

Twenty Years of Transformation in South Asia

Will India Ever Be the “Locomotive of History” in South Asia?

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ASHLEY TELLIS: Well, thank you all for coming here this morning. I'm Ashley Tellis. I'm a senior associate at the Endowment. And we want to use the first panel to focus on the economic transformations that have been taking place in India and in South Asia over the last 20 years, which is what the theme of today's conversation is going to be.

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To do that, we have four distinguished scholars with us this morning, each of whom will explore different dimensions of the topic. Some of them will have slides, and I think some of them don't. But the slides, in this case, are actually useful because we're going to talk about some issues that are somewhat recondite and might be easier to explore with some visual aids. So without further ado, I'm going to ask Arvind Subramanian, who is our neighbor at the Peterson Institute next door, to lead with –

ARVIND SUBRAMANIAN: And the Center for Global Development.

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MR. TELLIS: And the Center for Global Development – (laughs) – to lead with a broad overview of where India is at the moment. I'm then going to yield the floor to Devesh Kapur, who will talk about some of the structural challenges facing India as it proceeds along the growth path that we expect it to move. I will then ask Milan Vaishnav to talk about some of the more contemporary issues in the Indian economy today, and then we'll finally end up with Vikram Nehru, who will speak about India in the context of a larger Asian story, South Asia and East Asia more generally.

So over to you, Arvind.

MR. SUBRAMANIAN: Thank you very much, Ashley, and to Carnegie for inviting me. It's a great pleasure to be here and, you know, a real honor to follow in Jagdish's footsteps.

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So let me – you know, we have a lot to cover, lots of great speakers ahead. So, you know, the topic is where does India's economy stand. Just to give you a quick overview, I want to give you a brief historical perspective on the Indian economy and then talk a little bit about what I call the current model, which is, you know, a mixture of what I would call microprecociousness and macropopulism, then talk a little bit about the prospects for this model. And then Ashley wanted me to spend a minute or two to address the question, will India make it big? And I will try and do that here.

So I think if you look back over the last – you know, the title is 20 years; I think it's more like 30 years – I think one has to recognize that, you know, there have been considerable achievements in India, economic reforms, you know. And Jagdish's contributions to those were quite rightly noted by Jessica. You know, Indians love to argue about the numbers, but poverty has been reduced quite substantially. India is integrated with the world. We have really an amazing, vibrant, dynamic private sector, which actually now not just, you know, runs things within India but

runs things internationally, including, you know, car factories and, you know, telecom factories and – companies and so on.

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And then less noted but, you know, no less important is the tremendous social transformation that's been taking place. You know, I would particularly, you know, recommend Devesh's paper on what's happened to the talents in – not just in UP but all over India, where, you know, not just their economic prospects but, you know, basically their way of life, you know, socially, culturally is really being transformed by this – by what's happened over the last 20 years. And you know, Devesh compares it a little bit to the breakdown of feudalism. I don't know whether one would want to go that far, but I think what's happening is really, truly radical in India

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So I think we have to – you know, and I'm sure I've left out many achievements, but those are very important and very dramatic.

But I want to then, you know, step back and say, you know, where has the Indian economy come by way of economic growth? And the way I like to see it is to distinguish, you know, three kind of time periods. One is the Hindu growth from, you know, 1950 until '60. For about 30 years we grew at about 1.8 percent per capita. Then we had 20 years of what I would call the turnaround, which is about 3.2 percent per capita between 1980 and 2000. And then we had 10 years, beginning 2002, of, you know, what I would call the takeoff phase, which is about – close to 7 percent per capita, almost Chinese rates of growth.

And so the big question – in some ways, we're standing here because the question is what follows now because this model seems to be sputtering. You know, growth this year is going to be closer to 5 (percent), 5 ½ percent. Projections for next year are not very different. So the question is, going forward, are we going to lapse back into this good but not spectacular phase of growth, or are we going to continue these Chinese-style rates of growth? So that's, I think, the big question.

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Now, setting this in comparative perspective, you know, the top chart actually plots a bunch of countries to whom India should compare itself in terms of how they've done in terms of economic growth once they started taking off. So India – I've started the clock in 1979. China is '78, and a bunch of all these Asian countries, you know, in the '60s and '50s and 70s.

But the point is that, you know, despite what India has done, these considerable achievements, India has, you know – their growth rate – India has, you know, between '79 and now, kind of 3 ½ – its per capita GDP has increased 3 ½ times. But you compare that with China, and this – you know, this is not a very spectacular performance compared to the Asians. And if you look at where India stands relative to the economic frontier in terms of standards of living, India is roughly, you know, about – China is 2 ½ to 3 times richer than India, and India is about 10 percent of the frontier if you think the United States is the frontier. So, you know, we've done well, but comparatively, this is not spectacular by any means. We're lagging way behind, and we're far behind the economic frontier.

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So what is kind of what I call the precocious India model – we have a very unusual pattern of both political and economic development. I mean, the fact that India has been a democracy at low levels of income, whereas China, the other way around, has been widely noted. But even India's growth has been very precocious, in the sense that, you know, it's relied mostly by using its skilled rather than its unskilled labor. You know, everyone knows about the services revolution. I'm going to show you a chart. You know, manufacturing has been stagnant, and even within manufacturing, we do much more – increasingly more skill-intensive stuff than unskill-intensive stuff.

And to me, of course, the most telling example of this precocious pattern of development – I use the word “precocious” in the sense that we are doing things that countries normally do, you know, at 3 or 4 times their current level of per capita GDP. India should be doing services the way it's been doing – or should have, you know, 20 years from now, but it did it, you know, well in advance. India should be exporting FDI, you know, much later in the game, as many advanced countries have done, but India has been doing it relatively early. So this is a precocious pattern of development.

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So just to compare this – you know, the sectoral shares, India and China, the key thing to note is manufacturing. It's about 16 percent and now even declining, and China's at one point even reached 40 percent during its boom phase. And even today it's closer to 30 (percent), 35 percent, compared to India's 16 percent. And you know, in a paper I did with Raghu Rajan, we showed that even within manufacturing, we do a lot more skill-intensive stuff than unskill-intensive stuff, and that's been changing over time.

So another example of this is that FDI – you know, China, we know, imported a lot of FDI from the U.S. and elsewhere, but now China and India are both exporters of FDI. Remember, this is precocious because you think of FDI as – you know, countries export FDI when they have this, you know, comparative advantage in – you know, in entrepreneurship, in capital, in technology. That's when you do FDI exports. But India and China have been doing this well in advance of what other countries did at comparable stages of development.

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And India's – for example, you know, until recently India was exporting more FDI than China as a share of its GDP. So, you know, this is the whole Tata buying Jaguar, Land Rover, the hotels, the IT sector. And the interesting thing is that India's exports of FDI have not been in services predominantly; they've been in manufacturing. So even though domestically, we do very little manufacturing and very high-skilled manufacturing, internationally, you know, we export more FDI in manufacturing than services.

So this precocious model of development – is it sustainable? Now, the way I think about it is to say, look, in – you have certain factors of production when you develop. You have skilled labor, unskilled labor, land and social capital. Let's say these are the factors of production. India – this model, for the last 20 years, has been based on using up its scarce skilled capital. And believe

me, it's becoming scarce. You know, skilled labor has been growing, at dollar terms, skilled wages, at about 15 percent for about 25 years. So we're running into capacity constraints on skilled labor. And as Devesh will later tell you, our dysfunctional education system is not generating, churning out the supply to match the demand, so this is a commodity that's becoming in short supply. And our development model has been based on this.

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Second, we have lots of abundant unskilled labor. India is a poor country. But we've really underutilized that. So this is a model that doesn't utilize its – you know, a factor of production with which it's generously endowed and uses its scarce factor. And then if you think about, you know, land and social capital, which are really key ingredients of development, what you find is that we have, on the one hand, what I call the rents raj. You know, we used to have -- when Jagdish was writing about these things in the '60s and '70s, we had the import quota or license raj, then – but now we're replacing it with a kind of rents raj, which is a lot of corruption in the system, partly to do with the fact that growth has been so rapid, and because of bottlenecks and scarcities, you get a lot of rents. I call these endogenous rents – you know, kind of growth-driven rents, which have really taken off in India, which is a huge source of corruption.

