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**SPEECH BY MR.P.CHIDAMBARAM, UNION FINANCE MINISTER, AT THE
CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE ON RECAPTURING
INDIA'S GROWTH MOMENTUM**

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Dr. Perkovich, Vice President for Studies at the Carnegie Endowment for International Peace,
Ladies and Gentlemen!

Thank you for the invitation to speak at one of the oldest and well-regarded global think tanks. I understand Carnegie is in the midst of establishing a Carnegie South Asia Centre based in New Delhi, and I welcome that initiative. Carnegie currently has two captains of Indian industry on its Board of Directors, Shri Sunil Mittal and Shri Ratan Tata. I am glad to see these growing Carnegie-India links. One of Carnegie's core priorities today is building a research program on India's political economy. To this end, I gather you have recently launched your "India Decides 2014" initiative. I wish you all the best in this exercise, but may I tell you in advance that your study will discover that India will vote my government back to power. I thought I may caution you lest you should waste too much time and effort to figure this out.

Let me now turn to the topic of India's economic growth. India's growth story attracted the attention of the world when our economy grew at an average of 8.5 per cent per annum during the period, 2004-05 to 2010-11. This was achieved despite the strong negative spill-over effects of the global financial crisis in 2008 and subsequently. Growth slowed down in the crisis year, 2008-09, but India took the world by surprise by rebounding quickly from the slower growth of 6.7 per cent in that year to record rates of growth of 8.6 per cent in 2009-10 and 9.3 per cent in 2010-11. However, there was a further downturn in the global economy in 2011 on account of the sovereign debt crisis in Europe and the subsequent slump in the World economy. We also witnessed the emergence of domestic constraints on investment and consumption. As a consequence, India's growth rate declined again to 6.2 per cent in 2011-12 and further to 5.0 per cent in 2012-13. The increasing trade deficit and fall in net invisible earnings led to a widening of the current account deficit to USD 88 billion or 4.8 per cent of GDP in 2012-13. With a sharp slowdown in manufacturing growth and a moderation in the expansion of services, the growth in the first quarter of 2013-14 further declined to 4.4 per cent. India's experience in this period is not unique. Virtually all the major emerging economies around the world have seen a sharp decline in growth -- the so-called Great Descent.

However, we are now seeing that some of the worst-affected countries of the Euro zone are

showing signs of recovery, with significant improvements in their current account and fiscal deficits. The expectations of improvement in the economic and financial conditions of the US, coupled with the decision of the Fed to postpone the tapering of the quantitative easing, have shaped expectations of a gradual global revival. But I am aware that there may be possible ‘bumps’ on the road ahead. In line with this emerging global outlook, the Indian economy has also showed early indications of recovery with a pick-up in exports in July, August and September – our second quarter; reversal of the negative growth in manufacturing; and a reasonable rise in freight traffic, indicative of economic activity picking up. With very good rainfall in the current year and a sharp increase in the sown area, we expect robust growth in farm output. We have also taken numerous reform measures over the past one year. We expect these measures to show their impact from the second half of the current fiscal and believe that the Indian economy will grow at over 5.0 per cent and perhaps closer to 5.5 per cent in 2013-14. I know that the World Economic Outlook report does not share my optimism, but I may tell you that we do not share their pessimism. Set against the current global economic background, even a growth rate of 5.0 per cent looks good, but is much lower than the ambitious standards that we set for ourselves in 2004. I would be the first person to say that we need to do better and recapture the growth momentum of the last decade.

Macro economists maintain a very clear distinction between trend and fluctuations. The fluctuations are the function of open economy macroeconomics, of fiscal policy and of monetary policy. To understand trend growth, however, we have to look deeper. Trend growth is largely determined by the underlying microeconomic fundamentals. In the next ten minutes I wish to speak to you about the microeconomic fundamentals which have given us one doubling of our GDP every decade. In my reckoning, there are at least six main stories:

(i) Demographics. As is well known, India has young demographics. Alongside, we are doing well on improving the quality of the workforce. Household survey data (the CMIE Consumer Pyramids database) shows that for children of age 12, literacy is now 95%. We have a great surge in college enrolment: a full one-fifth of 21-year-olds now have a college degree. Every year, millions of young people are added to the labour force and their education is qualitatively superior to that of the elderly cohort leaving the labour force. We have also launched an ambitious national mission on Skilling in order to qualify young men and women with only a school education for jobs in the manufacturing and service sectors.

(ii) The second growth fundamental is international economic integration. On the current account and on the financial account, India is now engaging with the world on an unprecedented scale. Gross flows on the current account are now 63.3 per cent of GDP and gross flows on the financial account are now 55.3 per cent of GDP. These add up to gross flows across the border of 118.6 per cent of GDP. This makes India one of the more open economies of the world. Engagement with the world drives a flow of ideas into the economy, which is a growth fundamental.

