

The Policy Legacy



- India followed an idiosyncratic set of policies post independence
 - Import substitution
 - Emphasis on public sector commandeering the commanding heights
 - Restraining size and focus of private firms
 - Licensing
 - Directed credit
 - Small scale preferences
 - Anti-monopoly - MRTP
 - Labor laws
 - Emphasis on higher (tertiary) education relative to primary education



Questions and Approach

- Did these policies affect the way India specialized across sectors?
 - Yes -- Constrained adaptation
- Were the specializations reversed when Indian policies were reformed?
 - Not substantially
- What will happen going forward?

Approach

- Look at India in the cross-section of countries
- India through the prism of the states



India circa 1980: Effects of pre-1980s Policies

IN 1980 and after controlling for income, income per capita, and size in India:

- Manufacturing is “normal”
- Services below normal



Industry characteristics

Define industries as

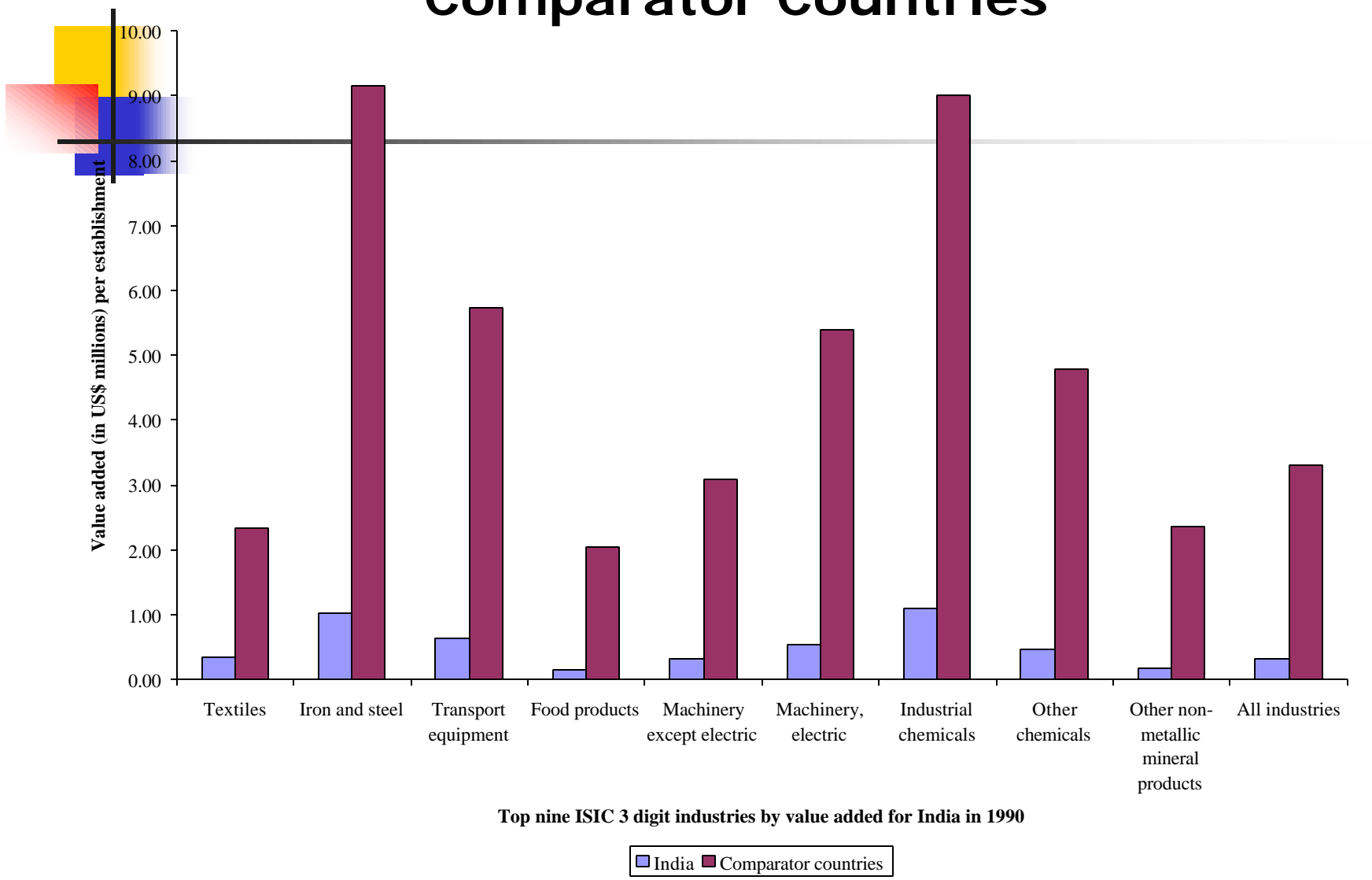
- large scale – iron and steel vs furniture
- skill intensive – professional and scientific equipment vs footwear
- labor intensive -- textiles vs petroleum refineries



India's manufacturing

- Specialized in
 - Large scale industries (public sector?)
 - Skill intensive industries (tertiary education?)
 - But not in labor intensive industries (labor laws?)
 - Unregistered sector: labor intensive vs skill intensive
 - More diversified than the typical poor country
- Establishments far smaller than the norm in other countries (licensing, finance, labor laws, MRTP, reservations)

Chart 1. Average Firm Size in India and Comparator Countries





Effects of liberalization since the early 1980s

- Liberalization has had effect
 - Services have exploded in value added (but not service employment)
 - Manufacturing share has fallen slightly
- Industry not gone back to more traditional focus of poor countries, i.e., labor intensive manufacture. India still focuses on
 - Skill intensive
 - Large scale industries

