

Bruce Edwards:

India surpassed China last year as the world's most populated country, but while its economy is the fifth largest in the world, it's only one-fifth the size of China's and growing too slowly to provide jobs for its millions of ambitious youth.

Krishna Srinivasan:

Raghu, in terms of the longer term issues for developing our human capital, what are the measures we should take explicitly?

Raghuram Rajan:

So we have the best and the worst in India, right? In that we have fantastic kids graduating from the IATs who are gobbled up by multinationals immediately, who are capable of everything. And then we have kids in third grade who can't read at second grade level. And we have schools where teachers don't show up, where no learning actually takes place. So there's a lot of work to do at every level.

Bruce Edwards:

In today's program, former Reserve Bank of India governor, Raghuram Rajan, talks about his new book, *Breaking the Mould: India's Untraveled Path to Prosperity*, with IMF Asia and Pacific department head Krishna Srinivasan. Rajan is now the Katherine Dusak Miller Distinguished Service Professor of Finance at Chicago Booth, and served as the IMF Chief Economist in the early 2000s.

Krishna Srinivasan is also an author of several papers in leading academic journals and co-editor of recent books on the economies of Brazil and the Caribbean. Look for Srinivasan's review of Rajan's book in the September issue of *Finance and Development Magazine*.

Krishna Srinivasan:

So Raghu, thank you so much for doing this. Maybe we should just start with the title of the book, *Breaking the Mould*. Can you just walk me through that? What do you mean by that exactly?

Raghuram Rajan:

Sure. I mean to some extent the mold is the tried and trusted way of development, which has emerged post World War II and typically been followed by emerging markets in Asia. Essentially start with agricultural surpluses. Start employing people outside of agriculture and manufacturing, and focus on not just servicing the domestic market, but an international market, using your advantage in low cost labor and the benefits of scale, so you produce at scale using your low cost labor to compensate for the other deficiencies you might have in the beginning, such as poorer infrastructure and institutional arrangements, which are not adequate for business, but build on that and reinvest corporate surpluses in more capital equipment, invest national surpluses in better infrastructure, and invest household surpluses in better education and skills for your children to move up the ladder. So that was the tried and trusted way.

Various countries did it... with some differences, but first Japan then Korea, then of course most recently China did it. And the question is why shouldn't other countries follow this tried and tested path? And to some extent what we're saying is the world has changed since China did it. Part of what has changed is China... You know, many of these countries sort of moved up the ladder, the Dornbusch-Fischer-Samuelson sort of ladder

towards higher skilled manufacturing. China is occupying both higher skilled manufacturing as well as lower skilled manufacturing because it has such a large workforce.

Krishna Srinivasan:

But it has vacated some space in the low skilled manufacturing, right?

Raghuram Rajan:

In the low end.

Krishna Srinivasan:

Yeah, low end.

Raghuram Rajan:

In the very low end. But it does imply that the climb up is going to be somewhat harder. But the second aspect is the world is becoming much more averse to seeing its manufacturing industries leave for other parts of the world, and increasingly countries are trying to retain manufacturing both through a combination of protectionism, but also by more automation, robotics, et cetera.

So this path is harder. I wouldn't say it's impossible, it's just much harder than it used to be, because you're not competing at this point with industrial countries with high cost labor. You're competing either with their robots or you're competing with much lower cost emerging market labor in China or Bangladesh or Vietnam.

And so given that, is that climb up the ladder as easy as it used to be? And the answer almost surely is no. Is it impossible? Almost surely the answer to that also is no. But what other paths are there? And that's where some of the developments in services are worth taking note of, that selling services at large distances has become much more feasible, especially after the pandemic.

Krishna Srinivasan:

And here you're talking about both exports and for the domestic market, right?

Raghuram Rajan:

Both. Absolutely. And so what Breaking the Mold is trying to say is, look, climbing up the ladder from low skilled to high skilled via manufacturing exports used to be the name of the game earlier. It's about time we explored different paths, one of which could be introduce an element of higher skilled services for your export markets and lower skilled services for your domestic markets, especially if you are a large economy.

Krishna Srinivasan:

So that's where the breaking the mold comes in... So you move more towards the services led growth in some sense?

Raghuram Rajan:

Yeah. Don't assume that the only source of job creation is going to be low skilled manufacturing. Accept the fact that there may be other ways, and instead of seeing what Danny Roderick calls premature de-industrialization as only a problem, a bug, think of it as a possible feature in new forms of development, right?

