DOLLAR & SENSE: THE BROOKINGS TRADE PODCAST

"WHY GLOBALIZATION IS SHIFTING IN FAVOR OF INDIA, NOT CHINA"

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Guest:

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Episode Summary:

Arvind Subramanian, senior fellow at Brown University's Watson Institute and Center for Contemporary South Asia, and former chief economic advisor to the Government of India, talks with host David Dollar about a range of trade and foreign relations issues India faces. In particular, he explains why globalization is shifting in India's favor rather than China's, how India views trade relations with China, Russia, and the West, and prospects for continued good relations with the United States, especially as India takes a more neutral stance on Russia's war against Ukraine.

DOLLAR: Hi, I'm David Dollar, host of the Brookings trade podcast Dollar and Sense. Today, my guest is Arvind Subramanian, a senior fellow at Brown University's Watson Institute for International and Public Affairs. Arvind was the chief economic adviser to the Government of India from 2014 to 2018, and he's a leading expert on development and growth. He has a recent presentation with the provocative title "China and India: Prospects for Convergence." Our podcast page links to the YouTube version of that, but I want to mention that the Brookings Podcast Network has a new show that you might like called Vying for Talent, about the U.S.-China competition for human talent.

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RYAN HASS: Hi, I'm Ryan Hass with the Brookings Institution.

JUDE BLANCHETTE: And I'm Jude Blanchette with the Center for Strategic and International Studies. We're the co-hosts of "Vying for Talent," a podcast examining the role that human talent plays in competition between the United States and China.

HASS: Both the United States and China are vying to demonstrate which governance and economic system is best able to deliver results in the 21st century. Much of this competition hinges on economic performance, which is driven by innovation, which is being pushed forward by talented individuals in both countries.

BLANCHETTE: "Vying for Talent," puts faces and stories to the sprawling competition underway between the United States and China. Through this podcast series, we're using stories to shine a light on what more the United States can do to improve its edge for the future.

HASS: "Vying for Talent" is produced by The Brookings Podcast Network and distributed by both Brookings and the Center for Strategic and International Studies. 3 You can download and listen to it on Apple, Spotify, or wherever you like to get your podcasts. Learn more at Brookings dot Edu slash Vying For Talent.

DOLLAR: So welcome to the show, Arvind.

SUBRAMANIAN: David, thanks for having me.

DOLLAR: So let's start with your basic thesis that obviously China has been converging on the U.S., the technology leader, faster than India. But do you think that that may now shift? Prospects are improving for India and will be less favorable for China. So, so what's the main argument there?

SUBRAMANIAN: Part of the main argument is convergence, the dynamic of convergence itself, right. China has been doing so well for such a long time that it's kind of closer to the frontier than India. Let's say China is roughly about one-third the per capita GDP of the United States. India is kind of probably, you know, 11 or 12 percent of that. So it's just the fact that China has done so much better for so much longer by definition means that it's going to slow down because, you know, as you get closer to the frontier, your wages rise, capital is not as productive, and unless you make certain shifts, there's a natural tendency for the economy to not stop converging, but certainly to converge at a slower rate.

India, way behind, still way behind. It's kind of, you know, as Gerschenkron put it very well, the advantages of backwardness, you know, still applies. And so it's further behind.

I think the key new argument I think we make in this presentation you referred to—Josh Feldman and I—is, I think the globalization opportunities are shifting in favor of India and away from China. That's, I think the key new post-global financial crisis, post-COVID, post-Russian invasion of Ukraine, I think that dynamic has shifted in India's favor. So in a sense, it's not that India is going to do better. It's not a prediction about what will happen. It's just the kind of assessment about the opportunity sets, especially related to globalization that, may be shifting in India's favor.

DOLLAR: So let's look a little bit in more detail at some of the things that are shifting in India's favor. I did a little work on India for the World Bank 20 years ago, and one of the striking things was the very poor infrastructure in terms of roads, rail, ports, power supply reliability. You argue that there's been a pretty big jump forward in what you might call the hardware. And so what's happened there? What broke the logjam in the infrastructure area for India?