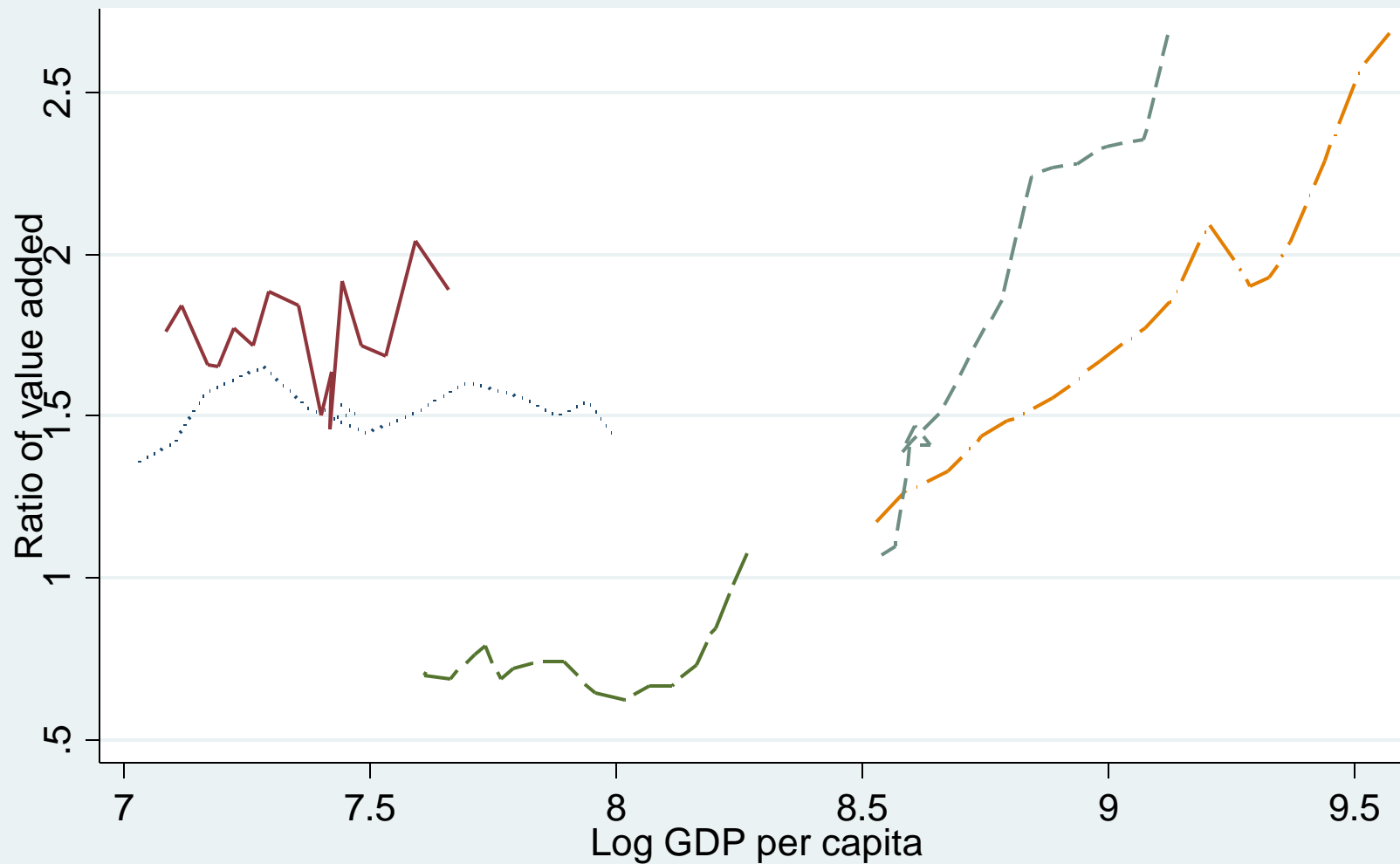
Chart 2. Value-Added Share by Labor Intensity



..... CHN — IND - - - IDN - . - . KOR - - - MYS

Chart 4. Value added Share by Skill Intensity

Ratio of value added in above median skill intensive sectors to below median sectors