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But even more important than the corruption aspect is what I would call, you know, basic capacity of the state to deliver certain essential services, like law and order, justice, you know, water, health, education. These are increasingly becoming a big problem and a bottleneck on growth. So if we look at this model, it certainly seems that this model is not sustainable from a kind of underlying micro point of view.

And then you come to the second part of this, which is the macro-populism, and here India is looking actually pretty bad. Now, various people have noticed this, that what I've plotted here is government expenditure per capita by the states and by the center. And in the last 10 years, it's actually doubled. In 10 years, expenditures per capita have doubled. And this is not just because of populism by the states; it's also populism at the level of the center.

So when you look at this populism, you immediately see that this has led to the first aspect of our serious macroeconomic vulnerability, which is that this is India's government deficit here, combined central and states, and the axis begins at 5 percent of GDP, and it, you know, reached about 12 percent, and now it's back to close to 10 percent again. So the Indian, you know, macroeconomic system, the fiscal system, is very vulnerable. We're running very, very high deficits, which we cannot afford.

And I cannot help but point out the correlation that, you know, in the old days when Jagdish used to write about the Indian economy, it used to be a micro-mess. Macroeconomically, things were not too bad. We had low inflation, relatively – you know, relative prudence on the fiscal side, but ever since 1980, when Indian politics became much more decentralized and much more kind of fractionalized from the rise of the regional party's point of view, I think India started becoming, you know, macroeconomically profligate.

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And the sad truth is that over the last 30 years, there have been a few ups and downs, but we've never really come to grips with this, and this has been a kind of – almost a structural problem in the Indian economy, which is this profligacy. And the consequence of that, we now have double-digit inflation for a very, very long time, and for the first time we're seeing current account deficits which are much worse than anything we've ever seen before, at about 4 percent of – (inaudible). So India looks very much like what some of the Latin American countries used to look, you know, in the '70s and '80s.

So if you put together the micro-precociousness and the fact that these factors of production are kind of running out of – are becoming more scarce on which India's development is based, and you add this macroeconomic vulnerability, things start looking a little bit not so

So the question is, where's the hope? So, where's the hope? I think the first thing to realize, as a growth economist, I mean, the fact is that India's still at 10 percent of economic frontier. So there's a lot of scope for catch-up and convergence, and that works in India's favor. You've got to do a lot of things wrong to really go slip behind 5, 6-percent rates of growth in India. It's not that India's incapable of doing this, but I think, you know, a lot will have to go wrong, and I don't think that will go wrong. So we have – you know, we have this advantage of backwardness working for us for some considerable time, and that will sustain us.

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I think that the second thing to note which is said – you know, I spoke about, you know, the whole capacity and the corruption thing. I think to some extent, you know, the private sector and technology can substitute, but I said only partially and only imperfectly can substitute for a kind of flailing state. A good example is, you know, our subsidies are wasteful, but then we have this new program called Aadhaar, which is a biometric identification program, and there's a lot of hope and promise that if we move from, you know, subsidies to cash-based transfers using technology, that, you know, it will be more effective, more efficient, less wastage, and also will have fiscal benefits, compensation as well. So technology as a partial solution to some of the flailing – to some of the flailing state is possible. And I can give you other examples of this.

The second, I think, another basis for hope is what I call, you know, the growth-begetting-growth dynamic that's taken over. So the way, you know, I think about Indian growth is that it's not that, you know, necessarily in the recent period or even if you compare India with, say, many of the Latins or the African countries, for example -- India's actually reformed much less than any of these countries, but yet, you know, India's growth rates have been much greater than many of these countries. So the argument here I have is that it's not necessarily that reforms beget growth, but that growth begets growth.

And it's a little bit of variant of – again, Jagdish has this nice phrase called, you know – Jagdish has the rising aspirations that, you know, leads to a greater demand for change from below. And one good example is primary education, for example. Indian was a disaster, the Indian state was horrible in delivering primary education, but now, because people want education, because the returns of education have gone up with growth, you know, educational attainment in India is actually improving, the private sector's partially filling in for it, so there is this kind of growth-begetting-growth dynamic. And there are, again, many examples of this that one can talk about.

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I think – the other thing which I think gives me hope is that fundamentally -- you know, I speak a lot on China and India as well, and people always say, you know, don't you wish India were like China in terms of decision-making? And then, you know, here I think Donald Rumsfeld was right. I mean, you go to bat with the political system you have, not with the one you wish you had. And so the point is that, you know, any solution to India's problems has to come from, you know, democracy itself. It has to be democracy that, you know, overcomes democracy's problems. As Eliot said, only through time is time conquered. And to some extent that is happening in India. We have much more this dynamic of competition between the states. Where some states do well, you know, that becomes both a model, a magnet, and so other states are being forced to perform to attract the capital and the labor and to get rid of some of the dysfunctionality.

So you see this emerging nascent dynamic of competition between states, and what you've begun to see more recently is a greater responsiveness of politics to this change; that when governments, state governments deliver, they get re-elected more than they used to in the past. So in summary, the hope is that – you know, you're stuck with this democracy, imperfect democracy, but endogenously this democracy is throwing up some of the basis for hope, as well.

And the last basis for hope, which I don't have here, which is very important, is that, you know, the fear of crises as an impetus for reform, very strong in India. And in that respect, the Indian political system is no different from the U.S. political system or the European political system. You know, when you see the brink, you know, you act. And that's what happened in India recently. You know, facing a downgrade, growth collapsing and so on, Indian policymakers were forced to act. And I think recently there've been a number of very promising initiatives. You know, FDI's been liberalized, as people have said, but very interestingly, the last couple of days a major piece of fiscal reform – you know, the implementation of the VAT, a VAT-like tax, which, of course, the U.S. would do well to look at the Indian example of how it came about – there's a good prospect now that this GST will be implemented, which means that our fiscal situation can also improve. So I think the fear of crises is also – .

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So, I mean, you know, when you say what's the bottom line here, I don't know what the bottom line is. I mean, you know, as Joan Robinson said, you know, everything and its opposite is true about India. And what my kind of slightly risqué kind of variant on that is, you know, Wendy Doniger says that, you know, India is like a Sanskrit word, and every Sanskrit word means itself and its opposite, and every Sanskrit word represents a god but also a position in sexual intercourse. So, you know – so India is a little bit like that, you know; everything and its opposite is true about India.

Now, will India make it big? I think it's a very simple question to answer. The answer is unambiguously no for the next 20 years. And so this is a chart from my book, where I plot, you know, the economic dominance – I have an indicator of economic dominance, which combines a country's GDP, its trade and its external financial strength.

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The answer is unambiguously “no” for the next 20 years. And so this is a chart from my book where I plot you know the economic dominance – I have an indicator of economic dominance which combines a country’s GDP, its trade and its external financial strength. And I plot these going back in history. You know, 1870 onwards, the index tracks pretty well what we know about the world in terms of, you know, superpower dominance.

And we find that India – even with, you know, very generous rates of growth for India over the next 20 years, India is not going to be a major, you know, global player a la the U.S. or China. Now, let me be clear: I am not saying this is a bad thing. I’m not saying that India will not have influence in South Asia or East Asia or that in some issues it’ll be a major player, like climate change. All I’m saying here is that, you know, one has to see India in perspective in terms of the basic size. You know, India is still very poor, very small, not a big trader, not very strong financially, externally. So unless things change dramatically, I don’t think India is going to be a G-1 or a – part of a G-1 or a G-2 like China or the United States.

But as I said, that may not be bad thing. So bottom line is that, you know, we – the wonder is that India still manages, somehow, to generate these rates of growth. And there’s enough hope that that model can, kind of, continue, even if it sputters along the way. Thank you.

MR. TELLIS: Thank you.

(Applause.)

