



# The Indian Economy - Some Challenges Ahead

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It is a matter of pleasure for me to be in your midst to deliver the Convocation Address of this Institute. Justice K.S. Hegde Institute of Management has, within a short period of time, been able successfully to create for itself a special position in the domain of management education. I am very thankful to the Chairman and the Director of this Institute for inviting me to deliver the convocation address. I am happy to know that the group of educational institutions founded by late Justice K.S. Hegde has been recently conferred the status of a Deemed University. This speaks for the high quality of education offered by these institutions. This is a fitting tribute to the memory of Justice K.S. Hegde.

Let me at the outset congratulate all of you who are graduating today. Let me add a word of special appreciation to those who are receiving awards. One stage in your life is coming to an end and another is about to begin. You will be leaving the sheltered collegiate life and entering the wide world with all its ups and downs. From the country's point of view, we welcome you as our next generation of managers and leaders. May you grow up to provide effective leadership over this new century. In a sense, your future is intertwined with the future of this country. You also have an opportunity to shape it.

We are living in a time of far reaching changes. Modern management must, therefore, be viewed as a dynamic process of seeking constantly to align a firm's internal resources with the external environment. It is this external environment which is undergoing a transformation in this country and elsewhere because of the technological changes on the one hand and of the changing perception of the roles of state and market on the other. It has always been the case that the extent to which a firm is able to achieve its objectives

has been dependent on its ability to understand the opportunities presented and constraints imposed by its environment and to respond with appropriate policies at the strategic and functional levels. This is summarised in the well-known strategy of SWOT. Only increasingly, the environment that is relevant is not only domestic but also global.

The Indian economy has done well in the recent past. The average rate of growth of the economy in the last five years is 8.5 per cent. During the three year period 2005-06 to 2007-08 the annual growth rate exceeded 9 per cent. However, growth slowed down to 6.7 per cent in 2008-09, primarily due to external factors. The growth rate in 2009-10 is likely to remain more or less at this level. Even as we address the immediate problems faced by the country, we must keep in mind the medium and long term goals and the constraints that need to be overcome in order to achieve these goals.

## **Economic Reforms - Break with the Past**

In the post-Independent economic history of our country, 1991 is a landmark year. This was the year in which the economy was faced with a severe balance of payments problem. In response, we launched a broad ranging economic programme not just to restore the balance of payments but to reform, restructure and modernize the economy.

The break with the past came in three important directions. The first was to dismantle the complex regime of licenses, permits and controls that dictated almost every facet of production and distribution – what to produce, where to produce, how to produce and how much to produce. The entrepreneur has now greater freedom to decide on all these choices. The second change in direction was to reverse the strong bias towards state ownership of means of production

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and proliferation of public sector enterprises in almost every sphere of economic activity. Areas once reserved exclusively for the state have been thrown open to private enterprise. The third change in direction was to abandon our inward looking trade policy. This elusive, and in hindsight ill-advised, quest for self-sufficiency was driven by a belief that there was a value to minimizing the economy's external dependence and producing what we need ourselves even if it meant high costs and low efficiency. By embracing international trade, India signaled that it was abandoning its export pessimism and was accepting the challenge and opportunity of integrating into the world economy.

#### **Post-reform Growth Performance**

That the content and process of our economic reforms are on the right track is vindicated by the performance of the economy since the launch of the reforms. Between 1981-82 and 1990-91, i.e. the decade before the reforms, the economy grew at 5.6% on a compound average basis. The year 1991-92 was an outlier because of the balance of payments crisis, and should therefore be omitted for the purpose of discerning trends. In fact, there is every justification for including it in the pre-reform period because it was also a culmination of the policies pursued previously. The effect of the reforms should be judged starting with the economy's performance in 1992-93. Between 1992-93 and 2007-08, the economy grew at 6.8% on a compound average annual basis, a significant improvement over the pre-reform record.

There are many imperatives on the way forward. We need to sustain the present rate of growth, if not accelerate it to higher levels. We need to translate growth into poverty reduction. In other words, we need to generate poverty reducing growth – i.e. growth *to* which the poor contribute and *from* which the poor benefit. We need to expand employment opportunities and improve productivity across all sectors of the economy. We need to narrow economic disparities

across and within states without compromising on efficiency. We need to improve on social indicators too; India still ranks a low 128<sup>th</sup> in the UNDP's Human Development Index in the bottom third of the league of nations. The agenda for achieving growth and poverty reduction is thus formidable.

