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KEC POLICY BRIEF

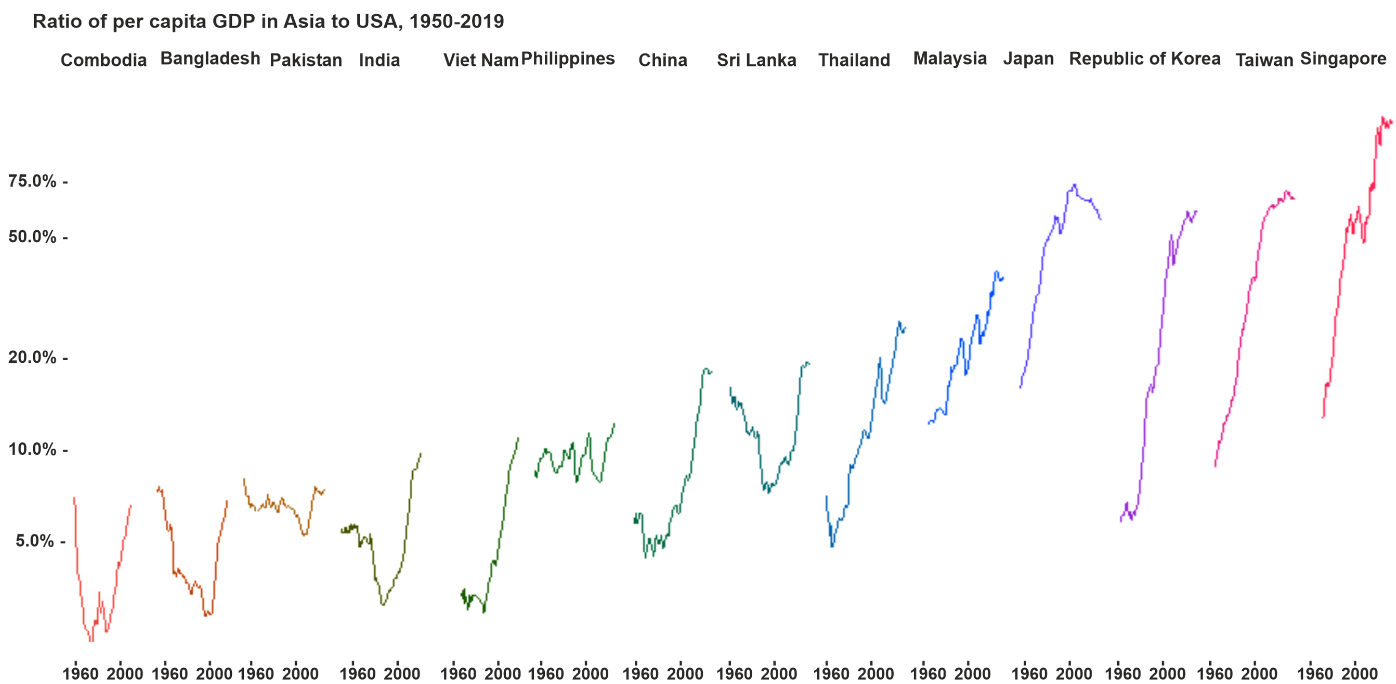
Kautilya Economic Conclave

What India can learn from East Asia's growth miracle [1]

Peter Drysdale [2] and Rojan Joshi [3]

Geopolitical conflict and competition, volatile economic conditions, and a fragmenting trading system have increased fragility in the world economy. Amid these uncertainties, the widespread re-emergence of industrial policy has reignited the debate about import substitution as a development strategy. In an era where globalisation appears to have peaked, the idea that openness to trade no longer offers the pathway to growth that early developers enjoyed is gaining credence, potentially infecting the framing of development strategy at a crucial point in India's rise as a leading economic power. Now, more than ever, it is imperative to have a clear understanding of the East Asian growth miracle – the most rapid and significant economic transformation in modern times (Figure 1) – and its lessons, which still hold true today.