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Thank you, Arvind. That was a quite remarkable tour de force. I’m always – I’m always reluctant to ask people to provide overviews of the Indian economy or Indian society, simply because it’s so hard to do justice to the complexities and to the tensions of the subject that one has to describe. And I think Arvind did a remarkable job of providing the nuance behind the numbers so we can actually move beyond the simplistic stories about 6 percent growth or 7 percent growth and the like. So thank you very much for that effort.

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I’m going to yield the floor to Devesh Kapur. Devesh is the director for the Center for the Advanced Study of India at the University of Pennsylvania and has really done some of the most remarkable empirical work in Indian political economy in the last few years. As Arvind mentioned, he has done this pioneering study on looking at the impact of economic reform on India’s lower castes, in particular the Dalit population. And so he has developed, over the last several years at U Penn, a remarkable body of work that gives us a very good view of India, in a sense, from the ground up.

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So without further ado, I’ll ask Devesh to speak – (inaudible).

DEVESH KAPUR: Thank you, Ashley. Arvind has already mentioned that one of the things that is going to be – is transforming India is our education. My focus here is on Indian higher education, and the reason is quite simple. India does not have much of natural assets. It's scarce in land, scarce in water, very scarce in sort of energy.

The only thing it has – and it has in abundance – is people. In the last 20 years India added a population of 360 million people. It added, in 20 years, more people than it had at the time of independence. It added, in 20 years, more than people than it had added over, whatever, 5,000 years. It added, in 20 years, more people than the entire population of the United States in one-third of the land size, right?

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So you can see that there's absolutely no doubt that this is going to have a profound impact on governance in India, and these people are slowly now entering the labor market, right? So if they are trained well, India will have a massive demographic dividend. If they're not trained well, it's going to be a massive – it'll be very, very bad for India.

Now, what I'm going to do is just – my talk will focus on some of these demographic pressures, the trends in Indian higher education. And the point I want to make is that higher education in India is never going to replicate the Western model of brick and mortar, like in U.S. states. That is not the way in the 21st century, and there is simply no way that India can replicate that given the massive numbers of people who are joining higher education. I'll look at some of the barriers and where we might see. So this is the age group – the working age group, right? This is where we see the demographic dividend. In the past, like, 20 years, in this particular age group, India added about 250 million people. In the next 20 years, it'll be 230 million, right?

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Now, the quality of their training – their human capital obviously will make a massive impact on the shape of – on the way the Indian economy goes. Now, the pressures on higher education are also being driven by the fact that for the first time, there's been major increases in enrollment in primary and secondary level, and these are now all – the bulge is now hitting the higher education sector. And there's massive changes in aspirations. I mean, it is really something that is hard to document, but it is very evident when you go, like, to India.

This is the enrollment growth. What you see is – one thing is that Indian higher education is basically – began – is now highly privatized, right? From about 2006, '7, the private sector began to dominate the public sector, and that dominance has begun to increase more and more, right? Sixty percent of all higher education students are enrolled in private sector institutions; this fraction is going to grow. So India is far more privatized in higher education than the United States.

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This was the last five years, from 2006 to 2011, and you can see where the growth has been taking place. It's been mainly in the private sector and a little bit both in – what I call, you know, degrees, which are normal college degrees. Diploma would be the equivalent here of community colleges.

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For you can see is where people who performed the study. And look at the contrast between science and engineering, right? It's almost an order of magnitude in difference, right? Very few people are going in the sciences – in the basic sciences. Really, the huge demand is for professional education, right? And so you see arts and science, which used to be the bulk of Indian higher education till the 1970s – there is absolute, you know, stagnation there.

And then lots of broader questions about what happens when liberal arts collapse. And basically, what we see is that India had a strong tradition of liberal arts type of education till about the '60s and '70s. That is virtually vanishing, relative to the massive growths in other parts of the higher education system. Is that – what are the broader implications of that, I think, is a completely open question.

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If you look at this on the growth of institutions, right, at the central level, the state level and private – just the one data which I want is at the bottom right. So India added 17,000 colleges, roughly, in the last five years. That means it opened 10 new colleges every day – weekday, weekends – in the last five years. Now, you can imagine what quality is when you open 10 new colleges every day, weekday, weekend, for five years. (Laughter.) And this number is going to actually increase. So that's the part that I'll come to about what are people studying and what is the quality of this.

The one thing that has transformed is the growth of (central ?). The quality of Indian higher education still is in the public sector, but in that tiny part of the public sector which is the federal government institutions, which are the IITs, the so-called Indian Institutes of Management and the institutions which I have sort of laid down there, that actually has seen a very large increase, for the first time after about 40 years. That was the big change in the past five years. But all of these combined are barely 3 percent of the Indian higher education system.

So if you think of higher education as a place of – where also, you know, you – it's not about just training people but where knowledge is also created, these are the institutions which are net generators of knowledge, not just consumers of knowledge. But that is, at best, about 3 percent of the entire – of the entire system.

Now, these are what the government plans – I was part of this body, and it was quite – sort of amazing how mechanically it's done, but nonetheless, that's Indian planning for you. Now, if you see the sheer aspirations there, right, to – India plans to increase its gross enrollment ratio in higher education from 18 percent to 25 percent. It plans to increase the number of Ph.D.s from 100,000 – so enrollment – to about 300,000.

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Now to give you a sense of some work we are doing there, the number of people born in India living in the U.S. who have Ph.D.s is about 85,000. The total number of Ph.D.s is – which India had in 2010 was about 10,000, of which about, at best, 10 to 15 percent are of the same quality as the number – as the number here. So it'll take 40 years for India just to get the stock within India

of the stock of Indians living here in the U.S. with comparable qualities at least. That's one aspect of the extent of the brain drain, but it's also had a very inimical aspect on higher education in India, because where Indian higher education has been weakest and has found it hardest to replicate quality is the complete absence of faculty, of faculty in – of sufficient numbers, given the massive increases in enrollment.

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So the – besides the shortage of faculty, I'll talk about some political-economic constraints of the governance of these institutions, and I won't get into that, but there are also broader systemic – this is not a problem peculiar to India. It's been a problem, you know, globally, where higher education really is about credentials but without many skills. People are looking for stamps of like degrees, even though those degrees don't really reward you, with, sort of, labor markets.

Now the reason that Indian – that Indian higher education has had so many problems of course is sort of rooted in political economy. When lower-caste parties came to power, beginning from the 1970s, they saw higher education as the bastion of upper-caste power, intellectual power. So the first thing they did, they spent 20 years trying to gut these institutions to undermine the political base of the upper castes, and there was absolutely a very conscious strategy, especially in state universities.

But as we know with higher education, easy to destroy, very, very difficult to rebuild. And so that's been why these institutions have foundered.

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So what's happened is all the elites have been – have been fleeing to overseas institutions. So the elite has less stake in public higher education because their kids are going outside.

Now you have a very complex structure of higher education, like regulation. Regulation is captured. If you see, almost every single regulator in the past few years has been indicted for corruption. In fact, there is not one who has not been of these institutions. (Laughter.)

So you can see how much rents there are in this – in this sector.

What are the mismatches? There is a big supply-demand mismatch. There's a credentials-skills mismatch and an aspirations and occupations mismatch. I'll just focus on the last, because I'm running out of time.

The thing that has changed hugely in the last few years is for the first time the Indian government is investing with the private sector on skills development, as distinct from the – what we call college education, right. And this is what we call the upper end of blue-collar worker skills, which is desperately needed for the sort of manufacturing that Arvind, you know, referred to.

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And you can see that – so what is – what is planned is to create programs to skill 150 million workers by 2022, which is about 15 million per year. That's a very large magnitude.

And so this is being – for the first time actually being led by someone from the private sector. It's a public-private partnership. The former CEO of Data Consulting Services is now heading this very ambitious program. And you know, what they have done, I think, very nicely is to bring in sectoral expertise from the private sector to see what is it that private sector labor markets really, what skills, and use that as ways to sort of skill these people.

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I'll sort of skip that. But this for one thing which I think is important.

