East Asian Model for India

This article is based on editorial **“Inappropriate template for a legitimate target”** which appeared in The Hindu on 19th July 2019. It talks about the viability of the East Asian growth model for achieving India’s target of becoming a $5 trillion economy by 2024-25.

According to the economic survey, India needs a “virtuous cycle” of savings, investments, and exports to transform India into a $5 trillion economy in the next five years. It rightly underlines the need for India to revive private investment to become the world's third-largest economy in the near future. So for reviving India’s floundering investment rates, the economic survey highlights the **East Asian model.**

How India can become a USD 5 trillion economy by 2024-25?

- To achieve the objective of becoming a USD 5 trillion economy by 2024-25, India needs to sustain a real GDP growth rate of 8%.
- International experience, especially from high-growth East Asian economies, suggests that such growth can only be sustained by a **“virtuous cycle” of savings, investment and exports, supported by a favourable demographic phase.**
    - The survey highlights that **savings and growth** are not only positively correlated but their positive correlation is even stronger than that between growth and investment. Giving examples of China and East Asia, it said these countries had high saving and investment rates that led to high growth.
    - Investment, especially **private investment,** is the “key driver” that drives demand, creates capacity, increases labour productivity, introduces new technology, allows creative destruction, and generates jobs.
    - Similarly, **exports** must form an integral part of the growth model
    - The above parameters will lead to **job creation which will further fuel higher savings.** The relation is crucial because jobs with meaningful wages become important in driving the savings rate in the economy.
    - It further said that India has got a **great demographic advantage** and like China, it can propel higher saving and thereby higher growth.
    - Together, these factors will create a virtuous cycle which will help in achieving the ambitious agenda of becoming a $5 trillion economy.

What is East Asian Growth Model?

- The East Asian model or **state-sponsored capitalism,** is an economic system where the government invests in certain sectors of the economy in order to stimulate the growth of new industries in the private sector.
- East Asian model includes:
    - State control of finance,
    - Direct support for state-owned enterprises in strategic sectors of the economy or the creation of privately owned national champions,

    - High dependence on the export market for growth, promoting high rate of savings and investments, high educational standards, assiduity and export-oriented policy.
- It differs from a **socialistic or centrally planned economy,**
    - In a socialist economy, the government would mobilize its own resources to create the needed industries which would themselves end up being state-owned and operated.
- The East Asian model was largely a story driven by the newly industrialised economies (NIEs) of Singapore, Hong Kong, South Korea and Taiwan, and Japan earlier.
    - Specifically, the prime goal in various NIEs was to raise gross savings rates. This was done by positive demographic dividend, macroeconomic stability, low inflation, lack of social safety nets and forced savings.
    - This, coupled with the fiscal discipline practised by the economies, ensured that the public sector did not crowd out private savings and, in some cases, actually added to national savings.
    - The state-owned banks were tightly regulated as financial stability was the cornerstone of overall macroeconomic stability.
    - Another goal was to ensure that the private savings were actually channelised into the formal financial system. for this Financial inclusion was encouraged.
    - While these economies were generally successful in encouraging savings, the cost of capital was rather high. To tackle this, the East Asian economies undertook financial repression.
    - What is **financial repression?**
        - Financial repression is a term that describes measures by which governments channel funds to themselves as a form of debt reduction.
        - This concept was introduced in 1973 by Stanford economists Edward S. Shaw and Ronald I. McKinnon.
        - Financial repression can include such measures as directed lending to the government, caps on interest rates, regulation of capital movement between countries and a tighter association between government and banks. For example:
            - Increasing **SLR(statutory liquidity ratio)** channelizes more funds to the government.
    - When the government is loaded with public money, it increases the money supply through public investment.
    - This, in turn, increases inflation and debt of the government is decreased
    - It also leads to economic growth but savings of public gets eroded.
- All these accompanied by central banks of these economies maintained tight oversight, and selective capital controls ensured that the low-yielding savings did not leave their countries of origin.
- Along with these, the governments undertook sophisticated industrial policies to promote domestic investment, much of which was export-led
- In addition, the bureaucracies of these East Asian economies were referred to as “embedded autonomy”. This allowed the state to be autonomous, yet embedded within the private sector and enabled the two to work together to develop policies or change course if the policies did not work.
- All these policies helped NIEs to escape the ‘middle income trap’ and become developed economies.

How India can replicate the East Asian growth model?

- Due to political and other compulsions, India’s reforms since 1991 have been rather haphazard and of a ‘stop-and-go’ nature, which has made it much more challenging for the country to take full advantage of its demographic dividend.
- So India needs heterodox policies and reforms that are carefully calibrated
- Indian government needs to understand that a vertical industrial policy (economic growth’) would not work without a sound horizontal industrial policy (dealing with labour and land reforms, bringing about basic literacy and raising women’s participation in the labour force).
- Though the government in the last five years has done well on ground of financial inclusion, a

banking system in crisis doesn't augur well for channelization of savings into investment.
- Measures like reducing policy uncertainty; ensuring that the fiscal expenditures do not crowd out private savings and investment; enhancing the efficiency of financial intermediation; and dealing with land acquisition and environment clearances are all essential so that investment rate can be again increased.
- Indian bureaucracies need to be imparted embedded autonomy.

Since the economies are intricately interwoven systems, it is high time for India to **switch from a traditional economic model** which assumes that the economy is basically in the balance until an outside shock upsets it, towards an economic model which is based on a **virtuous cycle or a vicious cycle.**

Drishti input

India needs to follow the East Asian growth model to achieve the target of becoming a $5 trillion economy by 2024-25. Substantiate?

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