Figure 1. Catch-Up Economic Development in Asia, 1950–2019



Source: Armstrong and Westland (2016)

» [1] This paper is based on a lecture delivered by the author at the Kautilya Economic Enclave, 2023 (KEC). Any opinions and conclusions expressed herein are those of the authors only and do not necessarily represent the views of the institutions organising the KEC.

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The East Asian economies each followed their own particular national paths, shaped by policy idiosyncrasies, geographic size, and location. But in all cases, development was founded on trade-oriented growth and deeper integration into the international economy, not retreat from it; government investment was directed towards social and economic infrastructure and withdrawal from state involvement in enterprise (including in China); rapid trade growth was supply-driven, built on the growth of market share in old, established industries, not expansion of trade in new high growth sectors of the global economy; and there was no successful case in which import substitution was the framing developmental strategy.

There are three main insights from the East Asia experience for policymakers in emerging economies today.

» First, economic development is about drawing relatively abundant labour into more productive employment, lifting productivity and national incomes. Opening up to competition from foreign markets and external opportunities was central to rapid growth in East Asia by diffusing low-cost capital goods and technology which could absorb abundant domestic supplies of labour into productive manufacturing employment. With the accumulation of technology and economic growth, dynamic comparative advantage then drove a more capital-intensive export structure over time (Garnaut and Anderson, 1979).

» Second, trade-oriented economic growth and industrial transformation in East Asian economies was dependent overwhelmingly on the growth of competitiveness and taking over market share in established (commonly slow-growing) international markets, not on rapid aggregate growth in international markets or on buoyant international demand in new growth sectors of the global economy.

» Third, successful industrial policy across the region, including in China, was typified by the increased mobilisation of state investment in education, health, transportation, communications and supportive industrial infrastructure, and by reduced state shares in economic enterprise and the allocation of capital, in addition to domestic reforms to support the opening up of the economy.

In short, the trope that a less optimistic outlook for global markets now recommends that emerging economies must turn to inward-looking, import-substituting growth strategies does not square with the experience of successful industrial growth in East Asia.

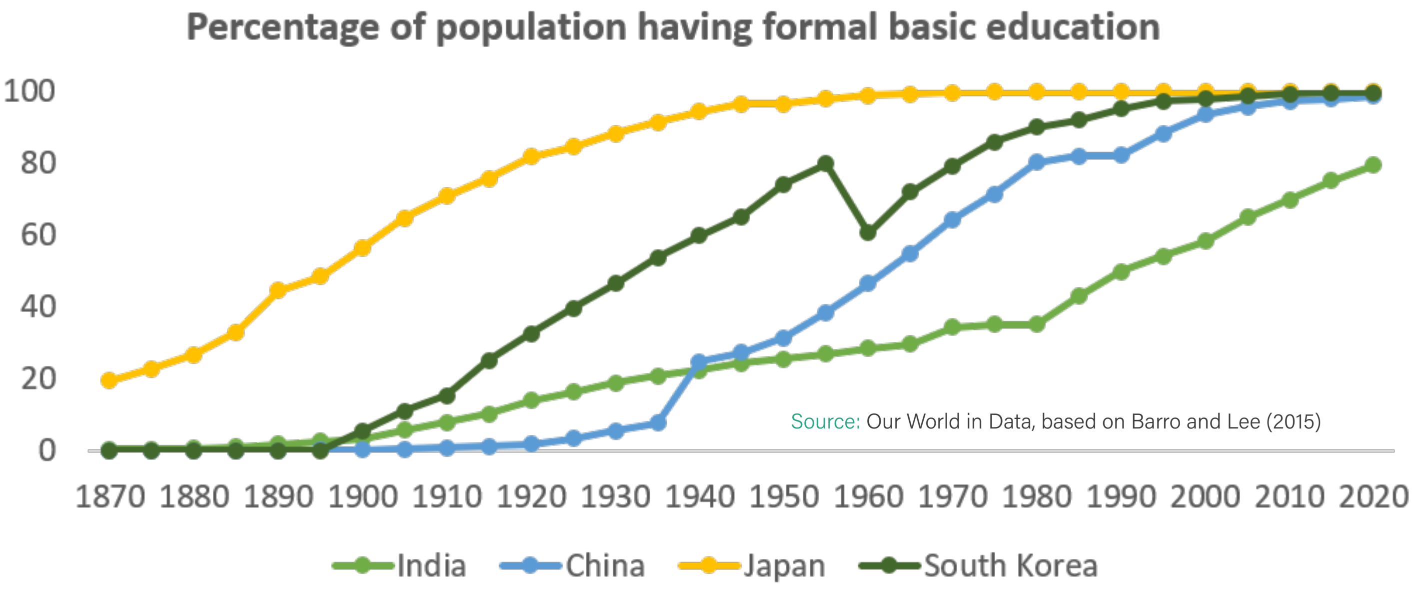
India stands at a critical juncture in its national development. Already the world's most populous country, India is projected by many to soon become the world's third-largest economy. India's youthful population and recent strong economic performance mean that it is well-placed to achieve its own ambitious development objectives. But an attunement of its strategy in line with the principles derived from the East Asian experience would place it in an even stronger position to fulfil its economic potential.