So we've just done a survey of young people in high schools across India, and what we've asked is then what is it that they want to study. So we're looking at the demand side, as opposed to what the economists are saying where the jobs are. And what you see is a huge mismatch between where people – what degrees that young people want to study and so where the jobs are. Where you see the box – oh, sorry. If you look at this box, which is where you have more jobs and where you have strong student interests, which is the ideal box, it's blank, right? Where you see few jobs, where you see you have the opposite box, where you have few jobs but also high student interest, so you see that the boxes where you have – where we think all the jobs will be are not what students are interested in so studying. And that, I think creates a huge mismatch between what students are studying and where the jobs are, which I think, again, will – is going to have considerable, sort of, effects.

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This is not just a problem with India. It's a problem that is plaguing global higher education, which is the – what I call the trilemma, right. There's an issue of scale, cost and quality. Public policy can only choose two of three variables. If you want scale and managed costs, your quality will be low. If you want really good quality and you want scale, costs will be very, very large, right?

And given the sheer number of people that India is – that are entering higher education, this is – this tension is much more acute sort of in the Indian case.

I think this is the future of Indian higher education. It is not going to be brick-and-mortar universities. There's going to be a lot of explosion of online because young people are desperate for quality. Most of these 32,000 colleges in India have zero signaling effect on labor markets, so they want some degrees, some course they can take, wherever they can, which can give some signal to labor markets.

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You are seeing the private sector starting its own sort of in-house, so-called corporate campuses. The largest sort of investments in higher education have actually been made by IT companies who've opened half-a-billion-dollar campuses, way exceeding the investments made by the public sector.

For elites, it's exit. It's overseas higher education. And that, I think, is the likely future of Indian higher education.

Thank you. (Applause.)

MR. TELLIS: Listening to Devesh on this is like the psychological equivalent of taking a cold water bath. (Laughter.) So – (chuckles) – I just hope that India’s planners can actually see more of this – can see more of the work done in this regard, because the real tragedy is not the reality that he describes but the imperfect responses that policymakers have made towards addressing this issue. So I hope we can come back to that discussion in the – in the Q-and-A.

[00:38:42]

I’ll leave the floor to Milan Vaishnav.

MILAN VAISHNAV: Should I go –

MR. TELLIS: Yes, whatever’s convenient. Milan is the newest member of the South Asia program, a Columbia Ph.D., just came on board, has done some extraordinary work with respect to corruption in India, but not corruption simply at the headline level, which is what people pay attention to, but the structural sources of corruption. And I hope he will get an opportunity to touch on some of that this morning.

Milan.

MR. VAISHNAV: Thank you, Ashley. It’s a real honor and a privilege to be here with – quite literally on a panel with my four gurus. And as I was thinking about it this morning, it sort of has two consequences of being on a panel with your gurus. One is that if you say something that’s not entirely sensible, you’re going to hear about it right afterwards. And the second thing is, everything I’m about to say, one of these guys has already said, so that it’s sort of an awkward position.

[00:39:39]

Ashley wanted me to speak about corruption, and I was reminded of, you know, being a – when I was a graduate student, the question you feared most as a Ph.D. student is, you know, what’s your dissertation on? And so what I would say – well, it’s on corruption in India, and nine times out of 10, people would sort of respond by looking aghast and saying, wow, your dissertation must be really long. (Laughter.) So I’m not going to read my dissertation, fortunately for you, but I just want to make a couple of points. I want to present three sort of stylized facts about corruption and how I perceive corruption today in India and then say three things about possible solutions and with all the caveats therein.

[00:40:23]

So the first is that, you know, I think India’s corruption problem, which has received a ton of attention in the Western press, as well, of course, domestically, is going to get worse before it gets better. But this can actually be framed as positive news on at least two counts. The first is that improved transparency in the system has led to greater exposure of corrupt acts. So you now have accountability mechanisms like the comptroller and auditor general, the CAG, which has broken

entirely new ground in being assertive and going after government corruption. The result is when you have greater sunlight, there's going to be a greater amount of perceived corruption. And corruption often operates with a lag. So there's a lot of rot in the system, and it's going to take a lot of time to come out.

[00:41:16]

And I think a lot of people are worried about, well, isn't this going to lead to increased uncertainty and the so-called policy paralysis, and I think the answer is yes. When you're a senior IS officer working in a ministry and the guy who had your job before you was hauled away and is now in jail indicted on corruption charges, that's going to have a chilling effect on your willingness to take a tough call in your ministry. But this can also lead, I think, to a fundamental rethink about governance and about the policy frameworks that are in place. And so I sort of agree with Pratap Bhanu Mehta, who said, you know, the silver lining in this corruption is that there's sort of a great cleansing that's taking place, and I think we should recognize that that's what's going on right now.

[00:42:04]

The second way to spin this somewhat positively – and Arvind actually alluded to this – is, you know, faster economic growth expands the rent-seeking frontier. It opens up all kinds of new possibilities for rent-seeking. So the improved productivity of the economy following the landmark reforms of the early '90s has actually provided new opportunities for rents. So we think about the natural resource sector, which has really taken off, and things like mining and coal and so on and so forth. These are things which the reforms didn't address. They were seen as sort of second-order issues. And this is a result of the economy taking off, that we see a lot of corruption.

So paradoxically, if you take a state like Bihar, which was, you know, a poor North Indian state; it traditionally is a sort of laggard state now being governed by a relatively upstanding chief minister who's tried to enact a lot of reform – growth has taken off. And we're likely, I would argue, to see more corruption in Bihar than we have in the past because growth is taking off, and as part of the modernization process, we're likely to see more corruption. So if you think about the scam of all scams, what used to be the scam of all scams was the fodder scam in which the chief minister of Bihar and his aides embezzled funds from the animal husbandry department. This was livestock and feed that was sort of falsified. This was about a \$500 million scam, which is just absolutely nothing compared to the scale of the telecom scam, 2G, which even if you take the lowest estimates of \$13 billion, you know, was orders of magnitude greater. So the corruption problem will get worse before it gets better, and this could be a sign of better transparency and improved growth.

[00:43:53]

The second point is that, you know, short-term fixes and the desire to enact short-term fixes could lead to long-term headaches. And I think here the government of India has to be very careful in addressing the causes rather than the symptoms of institutional dysfunction. So just to give you an example, you know, as kind of exhibit A, think about what's happened in the aftermath of this horrific gang rape in Delhi, which I'm sure all of you are well-aware of. So in light of that, the chief justice of India asked all of the state high courts to institute fast-track courts to deal with rape. So in three weeks, six fast-track courts in Delhi are now already burdened with 500 pending rape cases.

Even before this, the government of India had instituted rape – sorry, instituted fast-track courts for cases which had been sort of pending for quite a long time.

[00:44:51]

So again, to go – use the example of Bihar, Bihar has the largest number of fast-track courts in all of India – it has about 180 – but it also has the second-highest number of pending cases and a pretty poor clearance rate of getting through those cases. So fast-track courts, while they sound good, they also raise the possibility or the question, you know, well, why just fast-track courts for rapists? Why shouldn't we have fast-track courts for murderers? Why shouldn't we have fast-track courts for criminal politicians?

[00:45:26]

You know, the recommendation here, I think, is that we have to deal – the government of India has to deal with systemic deficiencies, so they have to deal with the fact that one out of three high court positions – judiciary positions – is vacant, one in every five district-level court positions is vacant. We have a pendency of around 32 million cases in India right now. And if you just take New Delhi alone – this data is from a couple of years ago – local magistrates had 480,000 pending check-balancing cases. So this is, you know, a challenge, but it's not going to be fixed by going for the instant – for the quick win, for instant gratification. These are just really Band-Aids.

You know, one – another example in this regard is thinking about the Lokpal bill, which is – it's the idea of setting up an anti-corruption ombudsman. This is what led to the pretty dramatic street protest two summers ago led by Anna Hazare and his team. And the idea was, you know, let's create an anti-corruption ombudsman to deal with India's corruption mess, and I think it's – there's a lot of merit in the idea. The problem is people spoke about it as if it was a panacea, unwilling to really acknowledge the underlying deficits in the system. So what was so frustrating as an outsider – I think a lot of us felt, you know, where is this group on things like the judicial accountability bill? Where are they on protecting whistleblowers? Where are they on reforming land laws and land acquisition? Where are they on reforming the system of election finance? So these are all crucial pieces, and no one is really going to be a panacea.

