not capable of building all-weather roads, and the government is not capable of monitoring that large number of little contractors. So the money gets spent. It basically is a transfer to these smaller companies. No all-weather roads get built.

Here the formula is very clear, I discussed it in the book. And it's completely doable.

The other thing, of course, would be electricity. That's harder. But that also needs -- I mean, so rural electrification. I think, you know, if you give farmers electricity, connect them through the roads to the mainstream of the economy, I think, you know, they can themselves can work their entrepreneurial talents into effective incomes. I have no doubt about that.

Some of it is certainly happening actually in -- you know, the share of non-farm income in the rural income has been rising. So that's part of the good news. And part of the poverty reduction that we have talked about, actually, I have no doubt is because the opportunities of non-farm employment, even within rural areas, have become much larger now. And that has actually helped raise the wages in general.

So, poverty alleviation, you see not only in the numbers, in the head-count ratios, you also see that in rising wages. So wages have been rising as well in the rural areas.

But those are the two things -- you know, two minimum things I would do: rural roads and rural electrification to help the poor.

MR. BOSWORTH: Let's have a question down here in front.

SPEAKER: One of the things that's unusual about China is that when you look at the provincial growth rates in China, they are really clustered together at very high rates. Even the most backward provinces in China are growing at 8, 9 percent if the economy overall is growing at about, say, 9 or 10 percent.

And in the case of India, that's not true.

If you look at China, the reason why the poorer provinces, Ningxia, Guangxi, Gansu and others are growing rapidly, not because of agriculture. Because, on average, Chinese households only get about 40 percent of their income from agricultural activities.

The reason they're growing fast is because of rural industry of various kinds, and because of urban development, and particularly urban construction, urban industrial development.

So my question is: why isn't that happening in India? Why is there such a cleavage, rather than much more of a sort of a, you know, clustering together of growth rates.

The second question I have is with regard to the automobile industry. This is going to be, or could be, an important lead sector in the case of India. It could be very important for all kinds of cluster developments. It could be important for innovation. But it would also have profound implications for urbanization in India, for infrastructure development, for pollution -- as we have heard a lot about -- and for a whole variety of other issues.

Now, is India ready for that? Is India going to use the automobile sector to drive the economy the way China is doing? And if it does, it becomes prey to all kinds of vested interests.

And so the decision will have to be made fairly soon. And once that decision is made, then I think the die is cast, and you kind of go into a certain kind of mode. But that has huge implications.

So what is the thinking about it in the country?

MR. PANAGARIYA: Do you want to take —

MR. DEVARAJAN: No, you can go ahead. You go first.

(Laughter.)

MR. PANAGARIYA: So, on the provinces, I place India about 10 to 12 years behind China. So, I mean, I don't know China well enough, but would you say like 15 years ago the provinces, the poorest provinces in China, were growing 8 percent?

SPEAKER: Not growing -- no.

MR. PANAGARIYA: So, I mean, I place them a little behind. You know, India is behind about by 10 to 12 years. So I will not be surprised at all, actually, if what is happening in China begins to happen in India within 10 years.

I tell you, among the BIMARU states -- the so-called six states in India called Bihar, Rajasthan, Madhya Pradesh and Uttar Pradesh -- so my own state, Rajasthan is flourishing. It is no longer a

BIMARU state, and you see the prosperity all over, actually, from the rural to urban, to smaller cities, (inaudible), Udaipur. Whatever has unleashed the energy has unleashed it in Rajasthan unit.

And so one of the points I make here in the book is that, look, you know, if you'd look at the growth rates even of the lagging states during the 1990s and beyond, they are higher than what they were in the earlier periods. So the growth rates of these lagging states have also shifted up a bit.

And if rural roads, particularly, get built up and -- I'm an optimist. I expect, actually, that that will happen. You know, the government ultimately will be held somewhat responsible and, you know, in the next 10 years I do expect that this will happen. I think you'll see that, you know, connectivity to urban areas will actually unleash similar energies. As I said, non-farm incomes are on the rise for sure, at least some evidence is very much out there.