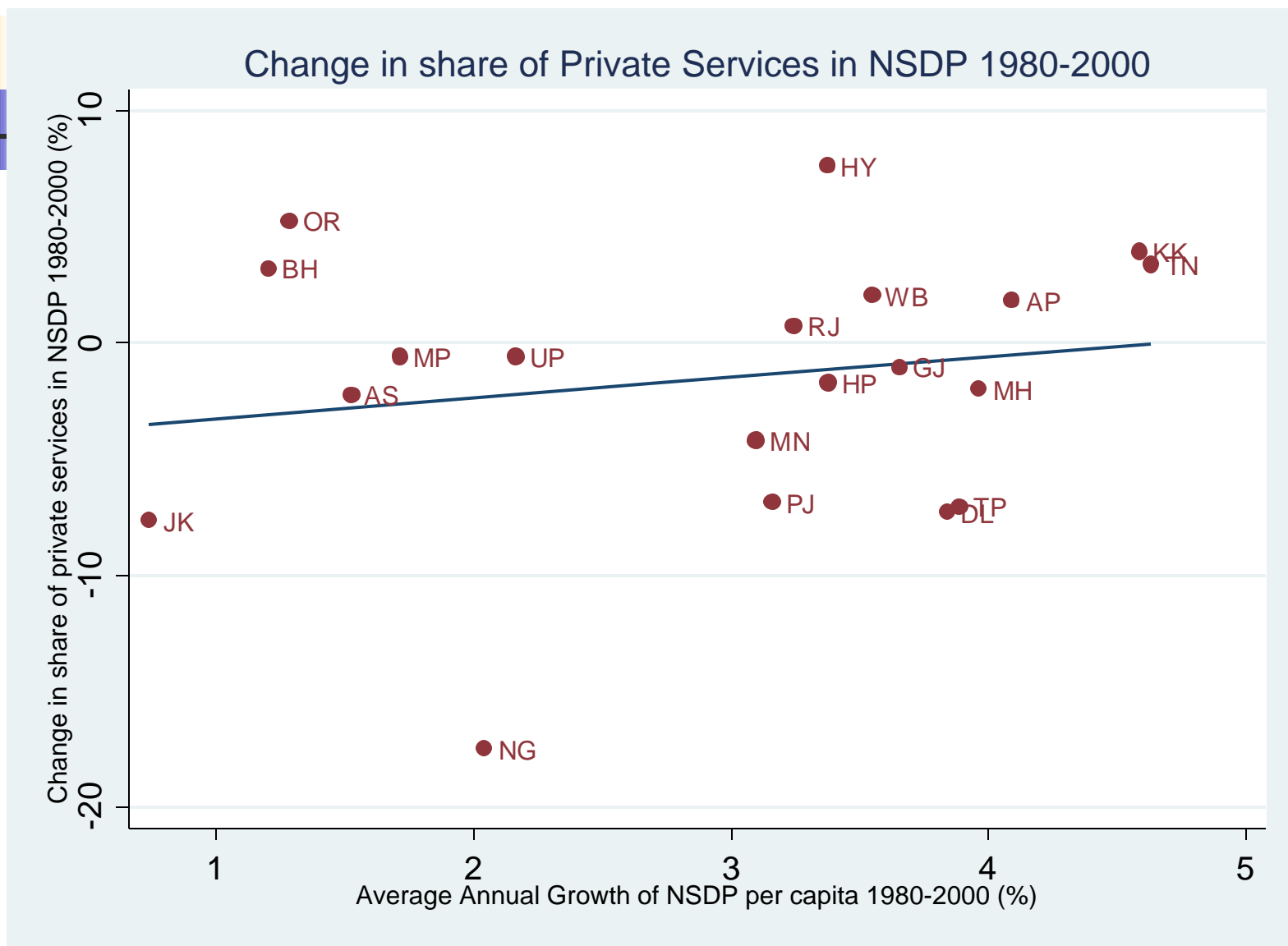
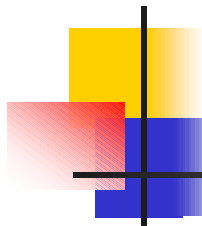


India through the prism of states



- All states shifting toward services
- Fast growing states:
 - Shifting towards private services