Krishna Srinivasan:

So Raghu, actually after reading the book, halfway through the book it almost looks like you're making a binary choice. I think talking to you now you don't seem to say it's a binary choice, but it's more skewed towards services. So it's not really a binary choice, because that's a debate which is ongoing in India right now, focusing more on manufacturing and services. So here you're saying it's not a binary choice, but focus more on services. Is that accurate?

Raghuram Rajan:

No. I would even put it a little more mildly. I would say recognize that services is a potential opportunity. But India, like many other countries, does industrial policy poorly. And by no means am I saying now put all your eggs in the services basket. I mean you're right in saying that when you read the book it looks like that partly, because what we are doing is highlighting services as an alternative path. It's what is not usually considered, which is why we devote a lot of attention to it.

But what we're saying is regardless of what you pick today, almost surely the role for government is to improve human capabilities, because whether you pick manufacturing or you pick services, you need a higher quality, much better trained personnel in both areas going forward.

Krishna Srinivasan:

We'll come to that in a minute. So one point you make in the book is don't subsidize manufacturing the way say India is doing through the PLI scheme. Now one could argue that the PLI scheme is one way to get manufacturing into your country, getting FDI in, but it could have some collateral benefits by attracting other forms of FDI too, right? Some kind of a signaling that India's open for business? So why are you so negative on the subsidies for manufacturing and why do you discount the collateral benefits?

Raghuram Rajan:

So I think you need to be quite specific in how you see the collateral benefits develop, right? So one way of talking about the collateral benefits is some sort of agglomeration economies.

Krishna Srinivasan:

Exactly. Yeah.

Raghuram Rajan:

I bring that first set of manufacturing guys in through subsidies, then other people come in and it becomes a virtuous cycle. Now the problem, however, is that it's not clear to me that the virtuous cycle is still present and going on. By all means we should measure and try to see whether in fact it is happening. But we've had manufacturing before without a virtuous cycle.

Remember Nokia to have a huge plant in Chennai, which used to make cell phones which it used to export, but we didn't see the whole sort of virtuous cycle build around it, which is component manufacturers come in, et cetera, et cetera. Now you could argue maybe the scale wasn't enough, there's some scale at which it comes in, but people aren't making that point.

And so it is possible to visualize a situation where you subsidize your way into a viable industry, but it is also possible to visualize a situation where the only reason you have an industry is because of subsidies, and the moment you take off the subsidies it all vanishes.

Krishna Srinivasan:

But that's to be seen, right? We don't know that for sure.

Raghuram Rajan:

Absolutely. But what I'm saying is let's be aware that in fact this is not a proven thing, and that unless we fix the disabilities... And that's why I go back to let's fix the disabilities, including the quality of the workforce, including the business environment. So when you say signal, I would say subsidies are the worst ways to signal. Why not signal through a better business environment? Stop harassing foreign direct investment which comes into India because it conflicts with your intentions for national champions, right? We have foreign direct investment, the Walmarts of the world, the Amazons of the world, why aren't we treating them really well and using that as a signal to get more of that in, right?

And so what I would like to see is if you are interested in foreign direct investment coming in focus on every aspect of it other than just the subsidies aspect, because the subsidies aspect is just all too easy, and we are not counting the cost. I mean where in the budget, if subsidies were the reason we had this explosion in cell phone exports, where are the contingent liabilities for all the promises we've made in terms of subsidies?

I mean I see numbers really small compared to what we think has been engendered by the subsidies, so I would like much more transparency, but much more of a focus on is it bringing in all the other stuff that we need, or do we need more subsidies to do that?

Krishna Srinivasan:

But the broader point is improve the business environment, do other kinds of reforms, horizontal- vertical reforms, as a way to bring in FDI. So one question, Raghu, which comes out in a book is you don't quantify the kind of jobs and the number of jobs you can generate following your strategy. Let's say break the mold focus more on services. You don't quantify how many jobs you can generate, which is a big debate in India right now.

A lot of commentators in India say that both production structure in India and those for exports have become a lot more capital intensive, and what we need is more labor friendly production in exports. So the question there is with India likely to add 14 million people to the workforce every year, do you think your strategy will generate the number of jobs that is required?

Raghuram Rajan:

Well, let's start first with how many jobs manufacturing has generated. As a share of the workforce manufacturing hasn't increased for the last 40 years, right? So forget all these fancy schemes. In fact... And the points you make is a very important one. Labor intensive manufacturing has actually shrunk. These sectors which are labor intensive, like textiles or leather, have shrunk in the last decade.