SUBRAMANIAN: I think this is one of the kind of underappreciated positive developments about India. And actually, it's not a recent phenomenon. I think it goes back to the late 1990s. The, uh, the government in power then headed by the same party as the current government in power, the BJP, the prime minister, Atal Bihari Vajpayee, they undertook a set of reforms. But I think that a major piece of reform apart from everything they did on the regulatory side was in fact to emphasize infrastructure. So what they did was they said, let's focus on rural connectivity and on linking the major cities via roads. So rural and broader road building was what they started. And that became a tremendous success because, you know, once you get rural connectivity, I think the gains are obvious.

Then a few years later, when the boom happened, and this is what I think is critical, in the early 2000s, we had this massive private sector involvement in creating infrastructure. The first, the late '90s, was still being done by the public sector. But in the 2000s, when the world economy boomed, and India boomed even more than the world economy, it led to this PPP kind of a framework where there was a lot of public sector bank financing, but of private infrastructure. And that led to a boom in, you know, roads, railways, ports, power, a lot of it being private sector led. And that has continued under this government. So I think there has been a shift in India in its ability to do things at scale and build infrastructure at scale. And that's kind of a a market development for the last 20, 25 years.

DOLLAR: So alongside this infrastructure improvement, you describe a deficiency in what you call the software that underpins the economy, meaning, you know, the institutions, the norms. Can you go a little bit into more detail? And what are the prospects for improving that software alongside the infrastructure improvements you just described?

SUBRAMANIAN: So, Josh Feldman and I have a piece in Foreign Affairs on India's stalled rise where we talk about this in greater detail. Essentially what has happened in the last few years, David, is that by software what we mean is what is the broader economic policy framework, the rules, the rule of law, the institutions? All these have been, I think, proven to be deficient and maybe even going backwards. Let me give you two or three examples, right.

One is just data—data quality, data integrity. India's GDP data, the COVID data, the unemployment data, the poverty data. They've all they're all under a cloud. And if you don't have good data for policymaking, it's always a problem. So it's kind of an essential ingredient.

The other is that is the kind of playing field level between foreign and domestic investors and also between among domestic investors is it level? And there are reasons to believe that they're not, you know? So some may be favored over others. And there's also a lot of instability in that—rules are enacted, regulations enacted, and then they're reversed because of pressure from some group or the other. So not only is the playing field, the rules and regulations, are they not always level—you know, because that's the certainty that private investment needs—they also change quite a bit. There's no real policy certainty or not as much as it ought to be.

Then of course there's the whole what you might call institutions, the independence of institutions, the regulatory institutions, the courts. Even the, you know, the statistical institutions. There's a sense that they are not as independent as they used to be. But then there's a, there's a specific kind of policy dimension to that, which is that India's kind of boom say between the '80s and certainly the '90s and the 2010s was based on opening up—as you know, India reversed its, you know, socialist *dirigiste* policy framework in 1991. It got 20, 25 years really gangbuster growth, which was actually powered by trade. And people don't realize this enough, India had the third fastest manufacturing export growth in the world over a twenty-five period after China and Vietnam.

That openness in the policy framework has being reversed in the last three, four years. Tariffs have gone up, there's kind of industrial policy, which is kind of picking winners and so on. And of course, India has also chosen to stay away from dynamic regional integration agreements, especially in Asia. So, so there's a kind of general inward tone which along with this policy framework, kind of software, deteriorating makes you pause and wonder whether these improvements in hardware can really be kind of parlayed into really rapid economic growth going forward.