So the third stylized fact is about politicians, and I think here we have to come to grips with the fact that, you know, politicians are both the problem and the solution, and I think there's a real tendency to sort of demonize politics and politicians that certainly went on during the Anna Hazare street protests, and I think we saw it again during the gender violence protests, where the chief minister of Delhi, Sheila Dikshit, came down to talk to the protesters, and she was chased away, you know? I mean, she had to be scurried away for fear of being lynched.

[00:47:53]

And you can understand the anger that people must have felt. But there needs to be a transition from the people who are agitating for fixing corruption and for better governance from agitational politics to a more pragmatic politics. So this means they need to start speaking the language of politics, and that means legislation. They need to get into the good, old-fashioned American style of lobbying and interest groups. And this also means that the middle class has to embrace electoral politics. They have to start fielding candidates for office, and they have to vote.

You know, traditionally India has been one of those outliers where the poor actually vote at much higher levels than the middle class and the wealthy, and this needs to change.

[00:48:40]

Another example of, I think, the demonization of politics has to do with India's so-called criminal politicians. You know, most people are familiar with the statistics. Thirty percent of parliamentarians are under criminal indictment; 1-in-5 state legislators are. And there are reported pleas by a wide variety of groups to – you know, please, political parties, stop giving tickets to these candidates under your Congress, BJP, regional party heading. But we never really stop and ask, why do parties want these people? Why do voters actually vote for them, quite often when they're given a choice?

[00:49:19]

So some research we're doing here at Carnegie shows that, you know, voters are actually supporting criminal politicians because, not in spite, of their criminality, that criminality is actually viewed as a signal of credibility to get things done. And so to address this, you need to focus on things like the inability of the state to impartially administer benefits, the inability for the justice system to adjudicate disputes, the tendency of frontline functionaries of the Indian state to prey on the citizenry rather than – rather than to serve them. So it's a complex problem, but we sort of demonize politicians without really understanding what the marketplace for these sorts of politicians are.

[00:50:08]

Let me transition to talking about sort of three remedies or potential remedies for the future in dealing with corruption. I think each has its merits. All are showing signs of stress and strain, and I think we need to examine them very closely in the coming months and years to make sure that they can be effective agents of tackling India's corruption issue.

The first is the Supreme Court. So whereas in this country, judicial activism has been sort of a bad word you don't really use, in India, judicial activism, in some ways, you could argue, has been actually quite productive. So the Supreme Court has been quite activist and – in terms of improving government accountability, especially through the use of public interest litigation, so ensuring things – trying to ensure things like the right to education, the right to food and so on and so forth.

The problem is, as Nick Robinson, who's a scholar in New Delhi, has pointed out, it's been so successful, it's completely turned into a lopsided judicial system. So you now have an overburdened top, the apex court of the Supreme Court, and very little functioning underneath. So in the last 10 years, from 2000 to 2010, the number of cases brought before the Supreme Court has actually doubled. So people are losing faith in the lower judiciary and the subsidiary courts and going straight to the Supreme Court.

[00:51:38]

So just in Delhi alone, you know, which one would think perhaps might have the more functional court, there have been judgments which were decided in 2011 which haven't been

announced yet. They're just sitting on someone's desk. There's a verdict in the case, there's a judgment there, but they've been waiting for someone to schedule a time for the judge to pronounce his announcement.

The second source of hope is the Election Commission of India, so – which I think rightly deserves praise for managing free and fair elections for 700 million voters using electronic voting machines, something we can't yet even figure out how to do in this country. (Laughter.) So it's been a model for democracies around the world, but it's really struggled to contain what I call the rise of money and muscle, so that's the rise of illicit black election finance and of criminality in politics. So the Election Commission places quite stringent limits on election expenditures, but politicians and parties continue to flout those restrictions without any kind of repercussion. So going forward, the Election Commission needs to be bold, it needs to interpret its remit broadly, and it needs to protect itself from – its independence from executive and legislative infringement.

[00:53:03]

Let me just end by saying something about the Right to Information Act, which was modeled after our Freedom of Information Act here in the United States. That's the third potential hope for India, where ordinary Indians can demand information about the functioning of government within 30 days, or the bureaucrat who is responsible for giving that information is subject to a financial penalty, which comes out of his or her paycheck. I think this has been a great tool, an invaluable tool for civil society activism, holding the government's feet to the fire. But there's a disturbing trend of violence and retribution against people who are filing so-called RTI requests from the government. And this system needs to be protected to make sure that it doesn't turn into something that people are reluctant to use going forward.

So let me just end there. Thanks very much. (Applause.)

[00:54:01]

MR. TELLIS: Thank you, Milan.

The last speaker we have today is Vikram Nehru. Vikram is formerly the holder of the Bakri Chair in Southeast Asian Studies at Carnegie, but he's actually a stealth member of the South Asia Program. (Laughter.) He didn't know it until this moment. Vikram actually began his career in the Indian Administrative Service and has a long and intimate familiarity with the country. After he resigned from the IAS, he went on to a very distinguished career at the World Bank, where he worked on Asia issues more generally and now, as I said, focuses formally on Southeast Asia but is actually a very close student of India, particularly in terms of its international engagement. And so what I've asked him today is to kind of round the story by talking about India's external economic engagement, with Asia in particular.

So over to you, Vikram.

VIKRAM NEHRU: Well, thank you very much, Ashley.

And good morning to all of you. I'm going to break with tradition and speak from the table. And being the last four speakers on the panel, I'm very conscious of the fact that I really should be

brief to allow time for questions. So let me start just by giving you my bottom line. That way, you can forget about the rest of the stuff that I'm going to talk about. (Laughter.)

[00:55:20]

And if you look around the world, the biggest opportunities for India externally are going to be in East Asia. And my bottom line is that developments in East Asia provide India enormous opportunities to increase trade investment flows and become part of the East Asian production network. And this could potentially be an enormous, a big, an important driver of future growth. And all of this, of course, would depend upon whether reforms within India continue to go forward, as my India experts have talked about on this – on this panel.

So in short, there is enormous opportunity for an elephant to enter the dragon's den. And by the dragon's den, I mean Southeast Asia. And I'm going to point to three important economic opportunities that are coming by India's way and three important geopolitical shifts taking place in East Asia which are likely to be very favorable for India.

[00:56:27]

But before I do that, let me just emphasize this point that Southeast Asia in particular is China's – is the dragon's den. And the reality is that a lot of the success of China, a lot of the success of Southeast Asia has been because of very rapid growth between those two parts of the world. Growth over the last decade, for example, has been at 20 percent a year. Growth in trade has been 20 percent a year between China and Southeast Asia. And this is double the growth that's taking place within Southeast Asia itself. And this growth in trade has permitted much greater specialization, much greater economies of scale within firms, within industries and within urban agglomerations and has created the famed East Asia production network which has proved so incredibly competitive in the world.

[00:57:26]

So that's – so that's what's been happening in East Asia. But this is going to continue, and continue in spades. It's going to continue in spades because you're going to – you're going to see a lot more infrastructure development, which is going to connect China with mainland Southeast Asia, and that's happening very quickly and very rapidly. Secondly, China saves 55 percent of its GDP and only invests 45 percent or thereabouts. And there is a large amount of accumulated capital in China behind capital controls. And I believe those capital controls eventually are going to come down. They are going to have to come down for that capital to earn reasonable rates of return. And a lot of – there's going to be, in other words, a substantial increase in outward foreign direct investment from China, and a big beneficiary of that is going to be Southeast Asia. So that's going to further create more integration between China and Southeast Asia.

[00:58:29]

And the third I would like to point out are the Chinese communities in Southeast Asia, the significant communities in Singapore and Brunei and in Malaysia and everywhere, literally, around Southeast Asia. And these Southeast Asian ethnic Chinese communities have outsized – provide outside contributions to economic growth and GDP, profits, and are – indeed, have been

instrumental in developing financial and trade links with the mainland. And that is obviously going to continue.

