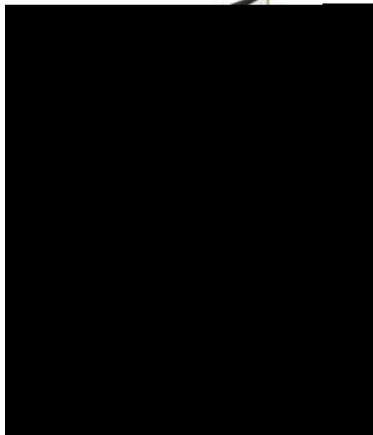


Demystifying the Hype



Arvind Panagariya

India: The Emerging Giant

Oxford University Press, Oxford and New York 2008, 545 pp., \$39.95 (cloth).

Arvind Panagariya has written probably the best all-around, up-to-date, and accessible book on the Indian economy. It is informed by the analytic apparatus of a leading international trade economist, yet it is packed full of useful real-world detail. It has a comprehensive range but it links the separate elements into a coherent whole. It is a superlative work of applied economics, and it is also sensitive to India's political economy. It has pointed, punchy policy conclusions: Panagariya is not shy about attacking those he thinks have got it wrong on the Indian economy, and he does so with a powerful combination of analytical argument and detailed evidence. Finally, though the book was written before the current global economic crisis, its fundamental conclusions remain as valid as they were before the crisis.

This decade's Goldilocks global economy (which ended in 2007±08) has encouraged 'India hype,' and with it a misdiagnosis of India's seemingly successful recent economic performance. India-hype peddlers paint an impossibly glossy picture of the Indian economy. This has very little to do with Indian reality.

One aspect of India hype that has been given a degree of academic

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respectability by some business school professors and academic economists is the thesis that India is forging a separate successful path to development, in contrast with the traditional comparative-advantage-based development of China and other industrialized Asian economies. At its extreme, this argument holds that India's growth engines are its high-end service and now manufacturing sectors, with their globalizing, world-beating companies. Dani Rodrik and Arvind Subramanian go one step further: they give some credit to past dirigiste policies for laying the groundwork for recent economic success and downplay the role of the post-1991 market reforms in generating better economic performance.

Panagariya attacks these arguments head-on. He highlights Indira Gandhi's disastrous economic policies (from the mid-1960s to the early 1980s), which turned India's back on its comparative advantage in labor-intensive activities and entrenched destructive regulations that are still difficult to dislodge (not least in labor markets). And he gives due credit to pro-market reforms, not just from reform bursts in 1991±93 and 1998±2004, but also in the late 1980s.

Reform gaps

Also threaded through the book is a dissection of India's growth dynamics and nongrowth statics. The vaunted successes in services based on information technology and in manufacturing niches are welcome. But they are merely a high-wage, capital- or skill-intensive drop in India's low-wage, unskilled, labor-abundant ocean. India's growth should be churning in these labor-abundant waters, but it isn't. Agriculture is stagnant, hobbled not just by very high external protection but even more by draconian domestic restrictions that fragment the internal market. Nontradable service sectors—where potential employment generation is huge—are also crippled by domestic

restrictions. Backbone service sectors (such as banking, insurance, and retail) suffer from external protection as well. And crucially India's glaring development gap is in manufacturing, for all sorts of national and state-level policies conspire to stand in the way of labor-intensive industrial production. Panagariya has no doubt that India needs its Industrial Revolution if it is to grow out of poverty. That means putting impoverished people in the countryside into (initially) low-wage work in mass manufacturing. That is what East Asia has done. But not India.

Nevertheless, Panagariya is optimistic about India as an 'emerging giant.' He believes that market reforms have forward momentum, that they will widen and deepen, and that Indian economic performance will come closer to its potential, to the benefit of a broader cross section of Indians.

I can't say I fully share such optimism for three reasons. First, the end of the Goldilocks global economy has exposed India's reform deficits and brittle growth foundations. Second, India is now paying the price for a government that since 2004 has not delivered any reforms. Third—and most important—the Indian state, led by its political-bureaucratic elite, remains unreformed. Indeed, state institutions have gotten worse at both the national and state levels. According to Arun Shourie, a former minister and leading Indian commentator, India's race backward as a state 'hollowed out by termites' is not compatible with its race forward led by urban professionals in the private sector; the former will drag the latter backward. That remains to be seen. But the upshot is that much-needed market reforms cannot continue to skirt reform of the state itself. Politically, that is the hardest nut to crack.

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