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The Indian Economy at a Crossroads

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Evolution of India’s Post-Independence Economy

1950s-1980s
- State control of “commanding heights” of the economy.
- Import substitution industrialization approach.
- “Small is beautiful” & “lump of labor” mentality.

1990s-2000s
- Greater embrace of economic and trade liberalization.
- Economy grew 40% faster per year next two decades.
But India Has Taken a Turn toward “Innovation Mercantilism”
- Turn toward Innovation Mercantilism a Result of:

1. Slowing economic growth.

![India GDP Growth, 2004-2014](chart)

Source: Trading Economics
Turn to Innovation Mercantilism a Result of:

1. Slowing economic growth.

2. Policies enacted by competitor nations (i.e. China).

3. Desire to bolster manufacturing sectors as primary response to persistent trade deficit and looming “demographic dividend.”
But IM Policies are Unsustainable and Non-Optimal

1. Raise the cost of key inputs and GPTs, including ICTs, while contributing to broad economic inefficiencies.

2. Damage countries participation in global value chains.

3. Cause reputational harm.

4. Perpetuate a contagion effect.

5. Usually fail to achieve their intended objectives.
Reformulating India’s Economic Strategy

1. Recognize centrality of across-the-board productivity growth to both economic and employment growth.
Indian Labor Productivity Growth Languishing

Average Annual Indian Labor Productivity Growth, 2005-2014

Source: The Conference Board
As Well as Relative Labor Productivity Levels

Labor Productivity as Percent U.S. Level, 2012

Source: The Conference Board
Reformulating India’s Economic Strategy

1. Recognize centrality of productivity growth to both economic and employment growth.

2. Embrace Say’s Law: If stable macroeconomic conditions exist, supply will create demand.

3. Acknowledge manufacturing won’t be an employment panacea; need strong contributions from services. ■ (Don’t favor ICT mfg. to detriment of ICT services)

4. Play an attraction, not a compulsion, strategy. ■ (Offer a superior environment for FDI)
Bolster Foreign Direct Investment

OECD Regulatory Restrictiveness Index Score

Average Annual FDI (net inflows, percent of GDP), 1996-2011

Source: OECD, World Bank Data
Reformulating India’s Economic Strategy

1. Recognize centrality of productivity growth to both economic and employment growth.

2. Embrace Say’s Law: If stable macroeconomic conditions exist, supply will create demand.

3. Manufacturing won’t be an employment panacea; need strong contributions from services. (Don’t favor ICT mfg. to detriment of ICT services)

4. Play an attraction, not a compulsion game.

5. Embrace the “Modern Economy Path.”
Modern Economy Path — Economic Growth Pyramid

- **Innovation and Productivity Policies**
  (e.g., R&D tax credits, support for regional clusters, ICT Policies to support e-government)

- **Key Factor Inputs**
  (e.g., robust physical and digital infrastructures, a skilled workforce, investment in knowledge creation)

- **Effective Tax, Trade and Investment Environment**
  (e.g., competitive tax policies, open trade and investment policies)

- **Key Framework Conditions**
  (e.g., rule of law, competitive markets, fluid labor markets, protection of intellectual property, culture of trust)
Feature Policy Recommendations

1. Appoint a National Productivity Commission.

2. Improve process of interagency communication and coordination in administrative and agency rulemaking.

3. Repeal the PMA and join ITA expansion negotiations.

4. Increase ease of business registration and operation.

5. Reform labor market regulations (e.g. Industrial Disputes Act).
Aspirational Vision for India’s Economy

1. Increase average annual labor productivity growth rate to 6 percent.

2. Grow real Indian per-capita GDP by 300% over coming decade, pushing per-capita income to @$5,000.

3. Become first-ranked developing country in World Bank’s *Ease of Doing Business Index*.

4. Run a balanced current account.

5. Successfully leverage the demographic dividend.
Thank You

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