Discussion of “Transforming India” by Arvind Panagariya

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Arvind Panagariya has a written an exhaustive review of the state of the Indian economy and its future prospects. As a good two-handed economist, Panagariya assures us that there is reason for optimism but much left to fret about. The rising importance of trade and foreign investment during a period of rupee stability underlie his optimism for continued strong economic growth. Panagariya views the absence of a more important manufacturing sector with associated employment in the organized sector as the fundamental roadblock to a more fundamental transformation of the Indian economy. That absence, in turn, is traced primarily to labor regulations and inadequate infrastructure. In short, Panagariya tells us “be happy and do worry.”

There are many reasons to be happy and to worry in India today but has Panagariya isolated the most important ones? The growth narrative that runs through Panagariya’s paper is one where manufacturing in the organized sector is required for “transformation” and long run growth. A comparison to the growth experience of Korea in the 1960s and China in the early 1990s is employed to make this point. This comparison may well be quite misleading due to the changing nature of manufacturing around the world. Using data from the World Bank it is hard to find a grouping of countries by income where manufacturing has grown over the last decade. Indeed, in various emerging markets, rising services shares of value-added are the norm over the last decade. Comparisons with South Korea’s experiences from the 1960’s may no longer be relevant in this regard. It is not clear what has happened to manufacturing and its measurement but it seems that it has not been critical to many growth success stories in the last decade.

Fetishizing manufacturing and the role of employment in the organized sector may be a particularly bad idea as such arguments can be used to motivate interventionist policies to spur manufacturing employment, not unlike the recent employment guarantee scheme. In fact, manufacturing is already enjoying a renaissance, as evidenced by sharply rising merchandise exports and strong investment levels. While it is not keeping pace with the continued red hot growth of services, it is not clear that this is an appropriate source of concern. Targeting growth rates by sector is an idea that we should likely leave behind.

An emphasis on the organized sector, manufacturing and the policies that appear to hinder such employment also obscures other concerns. The social infrastructure of public health and educational services and the fiscal demands of creating such an infrastructure are the critical challenges of the next several decades. Managing macroeconomic stability and inflationary pressures when the current account deficit, adjusted for private transfers, is at a level that approximates what it was in 1991 is perhaps the most daunting short run concern.[1] Understanding that remarkable levels of global liquidity and a benign global environment have contributed mightily to India's recent experience also suggests that bracing for a change in those conditions should be a primary concern.

There is much to be happy about and to worry about in India today. Labor regulations and the shortage of required infrastructure are surely hurting India and merit attention. The transformation narrative, however, may obscure other more worrying

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[1] Speech by Y. V. Reddy titled "Dynamics of Balance of Payments in India" available at http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?Id=319.

concerns and inspire the kinds of interventionist policies that India has most happily recently abandoned.