Chart 12. Private Services and States' NSDP growth

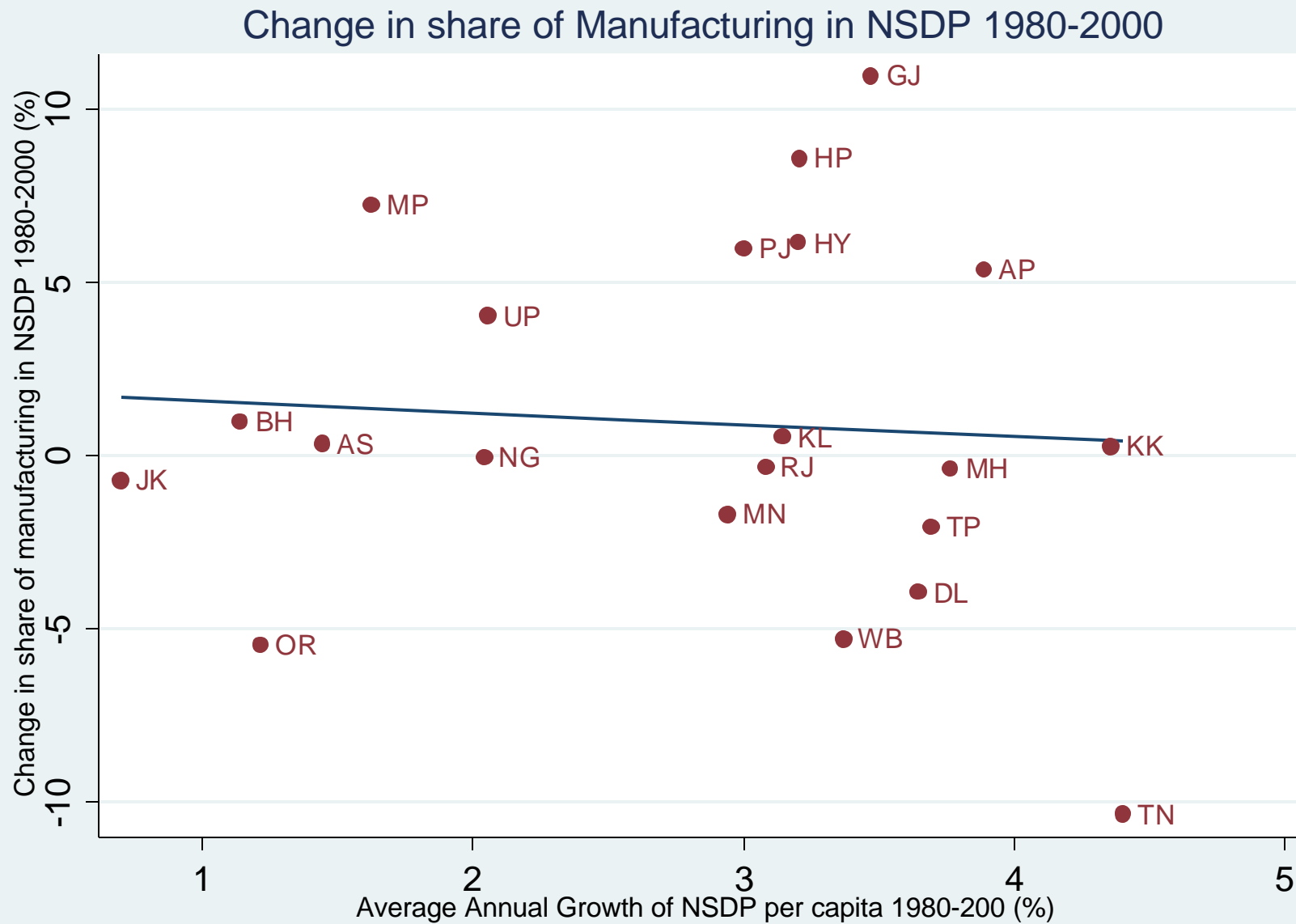




India through the prism of states

- All states shifting toward services
- Fast growing states:
 - Shifting towards private services
 - Not shifting toward manufacturing

Chart 8. Manufacturing and States' NSDP growth

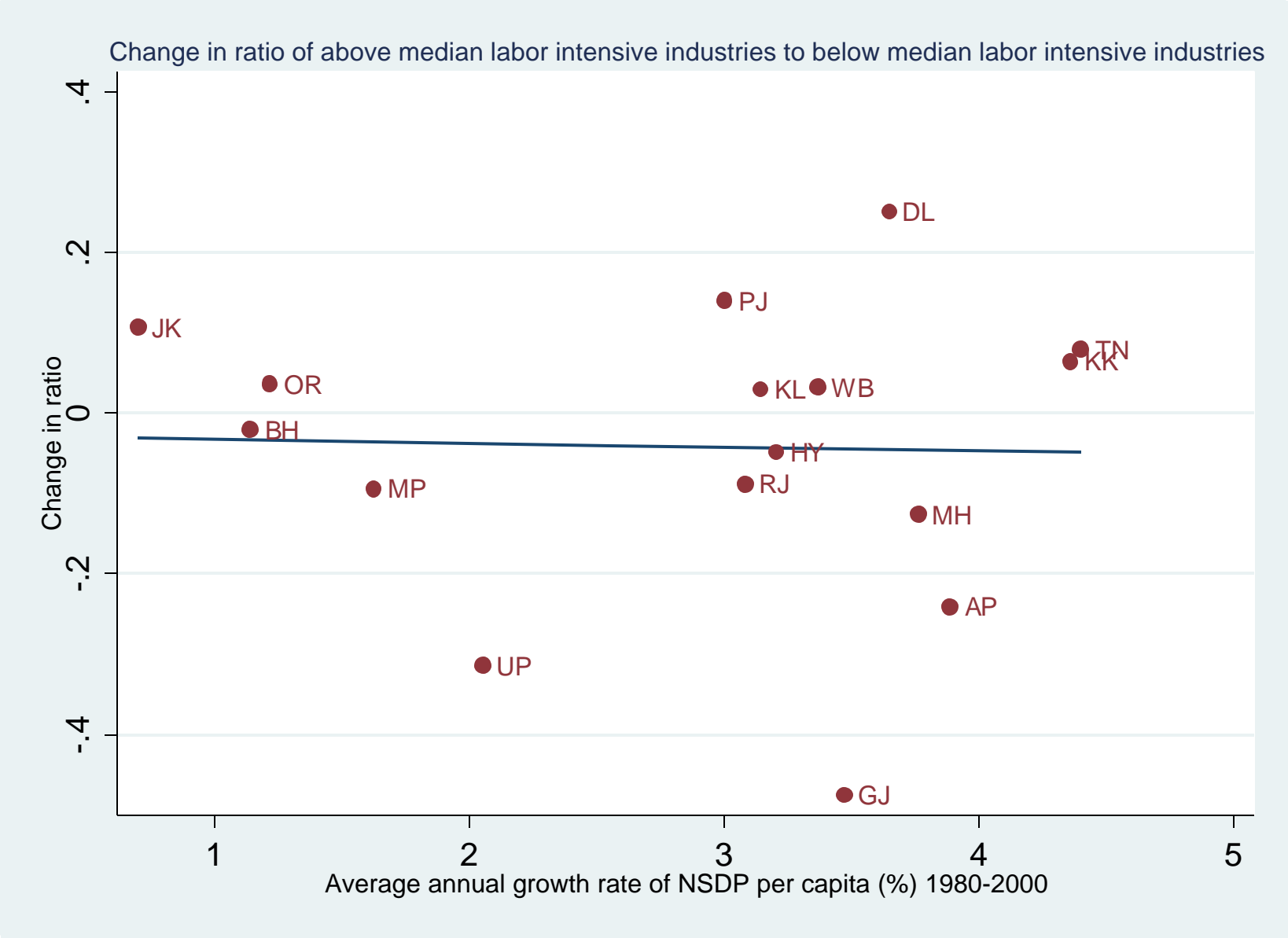




India through the prism of states

- All states shifting toward services
- Fast growing states:
 - Shifting towards private services
 - Not shifting toward manufacturing
 - Not shifting toward labor-intensive manufacturing (Gujarat—from textiles toward petrochemicals)