Krishna Srinivasan:

And why is that? Why has India not been able to fill the space vacated by China in these sectors?

Raghuram Rajan:

It's a great question and I don't have an easy answer to that. I would say perhaps part of the reason is we haven't seen these as favored sectors. Even while we are seeing the shiny chip manufacturing as a sector we should be in and willing to pay for enormous subsidies there, we've neglected the fact that textiles creates so much labor. Leather, of course, parts... Some of it is also because of our policies towards... I should say the source of leather, who actually... The slaughterhouses, the meat, the leather, all that has come under a little bit of cloud in the last few years, which has hampered some of that.

But I would say, broadly speaking, we haven't had a strategy on job creation in manufacturing. Some of that may also have to do with a skill base. When you talk to some of our industrialists, they say I can't find people, and you keep saying what do you mean, you can't find people? We have tons of people. What they mean is they can't find people with the appropriate skills and they're not willing to invest in training them up.

Krishna Srinivasan:

So that would also apply when you talk about your strategy about focusing more on services. Now you talk about chip design, financial modeling and so on in your book, but the number of people who can do that is small, right? So we don't have the kind of skills which is needed right now to pursue in great momentum the kind of strategy you are proposing. So the question is how do you fill that skill space?

Raghuram Rajan:

Well, so that's precisely the point of the book, that the first act is to focus on human capital. We have to improve the quality of human capital, regardless of whether it's for manufacturing or for services. That's why I think it's a no brainer to say our budget should focus much more on how on the one hand we remedy that last mile, people who have a high school education or even degrees, but don't have really any employable skills.

How do we create those employable skills? How do we create many more plumbers? Somebody who runs a plumbing enterprise wrote to me and said, look, this is a huge issue and we're trying to focus on it, to create people who have the skills in plumbing, because we actually have enormous demand for them, and we don't have enough of those people, carpenters, plumbers, electricians. With urbanizing India we need a tremendous number, and that's a lot of jobs we could create, right? That's on one hand.

The second is how do we create jobs for the skills people have? That's second. So think about human capital. One place, as you know, where human capital creation is very important is at a very young age. Well, you don't need to have a huge amount of skills. You need to have empathy at that, to train very young kids, to play with them, to encourage learning. So all these mothers in villages who have a high school diploma, could you employ more of them in the crèches, the Anganwadis? That would be, given the number of Anganwadis we have, a million plus jobs. So can we first train up people for the last mile?

Second, create jobs for the skills people have, again which can employ many more once we know where we need to go in terms of human capital.

And the third aspect is focus on the more medium term issues. How do we improve the quality of healthcare and education all round? And even that will require a whole lot of new jobs, right? Healthcare, for example, we've had this three-tier process for healthcare in India since pre-independence, the Burek Committee Report, but we haven't actually done that in an effective way.

What you need is modestly trained first tier healthcare workers who can recognize basic diseases, but also know what they don't know, and kick it up to the second level, where you have the trained doctors, and then kick it up to the third level, to the specialists, when they can't deal with it. But we need to make that more effective, and that requires training up both the guys at the bottom in a much better, more effective way, but it also needs many more doctors, and that requires more investment in medical education.

One of the big problems is we don't have enough educational training institutions of reasonable quality for the kinds of needs that India has. So I would say across the board instead of constantly lamenting that we are not creating jobs, let's seize the issue and say some things can be done relatively easily and some things need much more longer term investment.

Krishna Srinivasan:

So just on the relatively easy ones, can you just say what are the easy steps you can take to generate jobs now?

Raghuram Rajan:

So I think for the short term, I think the whole issue of apprenticeships which has been on the table. But not just have random guys offering apprenticeships, but also measure how it works out, who creates job worthy apprenticeships, do they hold onto jobs. Bring industry into the process, Bring the IT guys into the process so that they know how to train people up the last mile. I mean create that last mile skill building, whether it is in vocational jobs, but even you talk about chip design.

There's a firm which basically takes our engineers who have a basic understanding but have no sort of detailed understanding of chip design and has trained them up in the kinds of design capabilities that a firm like Qualcomm or like Broadcom would want, and essentially has created a whole host of these engineers who have the required skills, who can then be employed.

There's that last mile value addition, which can be done to a number of graduates, but also to a number of high school people which makes them employable. And they may be very different kinds of training, but we need to involve industry. We do need to involve the training institutions. And some of this... You know, India has a very vibrant private sector which is willing to step up in training, but it needs to also be given the right incentives, not offer fake degrees, but actually degrees that result in employability. So some kind of measurement process is also needed.