On the automobile sector -- I mean, speaking a little bit from the pessimistic side -- when it comes to the government actually, the government in India, you know, when it is important, when it is urgent, nothing happens. You know, you say it's urgent. You've got to do it -- build roads or something. It's not going to happen. When there is emergency, it happens.

And Bombay, for example, is now in an emergency, and so I think things will happen.

But, you know -- so, I really believe in this Hirschman idea of unbalanced growth. At least that's what is applicable to India, that, you know, if the automobile sector takes off -- it is doing very well actually, and the expansion, the rate at which automobiles on the Indian roads are expanding is phenomenal. It is for India, it is absolutely astounding. I mean, it's behind only cell phones.

And that, I think, you know, has a lot of -- I mean, I agree with you that a lot of linkages that are coming through it. Not only -- you know, it puts pressure on the government to actually build roads.

On the pollution -- again, we saw, you know, when it came to emergency in New Delhi, the judge gave an order that, you know, by September 1, all the taxis which are running on gasoline have to convert to CNG, the gas. And in the end, it happened. And Delhi air today, of course is much cleaner. It may still not be clean enough, but it is much cleaner than it was about seven or eight years ago since that order.

So, you know, locally, when problems are going to arise, I think the system will eventually react. Unfortunately, it's not -- you know, you'd like it to react in advance. It doesn't do that. But it will happen.

So, again, I'm generally optimistic. Yes, conditions will happen on the roads. Accident rates probably will rise. But then roads will get build up. I mean, it is happening. It is certainly happening. So I take an optimistic view.

MR. DEVARAJAN: Barry, can I —

MR. BOSWORTH: Sure. Go ahead.

MR. DEVARAJAN: -- just add one point to the answer to the first question, about the divergence compared to China.

I mean, one thing we've got to keep in mind: these states are huge. You know, Uttar Pradesh is 160 million people. And when you start looking, breaking that state down into districts, what you are observing is some convergence within those states.

So Uttar Pradesh has the same overall growth rate as the India-wide average, but has double the rate of poverty reduction of India.

And why is that? Because there's this growth in non-farm industries, or shifting in the agricultural sector towards higher valued crops.

Bihar has doubled the Indian rate of agricultural growth.

Again -- so there's something going on inside these big states that is actually reproducing something close to the China pattern.

MR. BOSWORTH: Go ahead. Yes.

MS. MULLEN: My name is Mary Mullen.

You mentioned water and clean water. Is that a service? Is that something that's being looked into? Is it a real serious problem?

I just wanted you to speak to that.

MR. PANAGARIYA: Yes -- that's —

(Laughter.)

MR. DEVARAJAN: Yes, it's a huge problem. But the source of the problem really comes back down to the original intent of policies. The policies were instituted decades ago that water is a human right, or people need it as a necessity so we should provide it free, or at subsidized rates to everybody.

It turns out what that meant was it was provided to only a very few people, and poor people are usually excluded from the water networks. And they're having to pay five to 16 times the meter rate to go buy water from water vendors, these monopolistic water vendors. So it's a huge problem.

But the other part of the problem -- a little bit like what Arvind was saying about agriculture -- is trying to reform those policies elicits huge resistance. Just simply by trying to allow private vendors -- I mean, for the government to contract out some of this to more efficient water providers, or even raising the price -- see, if the poor people are paying five to 16 times the meter rate, if you double or triple the meter rate and give them access to it, they're better off.

And yet those other kinds of reforms that elicit protest marches in the streets and the abandonment -- I mean, the example of the

Delhi Water Board, where they tried to make a very small reform, and there were such large protests that they canceled the reform.

MR. PANAGARIYA: And, you know, one of the problems you face in, not only this water -- water even more so -- but things like agriculture, labor, electricity, these are largely areas of reforms by the states.