India's large and rapidly growing endowment of labour is simultaneously the greatest opportunity and most significant challenge for its future development. East Asian growth was driven by the absorption of abundant domestic labour into more productive forms of employment, and India has an even larger, still rapidly growing, population.

The need to provide sufficient opportunities for its growing population has to be at the core of India's development strategy. Every month until 2030, one million Indians will turn 18 – and they, along with millions of others, will need jobs. McKinsey (2020) estimates that meeting demographic growth will require at least 90 million more non-agricultural jobs by 2030. But current labour market statistics, with an unemployment rate of 7.5 per cent and a youth unemployment rate six times higher at 45.4 per cent (Centre for Monitoring the Indian Economy, 2023), show starkly that already the supply of jobs is not meeting labour demand. One significant issue is the mismatch between the skills that young people possess and those sought after by employers. India has seen improvement in the proportion of its population that has achieved basic levels of education, but rates still lag those in East Asia (Figure 2) and not all are immediately ready to join the workforce. . In the IT sector, for example, only about 25 per cent of graduates with engineering degrees are employable (Nair, 2020). Targeted investment in education – both to ensure that more of the population has access to education and that it offers more practical and job-related training – is critical to ensuring that India's comparative advantage in labour is used more productively.

The lessons of successful industrial transformation elsewhere suggest that an effective development strategy needs a tight connection between trade and industrial policy. An approach that shelters domestic firms from external competitive pressures will provide little incentive for them to become more efficient and productive. Industrial policy can support increases in productivity – the application of production-linked incentives should involve targets in efficiency, not volume, else it risks wasting resources on supporting inefficient and expensive production. But openness to

Figure 2. India's Education Levels in Comparative Perspective



Source: Our World in Data, based on Barro and Lee (2015)

outside economies is the best way to enable innovation and productivity growth by requiring domestic firms to compete with global firms and giving them access to better inputs through cheaper and higher quality capital. This will drive productivity and make it easier to manufacture better quality products for both domestic consumption and international markets.

Critically, integration into the global economy will enable India to leverage its comparative advantage in labour-intensive production. The nature of 'factory Asia' and the East Asian growth experience was that manufacturing bases shifted between geographic locations as economic growth lifted incomes (and therefore wages). Focusing on the economy's endowments and what it could most competitively supply – rather than what was in greatest global demand – drove growth and enabled trade structures to adapt as comparative advantages evolved.

A few decades ago, what India did or did not do in international economic affairs mattered little to outcomes in the global system. But India's growing geopolitical and economic influence now means that it has a much more important role to play in shaping the future of the global order. Preservation of the core multilateral trading system and an international environment conducive to trade and development drove East Asian growth and, through its own trade and economic policy choices, India can be an active contributor to these policy outcomes now.

The lessons of the East Asian experience are that in any circumstance, even in a fragmented international system, a trade-oriented supply-driven development strategy is the catalyst to economic prosperity.

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