

WebMemo



Published by The Heritage Foundation

No. 2918
May 27, 2010

What a Market Economy Offers India

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While India's economic success is taken for granted by some, per capita income and other measures show the development road remains a long one. It is also treacherous: A strategy that appears to work for the moment but is not sensible for the long term could stall progress for a decade.

To navigate this road, India should embrace market liberalization tailored to its strengths as well as its sharpest challenges. In particular, clarification and formalization of rural property rights should have the highest priority. Simultaneously, the industrial labor market should be liberalized. As a complementary action, trade should also be liberalized to capture gains from what will be increasingly competitive manufacturing.

On June 1, the U.S.–India Strategic Dialogue will convene in Washington. A strong and prosperous India is good for the American and global economies, helps regional balance, and showcases democratic values. The U.S. can offer assistance to encourage India to make the best development decisions and help turn India into a global economic power.

Rural Property Rights. Consider the following: A country has

- A population in the 1 billion range;
- An economy dominated by agriculture; and
- Seemingly intractable rural backwardness.

The country assigns a modicum of property rights to farmers. Rural income then shows average annual gains of 14 percent for nine years. Grain output rises 120 million tons in five years and non-

grain farm output doubles in six years. What follows is mass migration to the cities, transformation of industry and trade, and 30 years of 10 percent GDP growth.

The country in question is China in 1979–1988. Similar stories apply to other successful economies. Property rights are the single most important factor in productivity in capitalist and mixed economies. Development involves rising agricultural productivity, rural–urban migration, and increased manufacturing. To develop, a capitalist or mixed economy must have clear property rights to land in rural areas.

Obstacles Abound. The state of rural property rights in India is unfortunate, highlighted by open rebellion and mass protests against granting of land to large corporate investors.¹ Hundreds of millions of people live on land whose ownership is unclear to them, to local and federal government, and to teams from global companies investigating multi-billion-dollar projects.

To increase rural income in sustainable fashion, agricultural productivity must rise. In a May 2010 press conference, Prime Minister Manmohan Singh acknowledged weakness in this area. His solution is to spend still more money, an approach that has

This paper, in its entirety, can be found at:
<http://report.heritage.org/wm2918>

Produced by the Asian Studies Center

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
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manifestly failed with regard to productivity.² A far more powerful alternative is to grant full property rights to farmers.

One obstacle to a property-rights-led approach is political: clear property rights infringe on Indian statism. The state effectively owns that which is not strongly claimed, enabling politicians to implement pet projects and dole out rewards. Some elites demanding aid for the rural poor find it expedient to control land—the chief asset of the rural poor—themselves. But if the People's Republic of China can partly overcome this bent, surely India can as well.

Practical obstacles to granting property rights will take time to overcome, but modern technology changes the game. A single computer with a wireless connection can map farmed areas and store detailed ownership records for a remote village. Federal and local coordination is necessary, but resource requirements are minimal.

Labor Market Liberalization. A third reason for the failure to grant rural property rights is fear of success. Higher agricultural productivity means greater rural wealth but fewer hours spent farming. Agricultural development from property rights will induce migration by perhaps 200 million people in a generation. Rural–urban migration is absolutely necessary but a frightening prospect nonetheless, given circumstances in many Indian cities.

First and foremost, migrants need jobs. A crucial aspect of rural–urban migration is a need to create large numbers of manufacturing jobs. Manufacturing—not services—employment should be featured due to two core elements of Indian development.

The first is demographic expansion. Job creation should be emphasized *everywhere*—the service sector cannot absorb all new urban workers over the next 15 years, much less an additional torrent from agriculture. The second element is education. Improving the quality of education should be the government's main focus,³ but most migrant laborers are nevertheless unlikely to possess high educational attainment, which rules out initial employment in large parts of the service sector.

There is a long-running debate over the extent of Indian labor market restrictions. The combatants often refer to different sectors: Those seeing a dysfunctional labor market cite industry, and those seeing a sound labor market cite services. It is no coincidence that services generally outperform industry. In contrast to services, the industrial labor market is horribly overregulated. This is true both at the federal and state levels, as states often inhibit labor flow across borders.

A second liberalization—of the industrial labor market—is thus required. Simplification of labor restrictions will draw domestic and foreign capital to manufacturing. Increased labor mobility will help create manufacturing clusters, thereby boosting efficiency. Labor market liberalization in industry is not a panacea; it is the minimum step required to create jobs at the pace needed for India to fully benefit from higher agricultural productivity and demographic expansion.