Now, India, on the other hand, at this point is a relatively small player in Southeast Asia. It's not that India's trade has not been growing in Southeast Asia; it's been growing very rapidly, at about the same rate, over the last decade, as China's Southeast Asia growth, in other words, 20 percent a year over the last decade. It's just that India was a relatively late starter. So India now has something like \$75 billion worth of trade with Southeast Asia, whereas China has \$300 billion worth of trade with Southeast Asia. So India is about a quarter – about a quarter of Southeast Asia's trade contribution.

[00:59:39]

And what's more important is that the bulk of the trade between China and Southeast Asia is in manufacture, this part of the production network story. But the bulk of the trade between India and Southeast Asia is not manufactures. In fact, it's commodities, minerals, ores, metals and fuels and agricultural materials. So India is not part of that East Asia production network.

[01:00:11]

Now, what's important, though, to recognize is that this very rapid growth of trade between India and Southeast Asia is – has been largely because of the economic reforms that were introduced in the early 1990s. Now, at the same time India also introduced a “Look East” policy, but I could not find and I cannot find many concrete manifestations of how that “Look East” policy actually influenced the economic relations between India and Southeast Asia. So it's primarily been general economic reforms, the opening up of the Indian economic system, the increased incentives to export that have contributed to this very rapid growth of trade between India and Southeast Asia.

So let me now come to the three economic opportunities that I think are opening up for India. And these economic opportunities will and can be captured, of course, if India is able to implement its domestic economic reforms.

The first economic opportunity is the obvious one, that within China, you're seeing rising real wages and an appreciating real exchange rate, and this trend is going to continue.

[01:01:25]

Now, the initial reaction of many of the labor-intensive firms on coastal China has been to move inland, where land prices and labor prices are lower and more than compensate for the increased transportation cost within China, thanks to China's excellent infrastructure. But very soon a large number of those firms – and many of them, incidentally, are firms that are owned or run by foreign investors – are going to have to look for other labor – look for other sites which have labor surplus – labor surplus. Many of the sites are, indeed, in Southeast Asia itself.

But I daresay India could be a very important destination for many of those investments, particularly because India brings many of the advances that China has: a large domestic market, potentially enormous opportunities for agglomeration economies and industry-wide economies.

[01:02:18]

The second important economic opportunity is that I firmly believe that the future of East Asian growth is going to lie now in a liberalization not of trade in goods but of a liberalization of trade in services. And I believe that India has a distinct comparative advantage in services. This is something that Arvind has talked about. And in fact, I want to point to one of Arvind's articles, which he produced some time ago, which showed that, in fact, when you do liberalize trade in services, it can have very important positive implications for growth.

So the liberalization of trade and services is not only going to lead to rapid East Asian growth, but if India is able to capitalize on that and able to take advantage of it, India is well-positioned to do so. But there are certain dimensions of trade and services which are important. It doesn't require just the movement of services through IT, for example; it also requires the movement of people; it requires the improvement of, say, visa services and labor market opportunities which permit the movement of people to provide those services.

[01:03:32]

The third economic opportunity that is coming by India's way is now the Regional Comprehensive Economic Partnership, the launch of which was announced late last year in the last ASEAN summit meeting. Now, India can't participate in the TPP because it is not a member of APEC – not that India necessarily wants to participate in the TPP, but that is the other game in town, so to speak. But for India, the RCEP, or the Regional Comprehensive Economic Partnership, is the only game in town.

And there are many reasons why I believe that India could benefit a lot from the Regional Comprehensive Economic Partnership. Just to let you know, the Regional Comprehensive Economic Partnership is the idea of having a free trade agreement between the 10 ASEAN countries, plus the six others that form the ASEAN plus six, and those six others are China, Japan and Korea, Australia, New Zealand and India. Now, if the Regional Comprehensive Economic Partnership were to come into being, it would be the largest free trade area in the world, because of course, it has both China and India in it. But India, naturally, would be extremely concerned about the competitive pressures that China's presence would bring to the Indian market, just as ASEAN was very concerned about those pressures when it signed the ASEAN-China free trade agreement. But in fact, that ASEAN-China free trade agreement is actually leading to very positive consequences for Southeast Asia and is going to contribute to further growth and trade there.

[01:05:10]

One of the big important advantages that the RCEP can bring to India is actually to bring some discipline, further discipline into Indian trade policy. Now, everybody's talked about how India's opened up, and that's very true. But the reality is that India's tariff levels still continue to be – or India's trade barriers still continue to be relatively high compared to its partners in East Asia. So for example, out of 104 countries that are – that are ranked in the Overall Trade Restrictiveness Index by the World Bank, India comes in at 82nd, which is very low, and there's enormous pressure. India can obtain enormous advantages by bringing down those trade barriers and, in fact, increase trade with East Asia.

So those are the three economic opportunities. Let me quickly turn to the three geopolitical events or shifts that are taking place in East Asia, which will work in favor of India. The first is what everybody's been sensing and seeing is the tension that's been created between Japan and China with the Senkaku Islands and the large backlash that's been – that's taking place within China, the anti-Japanese demonstrations and so forth that has affected Japan's trade with China. In fact, Japan's exports to China fell by 14 percent in 2012, according to the Financial Times – sorry, fell by 14 percent in 2012, according to the Financial Times.

[01:06:50]

In addition, Japanese are having to rethink their strategy of investing heavily in Thailand because many of their factories were flooded, many of them are located in the Bangkok region, and this, many people feel, is going to be a recurring problem in low-lying areas in Thailand. And so they are looking for other opportunities, other locational opportunities, and India clearly is a very attractive one. So there are legion now of Japanese foreign investors coming to India to look at opportunities there. As a senior businessman from Hitachi said, first, it was Japan for us, then we went to Thailand, and now the future for us is going to be – is going to be India.

The second geopolitical shift that's taken place is that there have been several events related to China that have not gone unnoticed in Southeast Asia itself. I've just talked about the anti-Japanese demonstrations within China, but there's also been, for example, the export ban on rare earths, which the Chinese introduced following the trawler incident in 2010. There is the ban on imports of Philippine bananas because the Philippines crossed the Chinese with respect to the Scarborough Shoals problem in the South China Sea. And there have been other such incidents, which has made – which has made Southeast Asian policymakers extremely wary of the fact that the increasing economic reliance on the Chinese economy as a driver of growth is or could potentially curtail their independence in foreign policy initiatives, those – or even economic initiatives. And while the United States pivot is providing them comfort with respect to a security umbrella, I think they are looking at India with fresh eyes in order to – in order to see whether India can provide an economic hedge in relation to China's increasing dominance of the East Asian economy.

[01:08:54]

And the last important regional geopolitical shift is the emergence of Myanmar. Now, China already has enormous influence in Myanmar, and in May, the Yunnan-to-Bay of Bengal oil pipeline will be completed and will start functioning. And India has been a small, relatively small presence, but with the – in Myanmar, but with the opening up in Myanmar, Myanmar now will provide potentially a land bridge between India – the Indian subcontinent – and Southeast Asia and, indeed, with China. And if India is able to develop infrastructure links with those two areas, it could significantly increase India-Southeast Asia and India-China trade, provided, of course, India's able to deal with the insurgency problem of the northeast, which presents a major complication.

So looking at the external environment for India vis-à-vis Southeast Asia and East Asia in general, it's very propitious. There are enormous opportunities for India on the outside. India's constraints are not external. They are very much internal. It's inside India where the binding constraints are, whether it's in human development, whether it's in corruption, whether it's in infrastructure or whether it's in the functioning of labor markets. And that's where the focus should

be because without that focus and without movements on those reforms, it's very unlikely that these economic trends, opportunities and geopolitical shifts can be captured to India's benefit.

Thank you very much. (Applause.)

[01:10:37]

MR. TELLIS: Thank you, Vikram. I want to thank my panelists for providing a really unvarnished view of the complexities of India, particularly in the economic realm, because I think the first step towards making good policy, both in India and in the United States, is dealing with the realities as they are, as opposed to simply our ambitions for India or our romantic ideas about where India may be going.

I want to open the floor, and we'll follow the same rules as before. Just identify yourself when I call on you. And if you have questions directed as specific panelists, then do that. Or just – if it's for the general panel, let me know.