#### **Six Challenges on the Way Forward**

If we are to sustain the high rate of growth achieved in recent years, and in fact accelerate the growth rate to higher levels and translate that growth to broad-based poverty reduction, we must address some important challenges. There are six important challenges warranting priority attention. These are,

- (i) Stepping up Agricultural Growth,
- (ii) Infrastructure Development,
- (iii) Building social infrastructure,
- (iv) Fiscal consolidation,
- (v) Managing Globalisation, and
- (vi) Good governance.

Let me make a few observations on each of these challenges.

First, we need to step up the growth rate of agricultural sector. Any programme of improving productivity of agriculture must include better credit delivery, investment in irrigation and rural infrastructure, improved cropping pattern, better farming techniques and development of food processing industries. Agricultural growth is critical for expanding employment and generating broad-based growth and sustaining poverty reduction.

The second critical constraint to growth is infrastructure deficit, more particularly, in power. In order to mobilize the necessary resources and build quality infrastructure, we need to put in place appropriate legal regulatory and administrative frameworks. We also need to address issues of price and cost recovery with subsidies where required being made transparent and explicit. Efficient and speedy implementation of projects is critical in all spheres and more so in the infrastructure area.

The third important challenge to growth is investment in social infrastructure particularly in the twin merit goods of primary education and basic health. We need to spend more on education and health. We also need to spend more efficiently.

The fourth critical challenge is fiscal consolidation which is a necessary pre-requisite for sustained growth. The negative consequences of excessive fiscal deficits are well known. Abiding by the targets set by the fiscal responsibility legislations is a good way to ensure financial stability.

In 2008-09 faced with a severe decline in aggregate demand because of the international financial crisis the Government had increased its expenditures, thereby providing a fiscal stimulus to the economy. As a consequence, the fiscal deficit for 2008-09 is estimated at 6 per cent of GDP which is 3 per cent above the FRBM target. It is quite likely that the fiscal deficit of the Central government for 2009-10 will also be of this order. In the context of the situation in which the economy was placed, such a high level of fiscal deficit may be justified. However, this order of fiscal deficit is not sustainable over an extended period. As the economy recovers, this deficit will have to be brought down. It is best to treat the FRBM target as a cyclical average so that over the cycle the target is achieved.

The fifth challenge is managing globalization. More than any other developing country India is in a position to wrest significant gains from globalization. Even as we make efforts to modify international trading arrangements to take care of the special needs of the developing countries, we must identify and strengthen our dynamic comparative advantages.

The sixth challenge is good governance. That good governance is at the very heart of economic growth and poverty reduction and even political legitimacy is now part of conventional wisdom. In the ultimate analysis it is the quality of governance that separates success from failure in economic

development. What is needed is a system of governance which is responsive, transparent and accountable.

The Indian economy has undergone some rapid changes in the last two-and-a-half years. Towards the end of 2006 and in the early months of 2007 a frequently asked question in this country was "Is the Indian economy overheating?". Inflation was on the rise and the trade deficit was widening. These were interpreted as signs of overheating. However, these signs abated and the inflation situation remained benign throughout the rest of 2007. Inflation touched as low a level as 3 per cent. Beginning 2008, there was a reversal of the situation. Since the first quarter of 2008 with rising international commodity prices, particularly oil, inflation at home started rising steadily. At one point, inflation touched the level of 12.4 per cent, even though the growth momentum was being maintained. However, in the last quarter of 2008, India was caught in the grip of international financial crisis. The Indian financial system had no direct exposure to 'toxic' or 'distressed' assets. The impact of the recession abroad on India was felt through the two routes of trade and capital flows. Exports have shown a steep fall while capital inflows have diminished. The Indian economy grew in the second half of 2008-09 at 5.8 per cent. My own expectation is that the Indian economy will grow at 6.5 per cent in the current year. Though this is a sharp decline from the high growth rate achieved earlier, it is nevertheless a satisfactory rate of growth, given the world situation. Domestic demand is still the major driver of economic growth in our country. Through suitable management of aggregate demand we should be able to achieve a growth rate of 7-8 per cent next year. To achieve anything higher than that, the world economic situation must improve substantially. Perhaps, this will happen towards the end of 2010 even though some early signs of recovery, green shoots as they call it, are even now visible.