Chart 9. Share in Labor Intensive Industries and States' NSDP growth

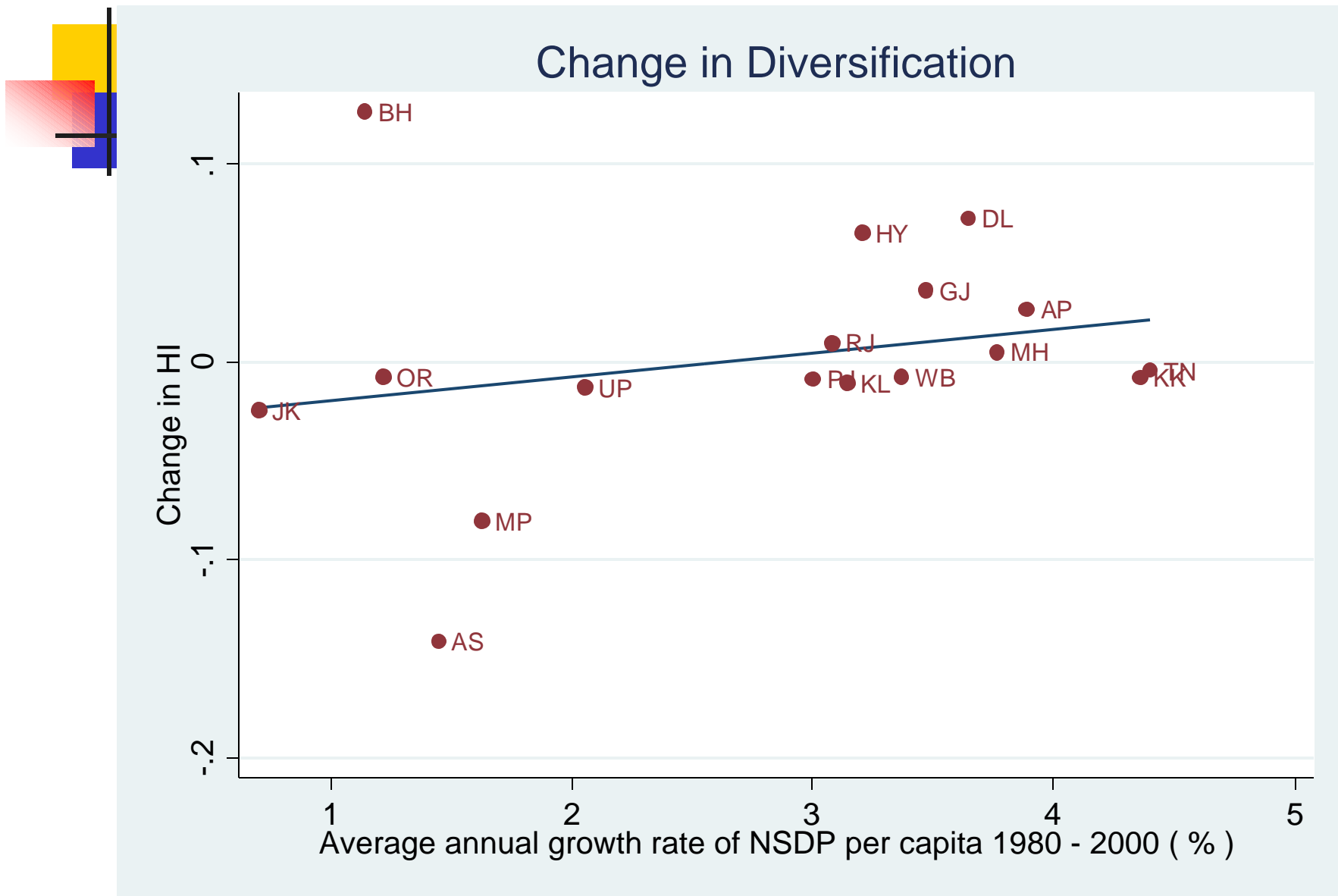




India through the prism of states

- All states shifting toward services
- Fast growing states:
 - Shifting towards private services
 - Not shifting toward manufacturing
 - Not shifting toward labor-intensive manufacturing (Gujarat—from textiles toward petrochemicals)
 - **Not diversifying**

Chart 13. Change in Diversification and States' NSDP growth



India through the prism of states



- All states shifting toward services
- Fast growing states:
 - Shifting towards private services
 - Not shifting toward manufacturing
 - Not shifting toward labor-intensive manufacturing (Gujarat—from textiles toward petrochemicals)
 - Not diversifying
- How unusual is this?

Table 10: How Unique are the Fast-Growing States?