Yes, ma'am. And wait for the microphone, please, because –

[01:11:18]

Q: Hi. I'm Amy Hariani with the U.S.-India Business Council. I wanted to ask a question to Mr. Nehru and maybe Mr. Subramanian on services in India. So you may know that the U.S. government announced recently on the International Service Agreement negotiations with, I think, 25 or so countries, that they're going to be launching I think this week or next week in Geneva. I wanted to sort of – Arvind, given your comments on how services have grown over the years in India and play such an important role in India's economy – I think one of your slides, it was 40 percent of something like that of the economy – and then Vikram, your comments on the opportunity for growth and services – what are your thoughts on India's participation in such a multilateral negotiation such as International Service Agreement? Is it possible for them to participate? Would it be beneficial? Are there other opportunities maybe outside of the regional agreement you mention where growth and trade, bilateral or multilateral, could benefit the services sector?

MR. TELLIS: Can I take two questions – (off mic) – I'll take another question too. Abela (ph).

[01:12:21]

Q: My name is Abela Shliki (ph). I'm a senior fellow at the South Asia Studies SAIS. My question is for all the panelists.

It's known now that in the rural space in India, we have 800 million people living, of which 250 million are below the poverty line. At the same time, as we've seen from the narrative today, rising incomes have brought about a huge middle class in India. I just wanted to know what are your thoughts on the most essential requirement of India as of now, and that is the effective delivery of core public services in rural areas. How effectively – how decentralized governance and reform in public sector in terms of grassroots governance will help these core delivery of – core public

services to happen? Because that alone probably would enhance the productivity, which adds, ultimately, to the growth story. And that, I think, is a critical factor. Your thoughts on that issue?

MR. TELLIS: Thank you. Arvind, do you want –

MR. SUBRAMANIAN: I'll take a crack –

I'll answer the first and leave others, especially Devesh to take on the second one on governance; and Milan.

[01:13:44]

On the International Services Agreement, I think the official Indian position is they've walked out of the agreement, is they're not going to join the agreement, so that's the verdict. Now, the question is, you know, is it good or bad? You know, what are the opportunities here, there? You know, I think that's – it's really a much bigger question than whether India should just join or not join the International Services Agreement. I mean, the short answer, you know, of course it should join because, you know, it's happening, it should participate. You know, being left out is not a good thing.

But I think – you know, picking up on what, you know, something Jagdish said, I think what India, China and the U.S. need to step back and think is how do they see the world trading system evolving. You know, we have this impulse, which Vikram spoke about, which the U.S. now is pushing, which is, you know, greater integration in East Asia. I think it has promise, as Vikram said, but I think it also has pitfalls, serious pitfalls.

[01:14:43]

One of the most serious pitfalls is, in fact – relates to what Vikram said in the second part, which is, you know, how do you manage the rise of China? I think that's the number one question, which, in my view, goes beyond, you know, International Services Agreement and so on.

So, I mean, one can't get excited about this, but I really think we need to step back and say, how do you want the whole trading system to evolve, and my own preference – which I kind of spell out in my book – partly because of the rise of China, is that we need a much stronger multilateral system.

[01:15:13]

So in that sense, I think if the ISA is a move towards that, I think it's very short-sighted of the Indians not to participate in this. But I can understand that because, you know, if it's only going to be in services, I think that's very – you know, it's not enough, and it should be much broader, something that brings in China much more.

MR. TELLIS: Is the solution then to tie the ISA to the reform of the larger trading system? I mean, does one need a roadmap that shows how one gets from A to B?

MR. SUBRAMANIAN: I think, you know, that's a tactical question, Ashley. And it's not clear to me that you can actually do that. You can't really say, no, because these things have a dynamic of their own, and, you know, God knows how these things end. And I think what, you know, what needs to happen is that the world needs to say, you know, let's – DOHA is dead, finished, let's bury it and let's start afresh. And that's how we – and if the ISA is part of that, very good. But I think we need a much broader agenda than just services.

[01:16:13]

MR. TELLIS: Yes, Devesh?

MR. KAPUR: I think on the rural India, some of the key trends are – which is sort of interesting – last five, six years has seen a surprising sort of upturn in rural India, in terms of farm output. What we don't realize is that in rural India, less than half of income now for the first time in Indian industry is actually farm income. All farm income is now the majority of income. The government program like the National Rural Employment Guarantee Scheme has pumped in huge amounts of cash in rural India.

Public services, as you rightly said, are very weak. There is little sign that they will change, at least, rapidly. Most of what is happening is being driven by the private sector. The Green Revolution of the '60s and '70s was driven entirely by the public sector R&D and extensions system, which has collapsed, at least the extension system, but new seed varieties are, like, reaching and it's entirely private sector driven. So they are driving the extension.

[01:17:21]

The other thing, which is very surprising, is that – is that – is that mechanization is increasing hugely in rural India. There are actually labor shortages; young people are not willing to work on farms. And you see a lot more migration than is being captured in the census because of the way the question is.

So these are some of the dynamic elements that are occurring in rural India in ways, I think, that we are not quite understanding.

[01:17:49]

MR. SUBRAMANIAN: Devesh – there's a second part to that – which you could – whether decentralization is the way for improving governance and services in rural India.

MR. KAPUR: I think that is absolutely – sorry – essential; as you know, that the government passed the historic 73rd and 74th amendments on decentralization. But you know, the usual thing is that decentralization involves the decentralization of functions and functionaries. And there – you know, it does not happen the way the amendments had envisaged, because the second tier of government, which is the state governments, have a great deal of interest in controlling the flow of funds, in controlling what happens at the local level. And I really think that the single biggest governance reform that India can make is now a decentralization from tier two to like tier three, not just in law, but in practice.

MR. TELLIS: Vikram?

[01:18:50]

MR. NEHRU: Yeah, I just want to come back on the services point that you raised: It's very interesting to note that India has been pushing trade and services agreements with Southeast Asia. So just last – in December, they concluded their negotiations; they haven't yet signed them but they hope to sign them by August this year once they have all the legal agreements in place. And that's an example of India actually seeing trading services being a very important component of its trade strategy vis-à-vis East Asia.

But my sense is actually that Indian negotiators are not happy with many of the agreements that they're reached. They see a difference in standards being applied to India by ASEAN vis-à-vis standards that they've applied to Australia and New Zealand. Because as I mentioned, any trading services agreement does require opening up labor markets, actually people moving between countries. And I think that there's a – there's a huge amount of concern in Southeast Asia that significant numbers of doctors, nurses, technicians, software engineers, et cetera, will start flowing into Southeast Asia to the detriment of local jobs, and so that's clearly been a factor.

[01:20:02]

Now, in the regional comprehensive economic partnership, services is going to be an important dimension of that free trade agreement. So India is –willy-nilly is going to have to now get into a discussion of the services arrangement within the broader East Asia framework.

So I think India is getting there, and it's seeing this as a part of its strategic intentions. And I – and I too sort of like Arvind believe that it's unfortunate that it isn't participating in the ISA.

Q: Thanks.

MR. TELLIS: Yes please, right there.

[01:20:38]

Q: Good morning, (Cap ?) Sharma from the Tata Group.

My question is general for the panel: It was clear what you've said that India does have a jobs problem. So I have three quick questions related to that: One, what is the current job creation that India needs to do to sustain its current level of growth? I hear various numbers anywhere between 600,000 to 800,000 jobs, so I'm curious as to what you would think those numbers should be.

Two, there's a heavy reliance on the agricultural workforce. Clearly, India cannot grow with such an agricultural workforce, so what does India need to do to reduce its dependence on an agricultural workforce? What number do you think it is – it should be around to sustain growth? Should it be 20 percent, 30 percent, 40 percent?

[01:21:22]

And third, can India afford, because it has a heavy jobs creation problem, not to have local sourcing requirements? Some of the biggest criticisms of India has been that it has a PMA rule, local sourcing requirement for multibrand retail, but to the Indian government's credit, what they're really trying to do is create new manufacturing markets so they can employ people. If it has such a high job-needs market, can they afford not to have local sourcing rules and requirements?