Wherever the reforms have to be done by the center -- except in labor market areas, for which there are good reasons why it hasn't happened -- the reforms, where the center has to do things, do happen.

When it is largely under the jurisdiction of the state, you've got a problem. Water is actually, you know, very much in that category. So there's this kind of general problem, but then there are some specific problems that Shanta has talked about regarding water.

SPEAKER: Who's resisting? You were saying there's -- excuse me, who's resisting this? Who doesn't want these —

MR. DEVARAJAN: You know, basically there are large groups of people, there are large groups of people who are earning rents from the current system. One are the workers in the water utilities. These water utilities have, I think, something like 10 times the global average of workers per connection. And so they're featherbedding. You know, there are a lot of people there.

There are also contractors who get sweetheart deals to maintain the waterworks. None of them want the private sector to come in.

And the trouble is that the middle class, or the upper middle classes, all have their own bore wells and things like that, and so they're opted out of the system. So they actually have no political stake in this water reform, either. And it's the poor who, unfortunately, don't have much of a voice in this who are excluded.

MR. BOSWORTH: Yes -- back there in the blue shirt.

MR. LUNCET: Thank you. Jeff Luncet from American University.

Can you comment on what effect the startling growth rates in India are going to have on its neighbors -- Sri Lanka, Nepal, Bangladesh? Maybe Pakistan is a special case because of the political issues.

Is India going to be the locomotive that pulls them along? Or are they going to get left behind and perhaps crushed by this?

MR. PANAGARIYA: No, I mean, first of all, of course, for the smaller countries, it should be the world economy that ought to be the locomotive. So, you know, it should be open to the world economy as a whole.

But, having a neighbor grow rapidly, it helps. I mean, I say this also in the context of, you know, if Bihar and Orissa are growing more slowly, when they look -- you know, when they look at China or Korea, they think, “Ah, these are different. These are Chinese, very different people than us. You know, we can’t do what they did.”

But, you know, when you see Tamil Nadu growing, when you see Karnataka growing you say, “It’s the same stock of people. If they can do it, we can do it.”

And some of that is happening, clearly, I mean, in Bihar and Orissa also. There is a huge amount of reform going on currently, actually, because the political realization that we are falling behind, so we’ve got to do something.

Similarly, I think, you know, it does help -- you know, ultimately, South Asians are the same stock of people and so, if India grows rapidly it should help. Now, Bangladesh is doing, actually, quite well -- maybe not as -- maybe it hasn’t reached 8 or 9 percent, but it certainly could.

Then you’ve got Nepal, Pakistan and Sri Lanka, each of which actually has a major political problem out there to solve. In Nepal maybe it will finally settle down and begin to move forward. But in Pakistan and Sri Lanka, we still have -- Shanta is from Sri Lanka, so he can speak to that perhaps.

But certainly -- and, by the way, you know with India opening up and growing rapidly, certainly the integration between these economies have improved, has gone up dramatically actually. The picture of, you know, what proportion of trade of Sri Lanka or of Bangladesh is accounted for by India is five, six, seven times larger today than it was in the early 1990s.

MR. DEVARAJAN: But I would just add that despite what Arvind just said, South Asia is the least integrated region in the world. Intra-South Asian trade is lower than intra-African trade, intra-East Asian trade and intra-Latin American trade. So we can't expect great things coming out of the trade locomotive.

But I think the big effect is what Arvind was saying, which is the neighborhood effect, the sort of peer pressure, if you like.

And it's not surprising that all of these countries liberalized about, more or less, at the same time, and all of them have actually had an acceleration of their growth. As he said, not 8 percent, but, you know, Bangladesh and Pakistan and Sri Lanka are between 6 and 7 percent.

MR. BOSWORTH: Yes -- in the purple, there.

SPEAKER: I have a political question for the speakers.

When you say that you're talking to the government, could you like differentiate between the BJP government and the Congress? Because both like to say that they were the ones who initiated the reforms.

So could you say who actually is more effective as a government? And could you also give some particular examples about what recommendations you made and which were not taken, by both the governments?