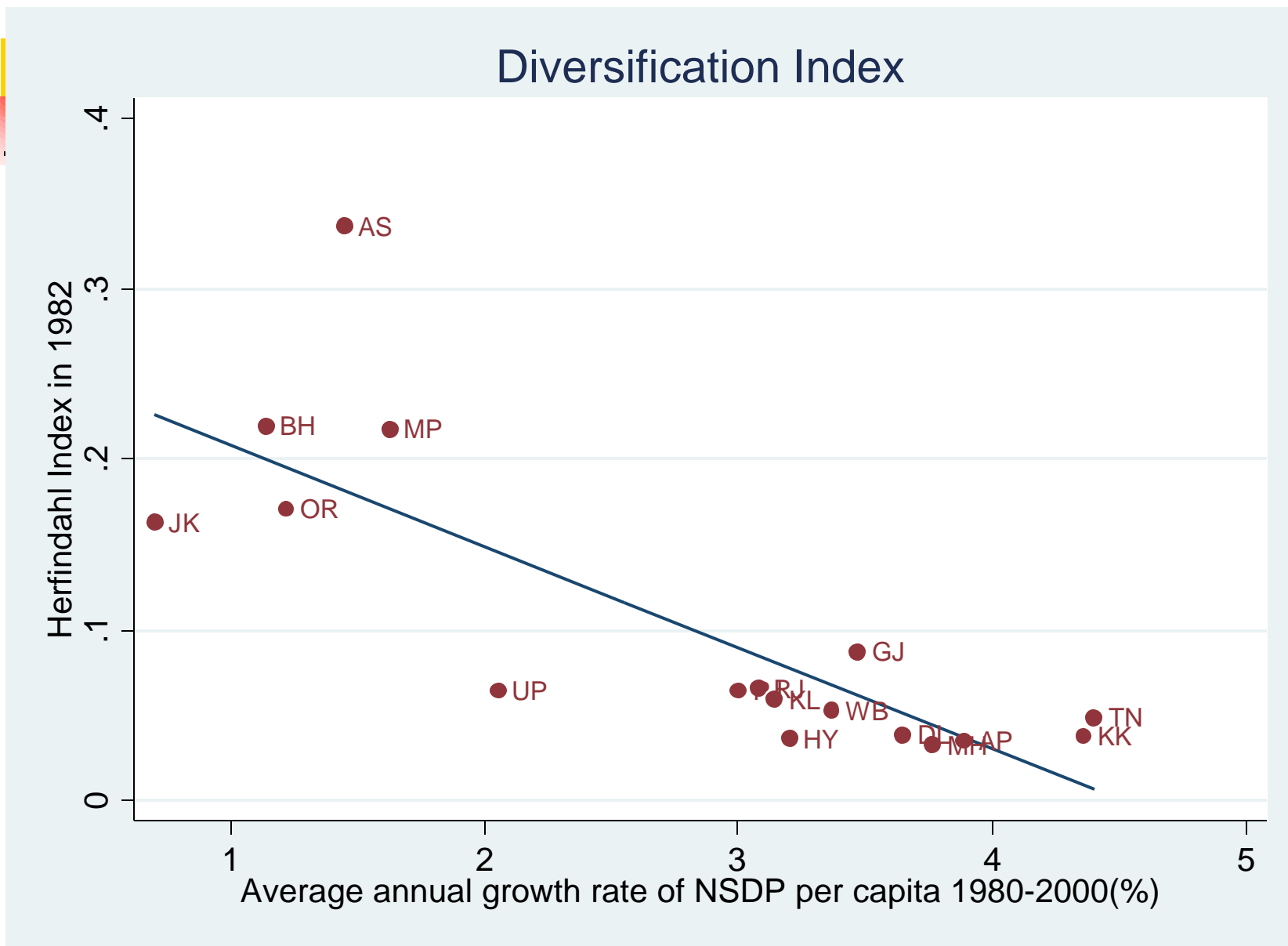
Criterion	Income level (in US\$ PPP per capita) at turning point in the cross-section	State income level (in US\$ PPP per capita) at turning point	
	(1)	(2)	
Manufacturing to GDP	14,728	Delhi	5,438
		Karnataka	2,649
		Maharashtra	3,375
		West Bengal	2,175
		Tamil Nadu	2,842
Diversification	18,216	Andhra Pradesh	2,220
		Delhi	5,438
		Gujarat	2,886
		Haryana	3,187
		Karnataka	2,649
		Maharashtra	3,375
		Tamil Nadu	2,842

Understanding Post-1980s performance of Indian states



- States that were most diversified in manufacturing grow fastest in the 1990s.

Chart 14. Initial Diversification and States' NSDP Growth





What drives this?

- Diversification could reflect
 - Built up capabilities – SBI, BHEL, CMC/ECIL
 - Private sector creativity
 - Chance
- Were the states in just the right sectors?
 - Services
 - In 2000, the states whose sectoral shares were most correlated with their 1980 shares should have grown the most.