Supporting Policies. Other initiatives would further increase gains, or reduce costs, from sharper rural property rights. Migration will drive down wages, boosting global competitiveness. India should adopt a more positive stance toward open

1. Barun Mitra, "Pull the Land Issue out from Under the Maoists," *The Wall Street Journal*, April 20, 2010, at <http://online.wsj.com/article/SB10001424052748704671904575194923557075124.html> (May 26, 2010); Abhishek Shankar and Bibhudatta Pradhan, "Police Firing at Posco's India Site Triggers Protests, Rallies," Bloomberg, May 17, 2010, at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aUY635WabqbQ> (May 26, 2010).
2. *Economic Times*, "Agri Boost Must for 10 PC Economic Growth: PM," May 24, 2010, at <http://economictimes.indiatimes.com/news/economy/indicators/Agri-boost-must-for-10-pc-economic-growth-PM/articleshow/5968608.cms> (May 26, 2010); "India Focuses on Rural Development in the Budget," *One World South Asia*, July 7, 2009, at <http://southasia.oneworld.net/todayshadlines/india-focuses-on-rural-development-in-the-budget> (May 26, 2010).
3. See Derek Scissors and Michelle Kaffenberger, "U.S.–India Relations: Ensuring Indian Prosperity in the Coming Demographic Boom," Heritage Foundation *Background* No. 2274, May 15, 2009, at <http://www.heritage.org/Research/Reports/2009/05/US-India-Relations-Ensuring-Indian-Prosperity-in-the-Coming-Demographic-Boom>.

trade soon, since international negotiations are hardly speedy. Export expansion, of course, will create additional jobs. There are opportunities in services, but again, greater opportunities exist in manufacturing exports.

Infrastructure is less important than rural property rights. In general, state-led infrastructure expansion leads to fiscal weakness and macroeconomic stagnation, with money wasted on politically motivated projects with little commercial return. Examples abound in India, where the federal government keeps raising the amounts it wants to improve infrastructure, citing its terribly poor state after the previous huge sum was spent.⁴

However, a targeted infrastructure expansion program can play a positive role. Migrants who find jobs will contribute to the growth and prosperity of cities but still need expanded urban infrastructure, especially housing and sanitation.

Rather than a trough where government departments lap up money for all manner of projects that never meet objectives, infrastructure should complement rural property rights by focusing on absorbing migrants. Profit opportunities from more productive agriculture and competitive manufacturing will draw private investment to related infrastructure, as compared to government expectations of private funding magically appearing despite lack of genuine profit opportunity.⁵

Offer American Assistance. For India to develop fully, rural property rights must be clear. The faster federal and state governments begin the process of property rights assignment, the sooner the rural poor benefit. Whenever it happens, migration will have a powerful impact on urban labor markets and infrastructure as well as India's trade competitiveness. Additional market-oriented reform is desirable.

On rural property rights, the U.S. can offer technical assistance as part of the economic and trade pillar of the Strategic Dialogue—for example, satellite mapping of the millions of possible land boundaries.

A second step is two bilateral programs. One involves the U.S. Department of Labor and simplifying industrial labor market regulations while protecting workers; the second involves the U.S. Department of Housing and Urban Development and cooperation on an exploratory urban housing and sanitation project. Long-term economic negotiations should immediately include contentious issues of mutual manufacturing access. These actions would, among other things, encourage American companies to participate in the acceleration of Indian modernization.

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4. *Economic Times*, "Infra Investment Doubles to 8% in 5 Yrs: Plan Panel," February 7, 2010, at <http://economictimes.indiatimes.com/news/economy/infrastructure/Infra-investment-doubles-to-8-in-5-yrs-Plan-Panel/articleshow/5544766.cms> (May 26, 2010).
5. Indo Asian News Service, "Delay in 327 State Projects Cost Rs. 54,727 CR," December 17, 2009, at <http://www.aol.in/news-story/delay-in-327-state-projects-cost-rs-54717-cr/713039> (May 26, 2010); Reuters India, "India Long Way Off from 20-KM Per Day Road Target," April 26, 2010, at <http://in.reuters.com/article/businessNews/idINIndia-47993520100426?sp=true> (May 26, 2010).