MR. PANAGARIYA: I have a political economy section in the introductory chapter of the book where basically I take the view -- I mean, you know, there are political economy models out there which are useful, as well.

But one thing that is under emphasized -- and I regard it as being very important, actually, in the Indian parliamentary democracy -- is who is at the top. We know what the person at the top, meaning the top leader now, in the current government is Dr. Manmohan Singh, or is it Mrs. Sonia Gandhi. We can argue about that, right?

But whoever is the decision-maker is very important.

Now, I can see both, on the Congress side, as well as the BJP side -- and I give lots of examples, actually, in the book -- when leadership at the top came along -- so, Narasimha Rao in 1991 came at the helm. And he decided that, you know, the house needed to be set in order. And bang, bang, bang, you know, some of the major reforms got done during that period.

Then I think we had a bit of a lull for four or five years. Some movement happened. You know, it's not like -- you know, some movement and reforms was always happening, but still slowed down, because you ended up with a lot of these very unstable coalition governments, which were supported by a very large chunk of outsiders -- the Congress Party, actually, when (inaudible) was ruling, Deve Gowda was the prime minister.

But then came along Vajpayee, in 1998 initially. That government survived only for a year. But then he got a full mandate for five years, so a total of six years of Vajpayee years. And those years were of enormous, enormous amounts of policy changes. Large magnitudes.

You know, without the reforms in telecommunications, for example, there would be no telecommunications revolution in India today. There's no question. I mean, there is a whole -- there's about half of Chapter 16 devoted to that.

So -- and you can go at macro, you can go at the building of infrastructure. So that period actually was a period of what I'd call mega reforms.

So you've got both of these.

But then came the present government, which actually interpreted its own victory and BJP's defeat as some sort of verdict by the people that these reforms and the economic growth had not helped the poor and that, you know, the rural folks had been left behind -- which is completely wrong actually. I mean, if you do systematic analysis, the election outcome had really nothing to do with that actually. It was antiincumbency all the way which -- at the state level -- that gave that outcome.

And even then, actually, you know, neither BJP nor Congress actually won big. You know, if you look at the popular vote each of them got probably something like 25, 26 percent of the popular vote. So it wasn't that.

Moreover, if you look at, you know, what was -- it was the DMK, which moved from out of the NDA into UPA. NDA was Vajpayee's coalition, and UPA is the current coalition of Manmohan Singh. That brought in about 15 or 16 votes from that side to this side. That's a difference of 32. And that was the balancing voice.

So, election outcome, to think that that implied somehow that because the NDA got voted out, somehow that was actually a verdict against the reforms' having helped the poor was completely misreading. But that's how the UPA government actually decided to read it.

And then it said that -- oh, so we've got to actually slow down. So the whole process actually slowed down. Very little has happened now.

You wouldn't have predicted that, right? I mean, everybody who was around actually -- I mean, I remember (inaudible) was at the end of his tenure here at the International Monetary Fund, and he was telling me that, "Oh, Manmohan Singh, Prime Minister, look for mega reforms."

So, you know, everybody was actually very hopeful that big reforms will happen. It didn't happen.

And here, again, you know, the top leadership, Mrs. Sonia Gandhi basically subscribes to the view that somehow the reforms have not helped the poor. And, as a result, she is not ready for reform. And she is the one, I think, that is calling the shots.

MR. BOSWORTH: Let's try over here.

SPEAKER: Thank you.

My question is actually following what you've said, it's sort of related to the political system.

Some people say that if you compare India to China, the level of reform, the level of development in infrastructure and stuff, are different because the Chinese government don't have the democracy in China, so it can do whatever it wants to. But in India, if you elect somewhere, you conduct a reform, somebody is going to go against you and you always have to think to go back and say, you know, how I'm going to react to those people who voted for me and disagree with me in the reform policy.

Would you say -- would you agree with this? Or would you say that the democracy in India actually is benefiting the development?

