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How India's Dynamism Can Energize Japan

— Cooperating on Infrastructure and Environment to Clear the Way for Growth —

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- India ranks with China as an engine of global growth
- To achieve high economic growth, it must address such issues as education and the laws governing trade and business
- The small number of Indian exchange students in Japan is a problem we must address

India stands alongside China as a nation whose huge population and ongoing rapid economic growth have put it in the global spotlight. Both the Indian and Chinese economies slowed briefly under the impact of the global recession precipitated by the US financial crisis that broke in September 2008, but in 2009 both economies rebounded. The speed of their recoveries compared with those of the advanced industrial economies of the West and Japan has fostered high expectations of India and China as engines of global economic growth.

A research team at the Japan Center for Economic Research (of which I was team leader) analyzed the factors behind India's rapid economic growth, identified challenges to further growth, and examined possible responses to those challenges. We compiled a report detailing our conclusions and recommendations, including ways to inject some of India's dynamism into the Japanese economy.

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In 2008, India's gross domestic product was $1.218 trillion, about one-third that of China and only one-fourth that of Japan. By purchasing power parity, however, India's economy is already the fourth-largest in the world, following those of the United States, China, and Japan. In both population (about 1.1 billion) and land area (some 3.28 million square kilometers), India is roughly nine times as large as Japan. A high percentage of its population consists of people in younger age groups, and a large portion of its land is farmland.

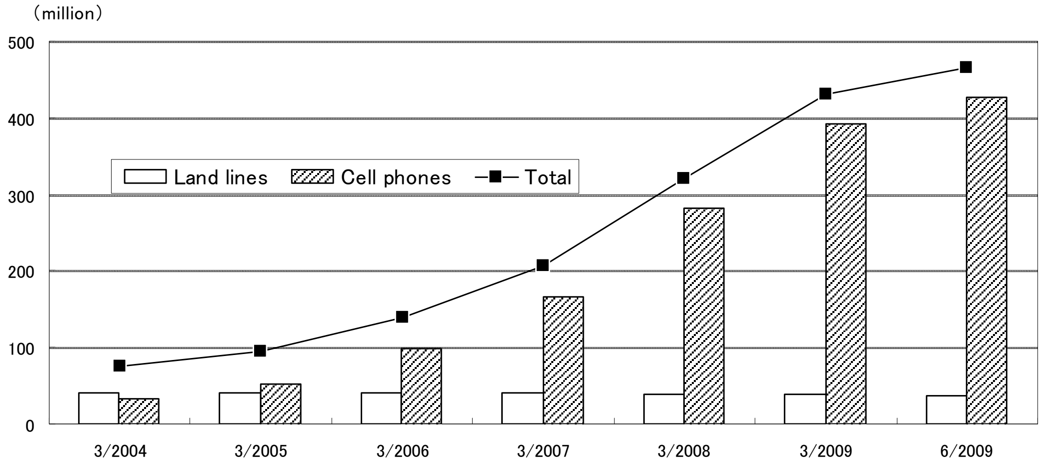
After achieving independence in 1947, India chose the path of a command economy on the socialist model. Instituting protectionist policies to nurture domestic industry, it promoted industrialization by substituting imports with domestically manufactured products. But low productivity, together with such non-economic factors as natural disasters and the conflict with Pakistan, hobbled the economy, and growth failed to meet expectations. During the 1980s, gradual economic liberalization helped boost growth rates, but at the same time the nation's fiscal and current-account deficits ballooned. In 1991, India found itself in the midst of a serious economic crisis.

Under the economic leadership of (current prime minister) Manmohan Singh, then serving as minister of finance, the Indian government adopted a program of economic reform. By liberalizing external economic policies, such as those governing trade and investment, while reforming the domestic financial system and abolishing industrial licensing in principle, the new policies opened the door to competition and revitalized private business. The payoff from the reforms was most dramatic after 2000. Real economic growth from 1991 to 2003 averaged slightly less than 6% a year, but from 2003 to 2007, it was more than 8%.

Driving India's economic growth since the 1990s has been the service sector, particularly services in the new and fast-growing area of information technology(IT). The IT revolution and the trend toward globalization combined to give a major boost to India's IT industry, which also benefits from the nation's abundant supply of talented engineers.

After 2000, rapid economic growth and the resulting jump in incomes and buying power began to manifest themselves in the rapid expansion of India's middle class. Businesses began targeting this growing spending power with appealing consumer products, such as passenger cars and motorbikes, electric appliances, and cell phones, and domestic consumption took off. For example, Tata Motors, India's top automaker, has developed the world's cheapest car, selling for as little as 100,000 rupees (roughly US $2,200), in a bid to expand sales. Competition between cell phone companies has driven rates down so far that monthly growth in subscribers over the past two years has been in excess of 10 million (see figure). Another area of rapid growth is fast moving consumer goods, including such commonly used consumables as shampoo and beverages. Growing consumption has in turn spurred business investment, creating a "virtuous circle" of economic growth.