DOLLAR: Arvind, I love your point about data. You know, one of my best experiences in the World Bank early in my work on Vietnam, we helped the government do a national representative household survey with a lot of information about household production—weighing the babies, getting information on nutrition, income inequality, et cetera. And the government, with a little bit of urging, they just put it out there. You know, it's used by researchers all over the world, and there's been a succession of these. So if you create good data and you put it out there, then all these researchers all over the world will be studying all kinds of things. And some of that is actually going to be policy relevant. It's going to come back, really give the government something useful.

SUBRAMANIAN: Yeah, but David, you know China much better than I do. But one of the things we didn't mention in the seminar was that the data integrity is not an Indian problem alone. China, as you know is, you know, whether it's its GDP or even its population, the two biggest countries in the world both need to, I think, make improvements in their data integrity and what they put out. Even as we speak, there are doubts about China's COVID data as as you know. So that's a, seems to be a broader issue that afflicts both India, not just India, but also China.

DOLLAR: Yeah, no, I totally agree with that, Arvind. China does some pretty careful household surveys, but they don't make the underlying data available to researchers.

SUBRAMANIAN: Exactly.

DOLLAR: Let's go a little bit more into the trade issues. You already touched on them a little bit. You were a little bit pessimistic there, but I took the tone of your presentation to be that India actually has improving trade opportunities because of various changes in the world, whereas China faces various headwinds. So what, where are India's advantages there?

SUBRAMANIAN: So, let me begin with China's disadvantages and then segue into India's advantages. Remember, I think the world has seen three globalization shocks in the last, I would say, 10 years. One was the global financial crisis after which, as you know, trade-to-GDP around the world went down quite sharply because for whatever reason not fully understood—some say a big down[turn] of the global value chain, underinvestment, you know it's kind lots of hypotheses out there. But we know there has been de-globalization. That's the first kind of generalized shock.

But the second shock is actually more interesting, which is that COVID especially is kind of like an asymmetric shock between goods and services, right. I think COVID made globalization of goods more difficult because, you know, producing close together, et cetera, whereas, you know, activities at a distance got a premium. And so globalization in services was almost positively affected. So if you look at the global data on trade-to-GDP, trade-to-GDP in goods has been declining, but in services it has been kind of steadily rising.

And the third, of course, is now what one could call the post-Russian invasion shock, which one interpretation of that would be that it's going to affect autocracies, investors consider kind of problematic going forward that, you know they would be kind of asymmetrically affected and would want to asymmetrically de-globalize.

So if you look at these shocks—the generalized shock, the asymmetric shock in favor of services, the asymmetric shock against autocracies and illiberal places—they're all these are going to adversely affect China, but positive shocks for India. Take services, for example. Going forward, Chinese exports of services as a share of GDP is way below India's, you know. You don't have a English-speaking population, they've not been the back office to the world that India has been. So going forward, that's a kind of opportunity for India in services.

Second, I think even what is happening after the Russian invasion of Ukraine, you could argue that it's an opportunity for places like India, because if you think capital is going to more rapidly exit China, Russia, such a difficult place in the world, and they will need destinations for that investment, you know, low-cost destinations, potentially India should be one of those locations. Now, whether India can actually get its act together to attract this, become part of value chains, become part of the, you know, Asian economic framework, that's a question that's up to India, but at least the opportunities open up.

DOLLAR: That's interesting that you mention that India's manufactured exports had actually grown quite rapidly, just behind Vietnam and China over a twenty-five year period. But still, I take from your presentation that India's share of world manufacturing exports is very low. So, I want to ask you about India dropping out of the Regional Comprehensive Economic Partnership, the RCEP agreement among ASEAN and other major economies in

Asia. India was part of the negotiations for a long time, but then dropped out. Is this going to put them at a disadvantage? Because RCEP does seem conducive to value chains, and now India is not part of that.

SUBRAMANIAN: I'm glad you asked this question because India's share of global manufacturing exports is less than two percent. And China's is close to 18, 19 percent, let's say. Now, that, too, is in some ways an opportunity for India than China because if you're very big, and if you think you can, you know, become bigger, you're going to run up against political problems in in partner countries, you know, because just the political carrying capacity for globalization, for the world as a whole, that appetite is diminished after the last 10 years. So China is going to run up against those constraints by virtue of being big. India, by virtue of being relatively small, is going to be less prone to that. So the opportunities are greater for India.