MR. PANAGARIYA: I mean, it's certainly harder. It's certainly harder in a democracy to get things done. So even when the government wants to do, it has a harder road to travel. You know, the telecommunications reform, again, was a good example of it, that clearly the government was determined, and eventually it carried it through. But the road was much tougher.

If it was China and they wanted to do it I think, you know, it would be like that. Because there is a government which is not accountable to the people at large, not in a democratic sense, anyway. So it's easier.

Also, I mean, I also believe that Chinese government is better at organizing things than the Indian governments are, generally speaking. But that is not related to democracy versus authoritarian regime. But somehow, you know, they are better managers.

So, certainly -- I mean, it is true that the road is a bit harder. But, On the other hand, I mean on the optimistic side, I would say that, you know, India is a democracy. It is a very stable democracy. It's 60 years of experience. It's there.

China has to come through that somehow. It has to exert the authoritarian regime and exit into democracy. How is that going to play out. I mean, in the end, you know, is it going -- like Korea did kind of come out of authoritarian regime into democratic regime in a smooth way, but can that happen in China? The conditions are very different. I mean, the kind of authoritarian regime China has is quite different. So that is a big question mark, you know.

So for India, in a way, the road ahead is smoother than for China in some ways.

MR. BOSWORTH: Yes, in the back.

SPEAKER: Hi. I have a question about sustainability.

You've talked a lot about the possibility of India adopting China-style manufacturing-based growth, or labor-intensive growth. So far, it looks like China's managed to grow without that sort of industry.

Does India need to develop that sort of manufacturing industry in order to sustain these levels of growth? Or can it continue to grow, based on this capital-intensive industry that it's been growing with so far?

MR. DEVARAJAN: Well, I think India needs to develop some industries that will employ its labor force of 500 million. That's the big issue.

There are going to be limits, as I think Arvind was mentioning earlier, with the service sector being the driver of growth, because the wages are going to start rising very fast -- they already are rising -- and it can suddenly become uncompetitive. It's what they call the "Bangalore bug," sort of the equivalent of the "Dutch disease" in India.

So there's no question that there has to be some way in which the labor-intensive and low-skilled labor-intensive industries have to come up. I don't think this has to sort of completely duplicate the Chinese model. There could be lots of different ways of doing it. But it certainly has to be something in the manufacturing area.

MR. PANAGARIYA: And I think your specific question -- I think current growth can be sustained the way it is going, but if the labor-intensive manufacturing really joins in, I think it can accelerate to 12 percent.

MR. BOSWORTH: Right over here.

MS. CORMIER: Hi, I'm Michelle Cormier from Georgetown University.

And my question is, how much of India's success can be replicated in other regions? And I'm thinking specifically of Africa. You've mentioned the entrepreneurial, the strength of the entrepreneurial spirit in India. And some have argued that, you know, that they've caught a unique wave in global trends, and that can account for the success.

And so my question is: can we take some of the lessons from India and replicate those in other regions?

Thanks.

MR. PANAGARIYA: My take is, actually -- and there is a perfect example of the proposition that policies matter, and I believe that it can be replicated.

You know, a lot of the times we say that, oh the IMF and the World Bank in the 1980s promoted these policies and, you know, they were a complete failure and so forth.

Now, one thing also that comes through, at least from my reading of the Indian experience, is that there has to be local ownership of these things. This has to be driven internally. The country has to -- because otherwise it's not going to sustain. You know, if the Bank and the Fund give a loan and get some policy changes, they will be reversed, or they will not even be implemented actually in spirit. They might implement them in letter, but they'll not do it spirit.

So internal ownership, of course, internal driving of the policy changes is extremely important -- even if it's slower. But if there is internal determination. I mean, in the Indian case I said that's not -- you know, currently there is a slowdown in the reforms. But still there is complete consensus that, you know, you don't want to reverse this back. You don't want to bring licensing back. Everybody understands that, you know, the government is not going to reverse in any serious way what has been done.

So, very, very important.