Chart 16. Initial Diversification Index and Services

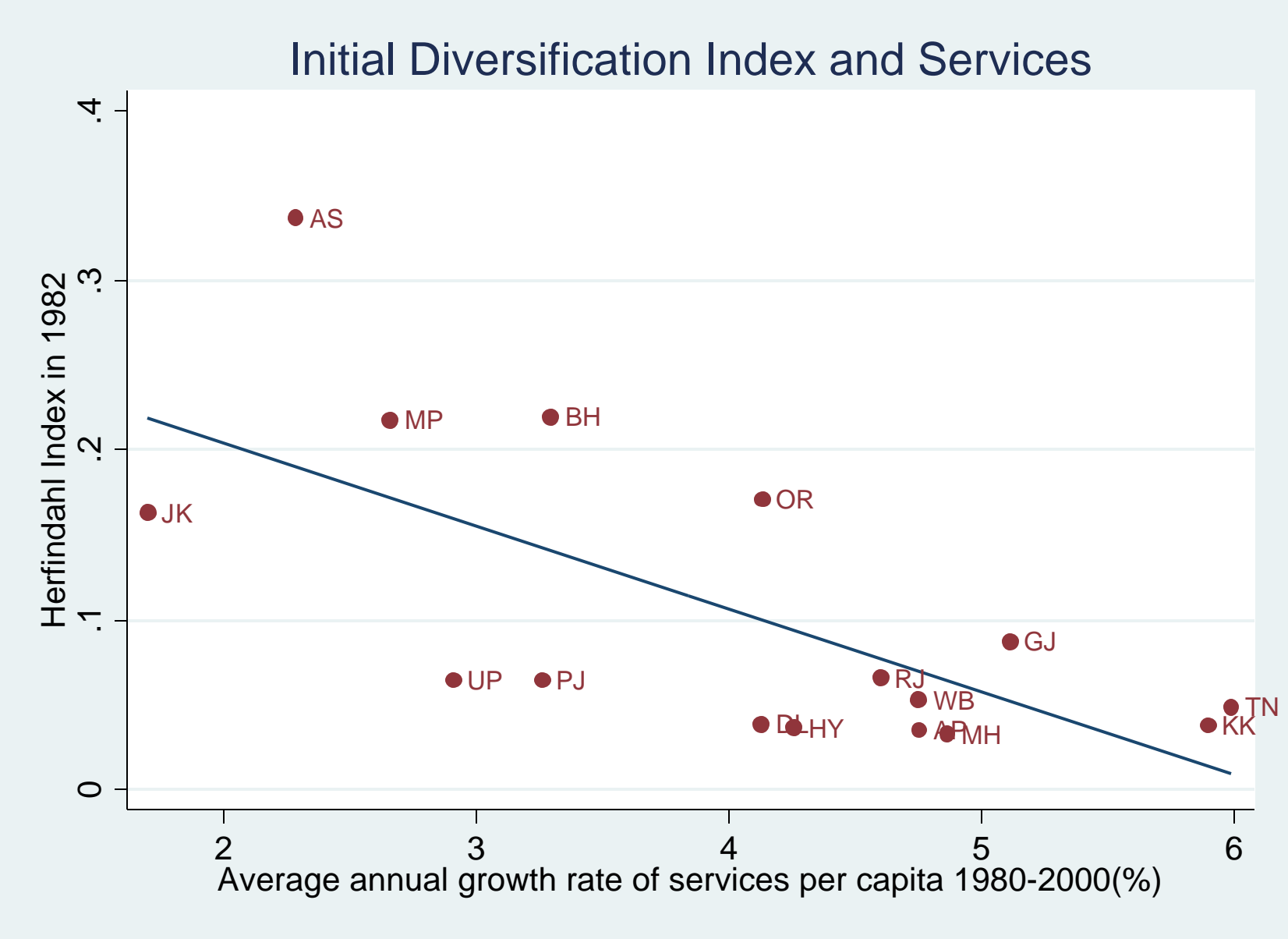
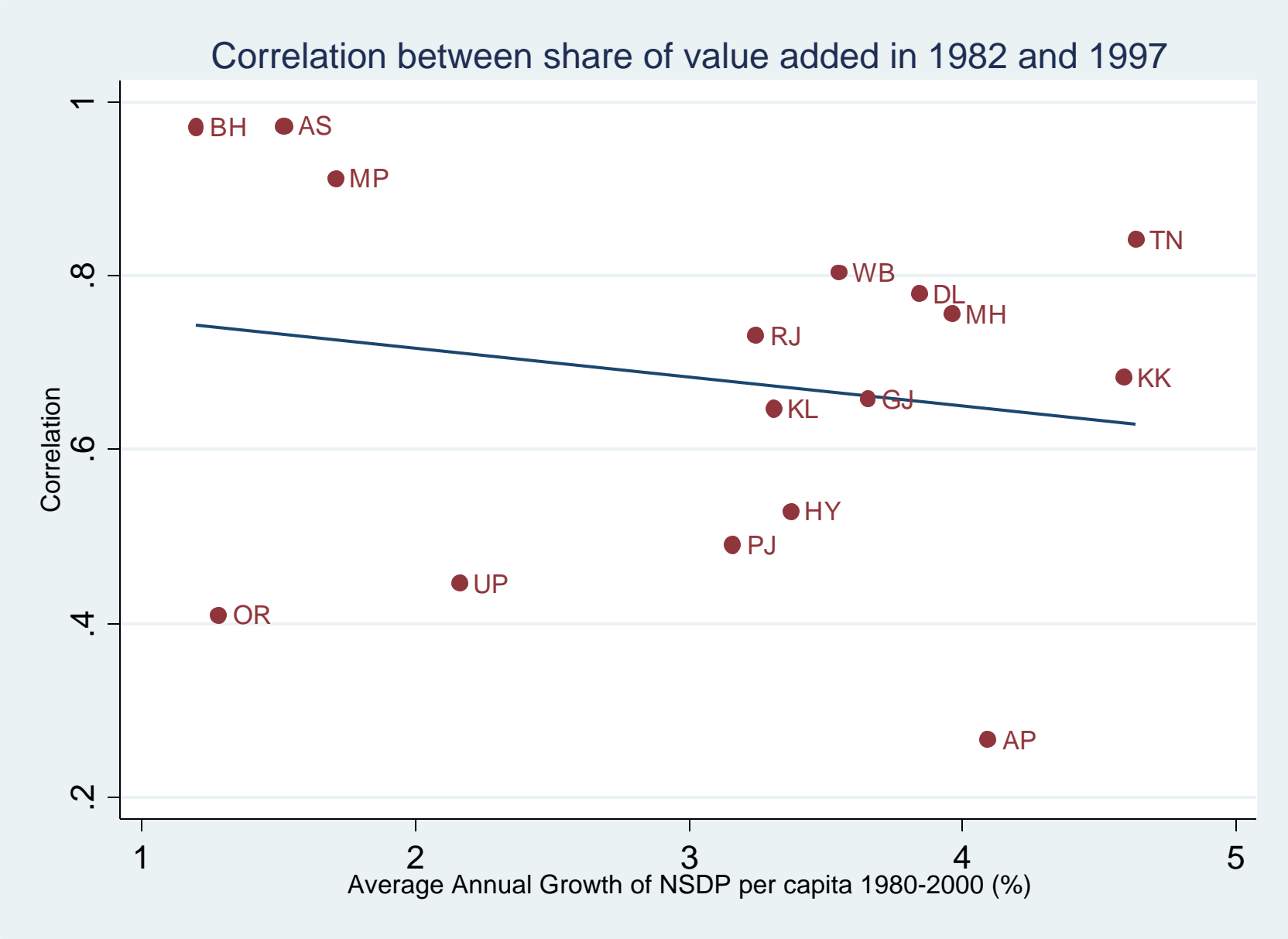