(iii) The third growth fundamental is an increasingly “capable” financial system. On

average, we invest 35 per cent of GDP every year. Finance is what determines the allocative efficiency of how this investment is done. What industries and what firms get is controlled by the financial system. We are taking measured steps on strengthening the financial system and taking the best that the global financial system has to offer. Every year, our financial system is getting better and stronger and, through this, we expect to translate our good investment to GDP ratio into a higher GDP growth rate. I shall speak a bit more on this in a moment.

(iv) The fourth growth fundamental is sophisticated firms. As all of you are aware, Indian firms are increasingly becoming capable and competitive. We used to think – and fear -- that if India opened up, our so-called large firms (I shall not take names) were third world dinosaurs that would collapse in the face of global competition. Instead, we have a clutch of firms in steel, oil and gas, mining, power, information technology, and hospitality that have become multinationals and are buying out companies in the advanced economies.

(v) The fifth growth fundamental is sophistication of the workforce. A young girl of age 21, who started her labour market career in 1991, now has 21 years of experience in a competitive and globalised market economy. She has dealt with modern technology, foreign companies, and a truly competitive domestic environment. The forty-somethings of India today are qualitatively superior to the older cohorts who grew up in a closed economy and did not face modern technology or foreign companies or competition.

(vi) The sixth growth fundamental - and I know this will be contested by many - is democracy. While it is fashionable to criticise the workings of Indian democracy, when we look deeper, I think it is working reasonably well. Liberal democracy is the ultimate foundation of rule of law and legal certainty, without which nobody can trust a country or invest in it. At its best, democracy is a great conversation, where diverse views and aspirations get heard, and the issues that genuinely concern the majority of the people become the priorities of policy makers. On a bigger scale of history, when we start from 1947, I think India has fared well on the project of constructing a liberal and open democracy.

To summarize, the Indian trend growth of the last 21 years was caused by several microeconomic fundamentals, and I have listed six of them. Nothing has changed on these. In fact our resolve to strengthen these fundamentals has become stronger. I believe India continues to have great prospects based on these fundamentals.

From the viewpoint of public policy, our job is to clear our minds of old cobwebs as well as of day to day problems and stay focused on laying the long-term foundations of a capable State that is able to deliver.

While India has greatly deregulated, there is much more to be done. However, looming large is the issue of State “capacity”. We need a State that has in place institutions to resolve market failures. We need a State that will deliver public goods quietly, efficiently and economically. This is the prime challenge in India today. In a liberal democracy, we need to build the full framework of laws that will clearly articulate specific objectives, empower the

arms of government that will enforce these laws, and put in place mechanisms that will ensure performance and accountability.

If you believe what our newspapers and television channels report you may conclude that no Indian politician or civil servant is doing any work. Actually, the pace of work has been quite hectic. Let me illustrate this with examples of what have been done to improve the Indian financial system, only in 2013. So far, we have had four historic events. A commission of eminent people has drafted a new Indian Financial Code: a path breaking piece of law that has been drafted to replace 50 existing laws governing finance with a single, integrated, coherent, modern financial law. This is a law which dwarfs the scope of the Dodd-Frank Act. We have enacted a brand new Companies Act to replace a law that was 57 years old. We have shifted the subject of commodity futures to the Ministry of Finance, something which has not been possible in the US even after the 2008 crisis. We have enacted a law establishing the Defined Contribution Pension system under a statutory regulator. The New Pension System is already one of the world's big individual account DC pension systems with over 6 million participants.

Each of these four was a huge project involving enormous planning and preparation. The genesis of the Indian Financial Code goes back to 2004, when we started deep thinking about the possibilities of Mumbai as an international financial centre. The Companies Bill was pending before Parliament for many years. The work on shifting commodity futures to the Ministry of Finance began in 2003. The NPS was originally designed in 1999. All these projects have been largely bipartisan. We have dug in through these years, chipped away at the objections, cultivated the technical capacity, and built consensus, through which we are now able to reap the fruits of the long years of labour.

To conclude, I would urge everyone not to lose sight of the microeconomic foundations of Indian growth, which are delivering one doubling of GDP every decade. That is not an insignificant achievement. It will find its place in history in due course. The defining challenge in India however is in augmenting State capacity. How do we construct a competent and ethical State, that will minimally interfere with the rights of citizens in property and contracting, that will focus on preventing or resolving market failures, and that will successfully produce and deliver public goods? A wave of new thinking in public administration is now underway in India. We need to build completely new organization charts within government, leading to sharply focused agencies that can be held accountable for delivery on specific objectives. Those are the first few lines of an absorbing new story that I hope will begin in the near future. And that is the story that I am sure will captivate the world in the next ten to twenty years, as India takes its place as the third or fourth largest economy in the world.