And then there is some -- you know, political stability is very important. In a lot of the cases in Africa there was war going on, there was strife going on. With that, you know, no economic policies are really going to be particularly -- make a big difference. I mean, you can get some basic gains from trade and so forth even in those situations but, beyond that, in terms of triggering growth and sustaining it, it's much harder. Much harder. I mean, not that it cannot be done. I mean, after all, Sri Lanka has done it, and Pakistan has done it.

But I think, you know, the Indian example in this respect should give everybody hope that, when India had these bad policies actually, it did grow at the so-called "Hindu rate of growth," and very little poverty reduction. And then in a matter of 20 years, you know, things were transformed because the policies changed.

MR. DEVARAJAN: Yes, well let me add one thing to that, too, as well.

It seems to me that the search for applications from one country to other countries just hasn't worked very well. I think more India is a good example of we learn: every country has to design it's own economic -- they're all different. What China does is not what India does.

I think the differences -- I think in Africa the overwhelming problem is these tribal situations that just seem to destroy countries, like they're now happening in Kenya. I think it's hard.

If it's raw materials based, for example, Africa's done very well in the last decades.

MR. PANAGARIYA: Well, I mean, I'd say that there is some commonality, though. I mean, you know, for a small country is (inaudible) is not going to help. Giving entrepreneurs the ability to operate, to take advantage of the incentives, I think that is important.

And I'm reminded, countries in Africa are beginning to do -- some of the countries are beginning to do well. You've got Senegal, you've got Kenya, which -- I mean, currently our vision is colored by the conflict that's going on. But Kenya, if you take the last our or five year period, you know, it's been doing well. You've got Tanzania, which is doing well.

MR. DEVARAJAN: Ghana.

MR. PANAGARIYA: And Ghana, which is back on track.

So, you've got successes happening there also. And I'm kind of hopeful, personally. And partly my hope comes from the fact that if India can turn it around other countries should be able to do it also.

I mean, there's a limit of local -- which is where I think -- local ownership is important, because they are the guys who would know where the bottlenecks are. They are the guys, you know, who respond to the pressures from entrepreneurs. But I still do think that there is a commonality of policies that is helpful.

MR. DEVARAJAN: Also, I mean, there are some negative lessons that can be transferred. Because the other feature about India is that the strong arm of the government is still quite strong, and it's quite pervasive.

But you take other countries, where it isn't so strong -- and I think Bangladesh would be an example -- where many of these grassroots-type movements can actually emerge much more successfully than they have in India.

Take micro-finance. Micro-finance has taken off in Bangladesh, but it hasn't taken off in India. And you know part of the reason is that the Reserve Bank of India has set a whole set of regulations regulating micro-finance, just as soon as it started growing.

Similarly, with girls' education. Girls' education is much more successful in Bangladesh than in India. Well, it's actually 98 percent provided by the private sector in Bangladesh. In India, it's about 50, 60 percent public sector.

MR. BOSWORTH: Yes, ma'am.

MS. CHANDRA: Hi. I'm Sho Chandra from Bloomberg News. Two questions.

In a perfect world, yes, there would be labor reforms, and everything would be fine. But given the fact that this is a lame-duck government -- we've got elections coming up in India next year -- how hopeful are you that the next government would maybe speed up reforms, or take up some of the trickier parts, like labor market reforms?

And if that doesn't happen -- which is a good chance it won't -- how serious a risk to growth would it pose if we kind of keep reform going at the sluggish pace that they are now? At what point, or how many years out, before it becomes the situation that India cannot afford to, you know, go further without really taking some drastic steps?

And on a more short-term basis, what do you think is likely to be the impact of a slowdown in the U.S. Some people are saying we're already in a recession here. Given that India is a more open economy now, in the next year or two years, what kind of a knock-on effect would we have?

Thank you.

MR. DEVARAJAN: I can take the last one, if you want, because I have an answer. No -- because we've done some, we've looked into that a little bit, on the impact of a slowdown in the U.S. on India.