Chart 15. Correlation vs Growth



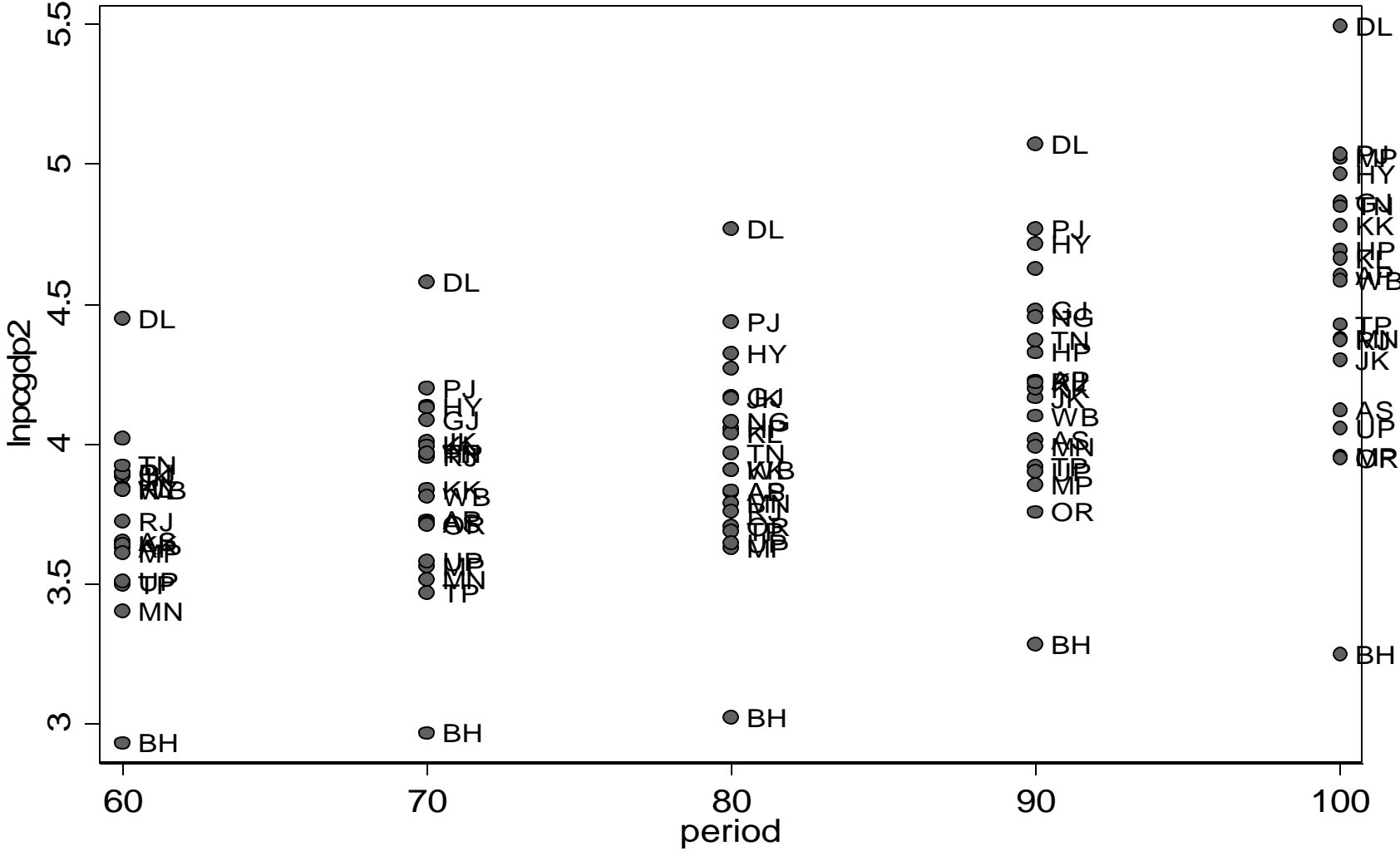


Institutions/Policies

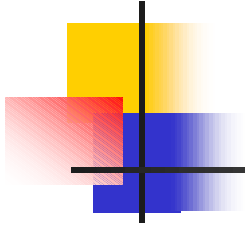
- Define infrastructure intensive industries – electricity use per unit of value added
- Measure of infrastructure quality/institutions/policy – T&D losses
- Infrastructure intensive industries grow faster in states with better infrastructure quality
 - Effect primarily in 1990s
- More generally, institutions/policy affect state growth in the 1990s but not before
 - T&D losses
 - Investment climate
 - Mass media
 - Education
- But diversification continues to have an independent influence.

=> Divergence

Divergence, Big Time: Real Per Capita Net State Domestic Product, 1960-2000 (at 1993-94 prices)



What lies ahead?



- Absent political mishap, advanced states will grow even faster
- But what of laggard states?
 - Further divergence => political power not congruent with economic power => political tension
 - Where will jobs come from?



What lies ahead?

- Can laggard states stimulate labor intensive growth?
 - Labor laws
 - Infrastructure
 - Institutions
- External conditionality (European Union)
- Even so, Bangalore Bug – a form of Dutch Disease?



Conclusions

- Cannot ignore past legacy
 - Enhancing supply of skilled labor.
 - Education reforms in tertiary sector even while reallocating government expenditures towards primary and secondary
 - Urban infrastructure
 - Attract and retain skilled labor
 - Absorb migrants



Conclusions

- Missing demand for reforms: Labor intensive manufacturing
 - Labor laws (Acharya)
- Center cannot afford not to be reformist
 - Conditionality with ownership