Expectations for the Further Development of the Indian Economy

By *Hatakeyama Noboru*

IN July 2005, the Chicago Council on Foreign Relations, the Pacific Council of International Policy and the Japan Economic Foundation (which I belong to) jointly held a three-day International Forum in Tokyo. The title of this forum was "The Rise of China and India and its Implications for Japan and the United States." The rise of China and India has been bringing many benefits both to Japan and the United States.

First of all, they have supplied inexpensive goods to the rest of the world, including Japan and the United States. Had it not been for those inexpensive goods having come directly or indirectly especially from China, the United States would not have been able to enjoy the economic prosperity of the 1990s. Thanks to those inexpensive goods, the US economy could grow without inflation. A similar situation applies to Japan and it will enjoy the prosperity even more in the years to come, making use of inexpensive imports from China and India.

Secondly on the demand side as well, China and India have become increasingly big markets for Japan and the United States. China's GDP in 2005 was $2,225 billion and India's was $728 billion. The Chinese and Indian GDPs had a combined value of $3 trillion which ranked No. 3 in the world just after Japan and the United States, surpassing Germany whose GDP was $2,907 in 2005.

Chinese and Indian imports were $660 billion and $109 billion respectively in 2005. Altogether the total amount of Chinese and Indian imports occupies more than 7% of the world's total imports. According to the US statistics, US exports to China were $41.9 billion in 2005.

On the other hand, India's exports to the United States were $8 billion in 2005. This is 19% of China's exports to the United States. In the case of Japan's imports, the difference between China and India is much bigger. According to Japanese statistics, China's exports to Japan were $80.3 billion, whereas India's exports to Japan were $3.5 billion, only 4% of China's.

As is clearly indicated here, there is a big difference between these two countries in terms of the development of their economies, although we tend to lump China and India together.

China is also contributing to the world economy as a major recipient of Foreign Direct Investments (FDIs). China received $54.9 billion of FDIs on a net basis in 2004 and the amount of FDIs into China in 2005 seems to have been approximately the same amount as that of the previous year. The amount of FDIs into India the same year was $4.4 billion, which was less than 10% of the figure for China.

Japan's investments in China were $6,575 million in 2005 on a net basis. This was the biggest annual amount of FDI for China from Japan. However, Japan's investments in India in 2005 were only $266 million, or 4% of Japan's investments in China.

Why does India receive a relatively small amount of FDI, as compared to China?

I think there are many reasons for this.

Firstly, India lacks industrial infrastructure such as electricity and roads. This electricity shortage is deeply rooted in Indian society. Electricity tariffs for farmers are kept very low and below cost. There are no incentives for electricity companies to increase the electricity supply.

Secondly, there is too much red tape in getting approvals from Indian governments. It is ironically said that China has a market economy without a democracy, while India has a democracy without a market economy. Of course the latter part of this joke is referring to Indian bureaucrats who once in a while stifle the Indian economy.

Thirdly, Indian workers are protected too heavily. For example, it is often said that it is quite difficult to close a plant in India, even if it is not making any profits because the Indian government requires wages to be paid to employees even after the closure.

In his book "Freedom of Choice," Professor Milton Freedman compared India in the 30-year period from 1947 with Japan in the 30 years from 1867 and concluded that Japan enjoyed higher economic growth due to the relatively freer trade policy forced by unequal treaties with other countries. At that time, Japan was obliged not to impose more than 5% tariffs upon any imported goods by the unequal treaties Japan had with the United States, the United Kingdom, Germany, France, and so on, whereas those developed countries had the freedom to impose import tariffs on Japanese goods however high their tariffs might be. However, the Government of India after World War II adopted rather socialistic economic policies, leading to a regulated economy.

In order for India to realize its potential power, the Government of India should not stand in the way. JS

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