And you're absolutely right, India is much more integrated, say, than it was during the East Asian financial crisis of the mid-1990s, but yet the actual transmission is still fairly week. Because, you know, the U.S. is no longer India's largest trading partner, among other things.

So, over time, India itself has been diversifying its sources of trade, it's export markets and so on. And I think there have been a series of models done to simulate it, and I think the extreme version was something like a 1 percent decline in U.S. growth would lead to .2 percent impact on Indian growth.

So even if, you know, the U.S. has a mega recession of, say, 5 percent decline in growth -- that would be a disaster here -- that would at most do a 1 percent decline, off of a base of 8 percent.

So I think it's a relatively mild effect.

MR. PANAGARIYA: On your other one, labor market reform -- there are various ways to do it. I mean, you don't have to do the wholesale thing. There are gradual ways to do it. I mean, one way to do it is simply that for any new workers that get hired, or for any new firms that come into existence -- I mean, you could restrict that reform to the new firms that come into existence -- all right? -- which is less contentious, could be less contentious. You could separate out -- I mean, I don't like it. I'd rather have it clean. But given that clean reform is not available.

Likewise, you could take out some of the labor-intensive sectors and change the rules of the game in those labor-intensive sectors. That's another way to do it.

So, there are ways to do it.

Now, suppose it doesn't -- I mean, what are the prospects? If the present government comes back, I don't know. It really is a part of its agreement, I think, with the other coalitions partners. So maybe it will not happen, actually, which will be very sad.

If a different government comes into power I would be more hopeful.

But, you know, again, these are unpredictable things. Sometimes the governments really change their minds and things may happen.

Now, in the long term, is there a big danger out there from it? It's not. But I think, you know, you would reduce poverty much more slowly than you could. And that, I think, is the main danger. And the growth rate can accelerate to 11, 12 percent if you do the labor market reform -- I think. This is my view. It's not the consensus view, by any means, you know.

And so acceleration will not happen and, particularly, poverty reduction will be much slower. Because what would then happen is, again, you know, mainly the poverty reduction will have to go through the current, what I think is coming through from a lot of spending. You know, when one automobile comes on the market there is a driver which has to be hired, so you create a job for the driver. There has to be a mechanic that has to kind of service it. You've got the gas stations that have to be there. So it generates that kind of employment, services kind of employment.

And that's how it will continue to happen, which is a lot slower than if you could actually kick-off manufacturing.

MR. BOSWORTH: Let's take the last question right down here.

SPEAKER: Thank you. My name is (inaudible). I'm from the Dutch Embassy.

My question is, would you expect that, due to the high prices and demand of oil in the coming years, general economic growth of India will slow down?

MR. DEVARAJAN: Yes, well, there's been -- I mean, the forecasts, including the government's own forecasts, are for a slight deceleration, I think by about .2 or .3 percent of 1 percent.

But I think the real problem, or the real issue with oil prices is not simply the increase in oil prices, but how the government adjusts to it. Because there are two options, basically. You can either insulate the domestic economy from that increase in oil prices, which means you subsidize oil. Or you pass it on to consumers.

And this again comes back to the politics, because you could have riots in the streets and so on.

So far the government has shown an ability to actually pass on a significant part of the increase sin oil prices. And I think they might resist, given that it's an election year coming up in the next 12 months, but as long as they can manage that fiscally, I don't think the impact's going to be very serious.

MR. PANAGARIYA: I think I would agree with that.

You know, you have to also take into account that some good things may also happen. I mean, if oil prices go up, you know, maybe Chinese demand for Indian iron ore would rise or something -- you know, things that you don't anticipate.

So, on the good side —

MR. BOSWORTH: Remittances from the Middle East go up.

MR. PANAGARIYA: Remittances, yes.

MR. BOSWORTH: Well, thank you very much.

I think it's clear that there's a lot of interest and a lot of questions about India.

I think that's enough. Why don't we take a break.

Thank you very much.

(Applause)

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