MR. TELLIS: Somebody else? Yes.

Q: Yes, Mike Anderson, former Foreign Service officer.

This question for Mr. Kapur – thank you for a superb update on what's happening in India in higher education – my question is this: Do you see any role for U.S. higher education in improving India's higher education system? And more specifically, is the Indian system becoming more welcoming to foreign investment, foreign influence in Indian higher education?

[01:22:31]

MR. TELLIS: I'll take one more question, yes.

Q: Good morning, wonderful presentation, all of you, great job.

Quick question: Recently, somebody said in India, very scholar person, that corruption conducted mostly in the government offices involved a lot of Dalit officers. And by meaning that, he was not accusing Dalits, but he was trying to highlight that corruption is the biggest equalizer in caste-based Indian society. But there is also – and for a voter, a young voter like me or many other Indians – the problem is there is an oligopoly within these corrupt regimes. Is it Jayalalithaa or Karunanidhi in the South India, or is Mulayam or Maya with the North India?

And the last question – and perhaps Vikram can highlight on that – that these kind of – when there is – there is no choice, people tend to get towards the civil society. And what happened during the Anna Hazare Movement and all, people saw that was a big event. And lastly, if I could ask very quickly, can India learn something from the mistakes of the Yellow Shirts – was this wretched movement in Thailand – which was, I could see that some perils there, although not completely similar, but there are some perils because of the civil society involvement.

Thank you.

[01:23:55]

MR. TELLIS: Thank you. Any one of you.

MR. SUBRAMANIAN: I'll let you do the higher education – I just want to answer the one on the local – the answer to a couple, you know, three questions – I think they're all related. And let me give a general answer, is that, you know, this whole local sourcing requirement – it's a classic case of, you know, using a third or a fourth best policy instrument to address a problem. The problem is that basically, India's pattern of development has been very unfriendly to employing India's abundant factor of production, which is unskilled labor.

And there are lots of reasons for that: one, because we emphasized higher education. You know, we had these labor laws, we had a phobia against size, so a whole gamut of factors have created this basic tendency of the system not to use unskilled labor.

[01:24:48]

Now – so as we go along, typically, the Indian system will try and fix this, patch it up, but it's not going to work unless it solves that fundamental problem. My own view is that I have very bad news, sad news – is that we are never going to solve that problem.

So as we go along, typically, the Indian system will try and fix this – patch it up. But it's not going to work unless it solves that fundamental problem. My own view is that – I have very bad news – sad news is that we are never going to solve that problem; i.e., I do not believe that when, you know, Chinese wages go up, that Chinese factories will rush to India. I think it ain't going to happen.

So what that means is that one or two cohorts of unskilled labor in India are going to be left out. So the hope for India is that, you know, we generate the supply and the skills to match India's pattern of development, because the Titanic of the model of development has set sail long ago. You can't turn it around and suddenly make it labor intensive. If you read Ed Luca's (ph) book on India, you know – you go to this factory in Pune and, you know, all these problems – he's thinking of employing robots in sort of unskilled labor, you know. That's where we are in terms of, you know, the incentives to employ unskilled labor. So I think – so I think it is going – it is a problem, and it's not one thing that's going to be solved easily. And the best way is through actually improving the supply of skills.

[01:26:11]

MR. KAPUR: I just answer two questions. Roughly, the total number of people who sort of enter the age of entering the labor force is about 10 million plus a year, not 600 (thousand) to 800,000. Now, of course, the actual labor force participation – not everyone who is of that age wants to participate in the labor force, and in India the participation of the women is about a third, so it's much less.

The thing, I think, that has transformed is, agricultural is no longer the sponge of labor absorption. In fact, over the last decade, for the first time ever, the labor force in agriculture actually had a negative rate of growth. Slightly negative, but that actually is both good and bad news. It means that this labor now must be absorbed outside agriculture. So jobs have to be created outside ag. The largest sector in which jobs grew was the construction sector, because of the massive boom, especially in urban areas. You see a lot of housing, et cetera. So the construction sector is really absorbing that semi-skill, low-skill labor which would have gone into agriculture but is now migrating and is going into construction.

[01:27:36]

Sectors like transportation – that's the second largest. But again, I think there's absolutely no doubt that part of the fear that the Indian government and the Indian state has about single, you

know, retail, et cetera, is its employment consequences. And there are very complex general equilibrium arguments whether it will be good or bad over the short term versus the medium run, but I think employment is a huge issue down the line.

Further, on sort of U.S. higher education institutions – see, the sheer size of Indian higher education institutions is – means that the effect of any U.S. higher education is really going to be marginal at best. You know, I’ve been in all these so-called ivy leagues; no one is going to set up – Harvard doesn’t want to set up a single institution in the United States other than in Cambridge; why would it go to India, right? Even if India sort of opened up? I mean, this is just nonsense. You know, people say all this stuff – we’re going to do it. When American universities go to the Middle East – you know, Cornell went to Qatar, Qatar had to write a check of \$800 million. That’s not chump change. So it makes zero –

[01:28:59]

MR. : For Qatar it is. (Laughter.)

MR. KAPUR: So I think where the opportunities which are happening is actually not in the traditional college space. It’s happening now as India opening up in the skills space, because it’s less regulated. Massive increases in demand – community colleges which India did not have, there are major interchanges that are happening in, I think, growth – and things like MOOCs, which I, like mentioned, which is – these are online course systems.

So most of the growth opportunities of U.S. higher education in India will be in these areas and in that narrow area of R & D links, which are happening between elite Indian universities and their counterparts here on, say, large science projects and so forth.

MR. : Great.

MR. NEHRU: Yeah, you – there was a very interesting question about red shirts and yellow shirts in Thailand and whether they’re – you know, is there some implication that could be drawn in the Indian context.

[01:30:00]

Just to give some people a quick background, the red shirts, which support, of course, Thaksin’s party – the Phua Thai Party, has its strength drawn from rural areas, and particularly, the Northeast. And the yellow shirts, which support the democrat party, primarily have their support from the urban elites, the military, and of course, are great supporters of the monarchy. And the irony in Thailand is that the yellow shirts can’t seem to – the democratic party can’t seem to get an electoral majority, and as a result, they can never seem to get into power through a legal – sort of, properly-run election, and the red shirts find it very difficult to maintain the support of the military. And so this is a – sort of a standoff that’s absolutely split Thailand down the middle.

And what are the implications for India? And it’s – well, a key implication – and this relates to what Arvind just talked about – and he and I may have a small disagreement here – is the danger of ignoring large portions of the country which feel they’ve been bypassed from the forces of development in Thailand.

[01:31:13]

Now, in the case of – in the case of India, when we talk about the possibility of investors coming to India in the labor-intensive industry sector, Arvind is quite right that there are many factors which will prevent that from happening, the most important of which, of course, is – are India's labor laws and the strong trade union movement in India.

But actually, when you look closer, I think, increasingly there seems to be a trend of rules and laws that are not observed – which is very common in India, incidentally – and this competition between states, which Arvind has referred to, where – I think there is a recognition now that there are huge electoral dividends for more rapid growth and improved poverty reduction and increased social development.

[01:32:04]

And more rapid growth is coming in states where – which have taken a harder line, so to speak, against the trade union movement – difficult as that may sound, but that's actually been the case. So I see a trend. It's not a big trend, but it's the beginnings of a trend where, if growth yields dividends and people begin to see what are the policies that lead to those growth impulses, they're going to begin to change policies – not necessarily change the laws, because those are going to be difficult to change, but actually ignore those laws more than they actually observe them.

MR. TELLIS: Thank you.

[01:32:45]

One of the most frustrating things in sharing a panel like this, which is so extraordinarily rich, is that I have to cut off discussions based on the pressures of a clock rather than the quality of the conversation.

In partial recompense, what we will do is put up the slides that our presenters had on the Carnegie website so you can continue to look at them. And I urge you to come and talk to the panelists throughout the day. They will be here. So – but I have to cut the discussion off because we have to go to a second panel. So thank you very much, and let me ask you to give them a real round of applause.

(Applause.)

[01:33:31]

(END)