theirview

Wanted: productivity-fuelled growth

Too much focus on redistribution and too little on productivity led to lacklustre poverty alleviation efforts

Alok Sheel
is a civil servant. These are his personal views.

There appears to be growing euphoria that, having hit a demographic sweet spot, it is India's manifest destiny to be the fastest growing major economy, overtaking China, and become a major world power.

This euphoria is bolstered by four recent events. First, the high expectations riding on a muscular new dispensation in power in New Delhi, reflecting the growing impatience of a large aspirational middle class. Second, China's resolve to slow down by rebalancing its economy towards relying less on investment and exports and more on domestic demand for growth. Third, the Central Statistics Office's (CSO) startling revision of the gross domestic product (GDP) that is out of sync with almost every other near-term economic data. And fourth, the International Monetary Fund's (IMF's) cross-country growth projections in its latest *World Economic Outlook* of April.

This complacency is troubling. While China and India have indeed been the two fastest growing major economies in recent times, the underpinnings of high growth are quite different.

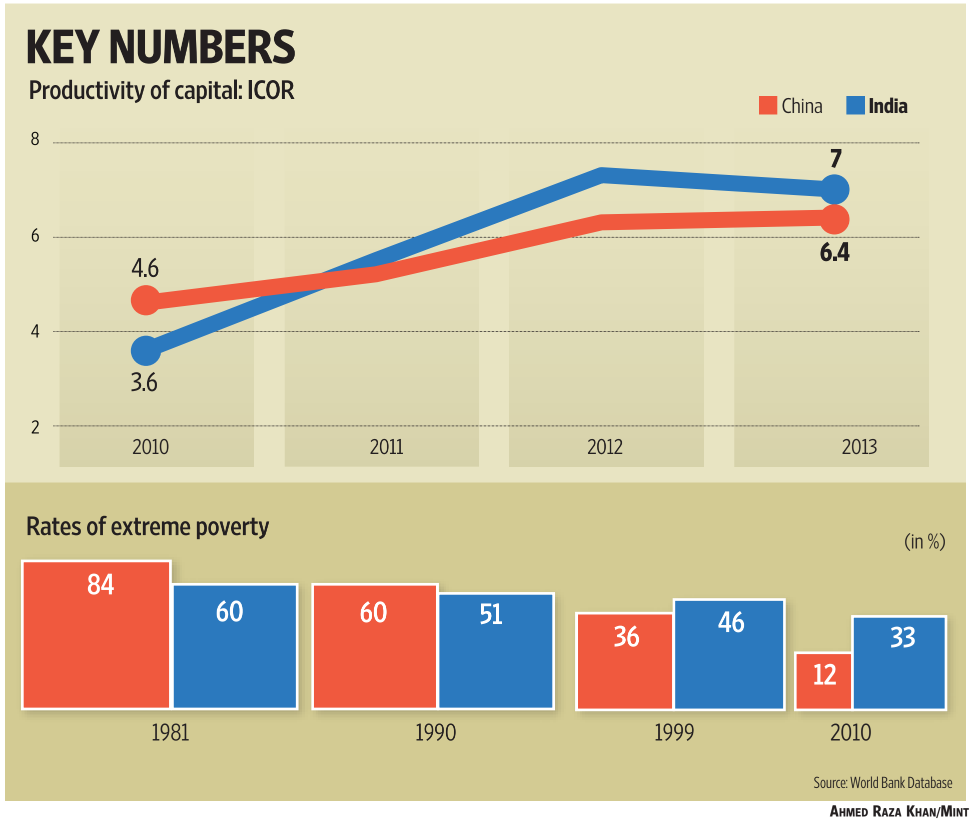
China's rapid growth is about reaping the productivity dividend from low productivity agriculturists pouring into what are virtually the manufactories of the world.

India's high growth, on the other hand, is about large additions to the labour force of small enterprises, including family-owned businesses, where productivity is relatively low. As a result, labour productivity has been about half that of China, even in agriculture. What is even more disturbing is that Conference Board data (using the old CSO GDP series) indicates that the gap has widened. Why is this the case? One can think of four obvious reasons. First, labour-intensive manufacturing in India continues to face daunting structural constraints. Second, large areas of India continue to be rain-fed. Third, while employment guarantee schemes may have shifted incomes in favour of labour, this was not accompanied by a matching growth in productivity. Fourth, growing infrastructural and governance bottlenecks have lowered both labour and capital productivity.

The productivity of capital (the incremental capital output ratio, or ICOR) in China was roughly similar. A significant gap has, however, opened up over the last few years. Being poor is all about low productivity. Measured by the Gini coefficient of income distribution, China is a more unequal society. Despite this, India has a far more modest record of poverty reduction, with more poor people than China, even though the latter is more populous. World Bank data indicates that among major regions, only sub-Saharan Africa has a worse track record, and that overall, even South Asia has fared better. India now has the dubious distinction of being home to the single biggest mass of the world's extremely poor. Such abysmal levels of productivity are not the trappings of a major global player.