And the other thing to mention about that global market share and India's rapid exports is that while India did well in terms of manufacturing, it did not do that well in terms of low-skilled manufacturing. It's all very much higher higher skilled manufacturing, exports consistent with India's performance on services as well. So both in goods and services, it is kind of the high skilled stuff that ended up doing well, that's why the structural transformation you saw in China, which kind of relies on providing good high-paying manufacturing jobs to unskilled labor, that's not happened remotely as much in India.

Coming to RCEP, you see not being part of RCEP has two disadvantages. One is the value chain, i.e. that, you know, you can't get cheapest inputs, you can't get cheap inputs and therefore, you know, your competitiveness declines. So that's on the productivity and the cost side. The other, of course, is that you're kind of competed out on the demand side because you face a preferential disadvantage. You face, your exports face higher tariffs going in. So that's going to make investors less reluctant to see India as the haven when they are fleeing China. In the context of, you know, China kind of becoming less competitive, investors becoming a more wary about China, that opportunity gets blunted because you're not part of these dynamic agreements. And that's, I think, the big cost of not being part of RCEP and things.

Now, there was a kind of, or there is perhaps even now, trying to see what the logic of staying out was. I think there was both a kind of political and an economic logic. I mean, logic within quotes, you know, depends upon, I'm just trying to understand this. The political logic was, you know, India and China have all these border issues. I think domestically to be part of a free trade agreement with a kind of, someone you're having conflict with on the borders was a bit problematic. I think the other reason is that joining RCEP is de facto for India entering into a free trade agreement with China. So, you know, if you don't have the confidence and domestic industry doesn't have the confidence that you can compete with China, that also, I think, was part of the thinking behind why India opted to stay out. But I think going forward the costs might be substantial.

DOLLAR: I think there's an interesting parallelism that India is not in RCEP and I don't think ever showed any interest in the Trans-Pacific Partnership. The U.S. has dropped out of the Trans-Pacific Partnership before it was implemented, and the U.S. has not made any effort to join RCEP. So these two enormous economies, India and the United States, are both outside of these emerging trade agreements in Asia. Meanwhile, the U.S. administration is pushing this so-called "economic framework" for the Indo-Pacific. So I'd like to get your views on that. India is seen as potentially a key strategic ally for Washington. I don't quite know what's going to be in this economic framework, but do you think it can operate like a trade agreement and really promote trade between India and the United States? Or is it more of a sideshow?

SUBRAMANIAN: First, just to put one new fact on the table, which is in the last, literally in the last one month, India has concluded two free trade agreements, one with Australia, interestingly enough, and one with the United Arab Emirates. I mean, that's kind of, leave that aside. But the Australia one is potentially interesting because the Quad comprises, as you know, India, Australia, Japan, and the U.S. So, I still think the strategic side is the one that's more important because even between India and the United States, you know, the strategic partnership actually in the last few years has been solid and been strengthened quite substantially, you know—joint exercises, whatever all these things that are happening and a lot which we don't even know about.

But the India-U.S. trade relationship has always been much more tricky. It's partly because if you decide to turn inward as India has, then it's not easy to say, you know, I'm going to turn inward domestically, but then I'm going to, you know, have free trade agreements, et cetera, et cetera. So while I think it potentially has some scope, but for it to become meaningful going forward, I think India will have to, you know, has to start believing in being more open as a way of exploiting its convergence prospects, as it were.