New Phone Subscribers in India



Source: Telecom Regulatory Authority of India

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India is blessed with a number of factors conducive to continued rapid growth, including an increasing working-age population, booming domestic demand, robust investment, and expanding foreign trade and direct investment. However, it must also overcome numerous challenges.

The first of these is inadequate infrastructure. India suffers from serious underinvestment in two crucial areas, transport—including roads, railways, and ports—and electric power. This deficiency not only hinders economic activity but also discourages the influx of foreign capital, an important contributor to growth.

The Indian government is keenly aware of the importance of infrastructure, but projects continue to be delayed by the need to iron out differences between the state governments and New Delhi, which has final say over financing and regulation.

Education is also a serious issue. High-quality human resources are vital to economic growth, and education and training are required to develop such human resources. But India's education system is inadequate at every level, be it elementary school, secondary school, or higher education. Close to one-third of all Indian children fail to complete elementary school because they are pulled out of classes to work in the fields or assist with the family business. Only 10% of India's youth enroll in an institution of higher education. And higher education is essential to the knowledge-intensive industries most likely to power the economy in the future, including IT, health services, and biotechnology. The swelling ranks of young people augur well for economic growth if they can find work; but if decent jobs are scarce and unemployment swells, it will turn into a minus. A key to increasing job opportunities for the young is to boost their skills through education and training.

Agriculture is another sector with a major impact on the Indian economy. Although the contribution of agriculture to GDP has been dwindling yearly, falling to about 17% in fiscal 2008, two out of three Indians still make a living from farming. Poor harvests cut into incomes throughout rural communities, depressing consumption and dragging down the entire economy. India's rural population, much of it impoverished, looms large in Indian society and politics. In addition to inadequate infrastructure, such as irrigation and roads, agricultural production is hampered by a dearth of investment capital and backward technology. The government has encouraged financial institutions to step up lending to farmers, but there is also a pressing need for non-financial support, including steps to accelerate the spread of new technology and expand marketing networks.

While economic reform has made considerable progress in India, many archaic policies and systems remain in place. Labor laws continue to provide excessive protection for workers at the expense of industry, legal compliance remains lax, and federal policies still restrict foreign capital and protect domestic industry from imports. As a result of the rising political awareness among India's farmers and Dalits ("untouchables"), politicians are apt to resist any reforms that could adversely affect farmers or workers.

Other issues waiting to be addressed are the fiscal deficit, health care, energy, and the environment. India's own efforts will be the key factor in solving these problems, but it should also make the most of any support that other countries, such as Japan, have to offer.

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Japan stands to gain economically from closer ties with a country expected to enjoy rapid economic growth in the years ahead. Although trade and direct investment between India and Japan have increased sharply in the past few years, volume is still low for the size of our economies. To further expand economic ties between Japan and India, it is important to lower barriers to trade and investment by quickly concluding the current negotiations for a Japan-India free trade agreement and by transforming the Comprehensive Economic Partnership in East Asia from a concept into a reality.

The biggest new initiative for Japan-India economic cooperation is the Delhi-Mumbai Industrial Corridor, an ambitious plan to develop the 1,483-kilometer stretch of land between Delhi and Mumbai into an industrial zone comparable to the Taiheiyo Belt between Tokyo and Osaka. If the plan comes to fruition, it will help boost India's economic growth and provide new business opportunities for Japanese companies. However, a number of challenges must be met to ensure the plan's success. These include sufficient investment by Japan, the Indian government's guarantee of a loan from the Japan Bank for International Cooperation (the international arm of the Japan Finance Corporation) to finance preliminary studies, and resolution of local issues regarding the industrial parks and development of infrastructure in the six states involved.

Environmental issues present a tough challenge that must be met in order to achieve sustainable economic development. Because of the huge scale of the Indian economy and its expected growth in the years ahead, India has an important role to play in protecting the global environment. Japanese companies are highly competitive in the environmental field and should be able to take an active part going forward.

People-to-people exchange is another important element in strengthening economic ties, but such exchange between Japan and India remains woefully inadequate. Here the focus should be on bringing more Indian IT experts to Japan, which faces a personnel shortage in the field, and expanding student exchange. In fiscal 2009, only 543 Indian students were studying in Japan, according to the Japan Student Services Organization. Not only is this figure dwarfed by the number of students from China (79,082), it even falls short of the numbers from Nepal (1,628) and Sri Lanka (934), countries with much smaller populations. The biggest reason few Indians come to study in Japan is the language barrier, but another is the difficulty of finding employment in Japan. To boost the number of Indian exchange students in Japan, Japanese universities need to develop more cooperative relationships with their Indian counterparts, and Japanese companies must make greater efforts to hire Indians exchange students at the end of their course of studies.

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