The Indian dream

By Ishrat Husain

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DURING a recent visit to Mumbai and New Delhi I attended two major conferences on India's economy. A report, commissioned by the Asian Development Bank,

India 2039: An affluent society in one generation, formed the basis of the Mumbai discussion.

The focus of the report was on how India would be able to make the transition from a low-income country to an affluent society within a generation if it was able to maintain and accelerate an annual average growth rate of 9.5 per cent over the next 30 years.

According to the report's projections the Indian economy would increase by a factor of 19 to reach $20tr from the current $1tr with a per-capita income rising from $1,000 to $16,000 by 2039.

India has consistently stepped up its growth path over the last six decades. In the first 30 years of its independence it was stuck at the 'Hindu rate of growth' of 3.5 per cent followed by an increase to 5.5 per cent in the next two decades. In the most recent period, 2003-07, growth accelerated to 8.5 per cent a year. Given this track record it was argued that the probability of achieving the 9.5 per cent target was feasible.

The question that was debated most intensely was: what could be done to reach this target? The report's optimism is premised on three factors. First, India is set to reap a demographic dividend as the ratio of the working-age population to the total population is on the upswing. As the population becomes more urban, rich and educated and more women join the labour force, participation rates are likely to rise. Evidence of the rising participation of women in the labour force was apparent during a visit to the CNBC studios in Mumbai. Out of 200 professionals working on the floor more than 80 per cent were young women in their early or mid-20s.

Second, the emergence of a large and strong middle class will provide the source of domestic demand, especially for consumer durables — cars, motorcycles, televisions, air conditioners, mobile phones and refrigerators. The middle class will also demand housing, shopping malls, infrastructure and services. Mortgage penetration in India is only six per cent compared to 15 per cent in the US. And the middle class saves for retirement, housing and children's education providing the resources for fixed capital formation, especially as the trend of two-income families catches on.

Third, savings and investment ratios in India have undergone a drastic upward movement in recent years and are catching up with those of China. Up to the 1980s, the domestic savings rate was below 20 per cent and, hence, the investment rate was constrained. Between 1990 and 2002, the savings rate jumped to 25 per cent of GDP and after 2002 escalated to 35 per cent. This was a remarkable turnaround in less than two decades and provided ample space for domestically financed investment which rose to 34 per cent of GDP.

This upward trend will be sustained if economic growth moves to a higher trajectory. As foreign investment has also been pouring in it is quite conceivable to attain a 40 per cent investment rate. With an Incremental Capital Output ratio of four the postulated growth rate can be realised.

However, the achievement of this goal set in the report is not easy or preordained. Despite these positive factors there are

many other policy and institutional changes that have to be put in place during the next 30 years if India is to move along the projected path.

First, the regional, income, spatial and caste disparities must be tackled forcefully. Rapid economic growth of the kind envisaged is most likely to accentuate these inequities. In a multi-ethnic, pluralistic society, the threshold for tolerating inequities is quite low. Unless policy measures to promote social, economic, political and financial inclusion are implemented the imperatives of a vibrant democracy and electoral process can, in fact, derail the process of rapid growth.

National parties, in their efforts to preserve their political space in regions that are lagging behind would take action to dilute or halt the spread of forces generating growth impulses. Regional parties, to appease their constituencies, would stage a revolt against those policies. Inclusive growth may result in a trade-off with rapid growth.

Second, governance structure and processes in India are a big hindrance in the implementation of policies and programmes and the delivery of services to citizens. The devolution of administrative functions and associated financial resources to local levels where most of the interaction takes place between citizens and government is absolutely critical.

A change of attitude is required in its civil services. Technology and e-governance tools are also needed to establish transparency and accountability in the system. Judicial reforms providing timely relief to aggrieved citizens are critical for inclusive growth. Public-private partnerships and social entrepreneurship in the delivery of services can also prove more useful than the current government model.

Third, India’s human skills have to be harnessed and upgraded at an equally rapid pace to keep up with the demands of the economy. Contrary to popular belief there are only a few thousand graduates from world-class Indian institutions. The majority do not have readily acceptable employable skills. Hundreds of thousands have to be trained by their employers after being inducted. The literacy rate of 65 per cent along with the mediocre quality of higher education can prove a drag on the economy unless measures are taken to rectify both these weaknesses soon.

Lastly, it is widely recognised that unless India has peaceful, friendly and prosperous neighbours its ambitions to become a global economic power could be thwarted. As the biggest country in South Asia, it is in India’s self-interest to promote regional stability, expand cooperation in trade, investment, access to technology etc. and to remove irritants in relations with others, and be ready to resolve outstanding disputes. The arrogant and patronising attitude towards its neighbouring countries has to give way to more understanding and empathy.

India’s economic aspirations to become a rich country within a generation are ambitious. The challenges facing the country are multiple but peace with its neighbours and prosperity in these countries are essential to achieving this goal.

The writer is a former governor of the State Bank of Pakistan.