Let's be fair as well. I think the reason why the U.S. pulled out of TPP is just that the domestic politics now are just not at all in favor of greater international engagement on the trade side. So the U.S., too, is kind of hobbled by domestic politics. So, so that's why I think that as people have said more broadly, the U.S. ability to reengage with the world in the aftermath of all that's happening has been hobbled and stymied by the fact that it cannot be as open and engaged on the trade side like it could in the past. So it's kind of going into this diplomacy game with one hand behind its, tied behind its back. And that's going to affect the India-U.S relationship as well, because both India is turning inward, has turned inward, U.S. is hobbled. So the prospects for having kind of smooth trade relations that can, you know, really be not seen as zero-sum, positive, win-win, that dynamic, I feel, is kind of going to be difficult to achieve.

DOLLAR: Arvind, I would just add to that that while China has joined RCEP and has applied to join Trans-Pacific Partnership, China has also turned inward on many different policies, and China has its own politics. They're different and complicated than American or Indian, but there are politics there. And you've got special interest groups that really don't do not want to open up certain parts of the economy.

SUBRAMANIAN: I mean, the interesting puzzle is that despite turning inward and despite all this domestic circulation, it's kind of turning inward quite sharply in many ways, right? And yet it's been in the forefront of saying not only will we join RCEP, we will join, you know, whatever the version of TPP that's now in place. So signing, it wants to sign agreements with Europe. So internationally, it seems to be no less enthusiastic about engaging despite the domestic politics, domestically turning inward on economic policy more broadly. So that, I think, is fascinating. The U.S. is at least being consistent. Domestic politics and international engagement are kind of in sync. India also, they're kind of in sync. But China, you know, there's kind of a cognitive dissonance between what it wants to do domestically and is engaging internationally not reluctantly but aggressively and proactively. And that's what's very interesting about China.

DOLLAR: Right, I agree, Arvind. So China can live with the contradiction. It's a Marxist state and it can live with the contradiction.

So, last question for you, Arvind. I want to come back to some current events. So you mentioned this emerging strategic partnership between India and the United States and then the Quad adding Australia, Japan. But is the Ukraine war, I mean a terrible humanitarian tragedy, of course, but looking at U.S.-India relations, is the Ukraine war going to be a problem given India's pretty close relationship with Russia and it's somewhat neutral position on the war?

SUBRAMANIAN: I think, David, if you look at the recent, there was a recent meeting between President Biden and Prime Minister Modi just a few days ago. The terrific scholar you have at Brookings, Tanvi Madan, I think her read on this is actually spot on, which is that, you know, the two countries now have a fairly mature and long-term perspective on the relationship, which is broadly in sync. This is about how do we deal with the rise of China, an aggressive China? That's the long game. We have a lot in common, therefore, strategically. And therefore, much as the U.S. would like India to do a bit more on the Russia thing, there's a sense in which a recognition that India is also constrained because of its dependance on Russia for arms and things. So, I see from what Tanvi Madan has been saying that this is a relationship that will kind of ride out these kind of blips and that it's on quite solid footing because of, I think, a broader alignment of strategic interests in the long run. Of course, I mean, nothing is a given. I mean, things could happen in both countries that could render all this a little bit moot. But I think for the moment one should not be unduly concerned about the India-U.S. relationship.

DOLLAR: I'm David Dollar, and I've been talking to Arvind Subramanian about convergence prospects for India and China, how things are in some sense turning against China. India has got lots of opportunities, but it's got some homework in order to seize those opportunities. So thank you very much, Arvind, for explaining all that to us.

SUBRAMANIAN: Thanks, David, for having me. A great pleasure to be with you.

DOLLAR: I'm David Dollar, and I've been talking to my colleague, Samantha Gross, about the energy situation, it's very complicated and actually quite interesting for economists. We're trying to get Russia to cut back its exports as a way of penalizing them, but we actually don't want that to go to zero immediately. That's going to be a big shock to the world economy.

So I think we can assume there's going to be a lot of uncertainty in energy markets for the next year, perhaps longer. So, thank you to Samantha for walking us through this and helping us understand what's happening in global energy markets.

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Until next time, I’m David Dollar and this has been Dollar and Sense.