How is India addressing the problem of low productivity growth? The Make in India initiative seeks to expand the scale and contribution of modern manufacturing. The government has also set up two high-level task forces on poverty and agriculture. Taken together with India's putative competitive advantage in services, this integrated quartet has the potential to propel India into a sustainable high-growth trajectory based on productivity growth and poverty alleviation.

We, however, need to be mindful of the long shadow that can fall between the idea and the reality. Similar initiatives in the past—most famously *garibi hatao*, sundry export and employment promotion schemes to promote domestic manufacturing, and even the Green Revolution—had rather modest outcomes relative to the scale of their ambitions. Will this time be different?



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Past initiatives towards poverty alleviation floundered because they focused too much on redistribution and inclusiveness, and, with the notable exception of the Green Revolution, too little on productivity growth. This balance needs to change. For this, the policy roadblocks, land and labour in particular, in the way of labour-intensive manufacturing need to be removed so that there is a large-scale movement of labour from low-productivity agriculture and petty production to high-productivity manufacturing and services. Agriculture itself needs to become more productive.

Low productivity thrives in closed markets. A virtuous cycle of productivity growth is closely linked to open markets. It is competition that drives economic agents to move up the productivity chain through technological upgradation, scale economies, and cost-effective management practices, such as just-in-time and production chains, through a process of creative destruction.

Productivity growth in China was accompanied by its accession to the World Trade Organization and reliance on international trade as its engine of growth. India, on the other hand, rather quixotically attempted to roll back the Industrial Revolution by insulating petty production from market forces through a system of reservations, limiting market access and high tariff and non-tariff barriers.

The bottom line is that its great potential notwithstanding, if India is to acquire a global role relative to its economic, geographic and demographic size, its economic growth needs to be underpinned by major productivity shifts and open markets.

Comments are welcome at theriview@livemint.com

otherviews

The vampires of Wall Street

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Last year the vampires of finance bought themselves a Congress. I know it's not nice to call them that, but I have my reasons, which I'll explain in a bit. For now, however, let's just note that these days Wall Street, which used to split its support between the parties, overwhelmingly favours the GOP. And the Republicans who came to power this year are returning the favour by trying to kill Dodd-Frank, the financial reform enacted in 2010.

And why must Dodd-Frank die? Because it's working.

This statement may surprise progressives who believe that nothing significant has been done to rein in runaway bankers. And it's true both that reform fell well short of what we really should have done and that it hasn't yielded obvious, measurable triumphs such as the gains in insurance thanks to Obamacare.

But Wall Street hates reform for a reason, and a closer look shows why.

For one thing, the Consumer Financial Protection Bureau—the brainchild of senator Elizabeth Warren—is, by all accounts, having a major chilling effect on abusive lending practices. And early indications are that enhanced regulation of financial derivatives—which played a major role in the 2008 crisis—is having similar effects, increasing transparency and reducing the profits of middlemen.

What about the problem of financial industry structure, sometimes oversimplified with the phrase "too big to fail"? There, too, Dodd-Frank seems to be yielding real results, in fact, more than many supporters expected.

As I've just suggested, too big to fail doesn't quite get at the problem here. What was really lethal was the interaction between size and complexity. Financial institutions had become chimeras: part bank, part hedge fund, part insurance company, and so on. This complexity let them evade regulation, yet be rescued from the consequences when their bets went bad. And bankers' ability to have it both ways helped set the US up for disaster.

Dodd-Frank addressed this problem by letting regulators subject systemically important financial institutions to extra regulation, and seize control of such institutions at times of crisis, as opposed to simply bailing them out. And it required that financial institutions in general put up more capital, reducing both their incentive to take excessive risks and the chance that risk-taking would lead to bankruptcy.

All of this seems to be working: shadow banking, which created bank-type risks while evading bank-type regulation, is in retreat. But the vampires are fighting back.

OK, why do I call them that? Not because they drain the economy of its lifeblood, although they do. What really makes the word apt in this context is that the enemies of reform can't withstand sunlight. Open defences of Wall Street's right to go back to its old ways are hard to find. When right-wing think tanks do try to claim that regulation is a bad thing that will hurt the economy, their hearts don't seem to be in it. What you mostly get, instead, is slavery-is-freedom claims that reform actually empowers the bad guys. The point is that almost nobody wants to be seen as a bought and paid-for servant of the financial industry, least of all those who really are exactly that.

And this in turn means that so far, at least, the vampires are getting a lot less than they expected for their money. Republicans would love to undo Dodd-Frank, but they are, rightly, afraid of the glare of publicity that defenders of reform such as Warren would shine on their efforts.

Does this mean that all is well on the financial front? Of course not. Dodd-Frank is much better than nothing, but far from being all we need. And the vampires are still lurking in their coffins, waiting to strike again. But things could be worse.

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