Krishna Srinivasan:

So what do you mean by incentives here?

Raghuram Rajan:

Monetary incentives. You train these people, they hold onto a job, I will check two years from when they get out. Those who have a job paying at least such-and-such, then we will continue sort of using you as a training institution, and we will hold some of the money that you have earned in escrow till such time as we verify that in fact you've done a reasonable job. I think we need to do much more of this.

Krishna Srinivasan:

But again, putting the private sector... Just for a minute. If a private firm was to start training people, they might fear that I train someone, the guy gets a training, and six months later he's out to a competing firm. So how do you correct for that?

Raghuram Rajan:

You pay. You pay for it, and you basically allow them first choice in the people they train. So if they do a good job training they pick the cream of the crop, but the rest are out there maybe working for the competitor, but you've got the best, right? And regardless, whenever you train there's always the possibility that people will leave.

So you also have, in addition to make it worth their while... So either in lowering their taxes or in direct payments, partial stipend or a full stipend from the government to those people being trained, and of course you want to make sure that they actually have a decent training program and they're training large numbers. And so, willy-nilly, this will come down to using some of the biggest firms in this. But that's where you tell them this is part of your contribution to nation building. But, again, it can't be just that. I think it has to be a mix of carrots as well as measurement.

Krishna Srinivasan:

Raghu, one last question. In your book you talk about the need for decentralizing power close to the citizen for securing what I would call a strong durable inclusive growth. Could you explain that a bit more, and how does that concept compare with what China was doing when it decentralized power to the provincial governments and allowed them to compete for investment and so on? So do you draw any parallels there, or how do you see that?

Raghuram Rajan:

So there are many virtues of decentralization, allowing local authorities to have more power. There are some problems. Let's start with the virtues. The virtues is when you see a local municipality mayor, or a sarpanch, you know that the buck for local services stops there. They're empowered to look after local schools, if your teacher doesn't show up you know who to complain to. You don't have to go to Lucknow, the state capital, or to the national capital to complain. You can complain to the local person. So that's a way for improving the provision of local services. You see that in India the states that are decentralized more tend to have stronger local provision of services, health and education.

I think the Chinese aspect was that the local authorities, when they're also sort of focused on creating growth opportunities locally, are going to be much more interested in attracting business and clearing the pathways for business, whether it's rural industry or businesses that usually set up in urban areas, but bringing them and clearing the pathway for them, That's what China did very effectively. It wasn't changing doing business norms at the center. It was allowing the local authorities to clear the way for businesses locally.

Krishna Srinivasan:

So kind of compete with each other?

Raghuram Rajan:

And to compete with each other, so what we call in the book comparative cronyism. Comparative was very important to make the cronyism not become inefficient and a protection of local elites. But that leads to the

concern people often express about this kind of localism, which is aren't you empowering the elites? Wouldn't there be capture and corruption? And of course this was a great fear of Ambedkar, one of India's founding fathers and the architect of the constitution, who basically did not want to go to the third tier.

He left it at a two tier country, the national and the states, but not the village or the local government, because he said that's a den of inequity and corruption. He basically feared the social conservatism of the village, where even today in some hopefully very few villages, lower caste people aren't allowed to drink from the village well and so on. So he saw that as much bigger at that point and did not want to empower the village to continue the kind of social oppression that used to exist.

But my sense is we've come a long way from there, and now there may be more value to local expression and less of elite capture. But certainly there is a role for the center and for the state governments to make sure that corruption is limited, there's more transparency locally, here's how much funds we sent. You've seen all these experiments in Uganda, for example, about where the funds are sent and how they are spent. So I think the time has come for more localism in India, and that will help in many ways, including most importantly in the provision of local services.

Krishna Srinivasan:

So basically decentralize, empower, and hold them accountable?

Raghuram Rajan:

Exactly.

Krishna Srinivasan:

Raghu, thank you so much for the conversation.

Raghuram Rajan:

Well, thank you, Krishna, for spending the time to read the book. And, yeah, thanks for doing this.

Krishna Srinivasan:

Lots of great ideas there. Thank you so much for talking.

Raghuram Rajan:

Of course.

Bruce Edwards:

That was Krishna Srinivasan speaking with Raghuram Rajan about his latest book, *Breaking the Mould: India's Untraveled Path to Prosperity*, published by Princeton University Press.

Look for Srinivasan's review of the book in the September issue of *Finance and Development* magazine. Go to imf.org/fandd, and look for more IMF podcasts wherever you listen.

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I'm Bruce Edwards. Thanks for listening.

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