India's Economic Reforms and Challenges of Globalisation

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Mrs. Pratima Doshi

Mr. Bharat Doshi

Mr. Mahindra, Mr. Bongirwar and Friends

I am happy to give the fourth Lalit Doshi Memorial lecture. You have heard from so many people such wonderful words of praise for Lalit. I can only say that having known him a little, not that much, but a little, I know that all of that rings true. I got to know him professionally rather than personally, when I was in Prime Minister's Office between 1985-90 when he was Joint Secretary in the Ministry for Petroleum and Petro Chemicals. These were the early days of the liberalisation that Keshub referred to and it was quite clear to me then, as we were trying to see what sort of changes are possible, that Lalit was a change agent. A change agent as a Civil Servant with the great advantage, that he was an extremely low profile person, enormously liked by every one, and I think as someone was saying earlier, with an enormous capacity for work.

It is a particular privilege for me to be able to speak on this occasion for some one whom I knew, and had learned to respect. As it happens I was in Davos on that fateful day not with the team that Lalit was with, but with the Central Government team that happened to be there and it was a great shock to us to hear, that he had passed away. But Davos is also the watering hole of the World's Global elite. So I thought it was fitting in choosing the subject of this lecture that I should address the issues of what are the challenges of globalisation that face India and India's reforms.

As Keshub has pointed out, I returned to India in the bad old days of Central Planning in 1979 when we didn't really think very much about liberalisation and globalisation. As a matter of fact, it is not until 1982/83, when the Latin American debt crisis exploded, that developing countries began to think very hard about economic reform, but really from about 1983 onwards most developing countries began to undertake major reforms. Perhaps, driven by crisis but very important reforms nevertheless. This included, for the post agricultural reform phase, it included China around 1984, towards the later part of the 1980s, it included the East Europeans, then of course communism collapsed. And in that sense we were the last fellows to reform, because we really didn't begin serious reforms until 1991. We did a lot of tinkering with the system in the 1980s. We were aware that the winds of change were blowing around, but they really hadn't touched our shores too much. But the focus at that time was to improve the functioning of the system by a little bit of improvement here and little bit of improvement there.

It was not until the big crisis of 1991 that an actual change-around in the economic system, if you like, was attempted. Because, we are a democracy and a very pluralist democracy where consensus is very important, as any civil servant knows very well. We have taken quite a long time to do the economic reforms. As a matter of fact, I think it will be fair to say that at present, they are still ongoing. That is the good news; the bad news is they are only half done. So, it is a gradual process. It is, however, a process that appears to have gained a substantial amount of momentum and consensus.

The reforms that were introduced in 1991 by Congress Government, were continued for two years by United Front Government and now the BJP led Government has said that they will deepen and strengthen the reforms. So across the political spectrum we have had changes of government and the broad message that the governments have said is that these reforms will continue. Now having said that, obviously, these are very very broad ranging reforms. They cover a huge spectrum of policies from internal deregulation, the removal of controls over private investment, trade policy reforms, tax policy reforms, public sector reforms, banking reforms, financial sector reforms, reform of policies towards foreign investment. When you make so many changes, the challenges before you are enormous. There are for each of these areas, there are resistances, there are vested interest, perhaps there is a lack of appreciation of what needs to be done. So the number of challenges before the Indian reform programme are very large and many of them are domestic. But I think there are some important global compulsions and challenges also.

This evening I don't propose to discuss any of the domestic challenges but really, to focus on global challenges and global compulsion. The two are not different, because when you say something is a global compulsion, it does not mean that the solution is global. The solution is going to be domestic. What it means is, we have to tailor our reform effort to recognise the nature of the external constraint within which we operate. How can we summarise this constraint? I think the simplest way to recognise this is we are part of the global economy and clearly therefore whatever reforms we do, must take into account the nature of our global interaction. That is a very minimalist approach. That only says that the global compulsions are an inevitable part of designing our own reforms. I think we have to go beyond that. That is, the global interaction that we have is not just unavoidable. It is actually, potentially very desirable. So, interaction with the global economy is not something that one simply has to take as a fact of life. It is in fact a huge opportunity from which we can derive a very substantial benefit. Therefore, the name of the game is, can we orchestrate our own policy changes in such a way as to maximise the benefit that can be derived from global interaction. In short, the pay off from our own efforts is that much greater if we can interact productively and interactively with the possibilities that global interaction offers us.

Now what are these possibilities and what is it that we have to do? The central message of the Indian Economic reforms, if one had to summarise it in one number, is the desire to raise our rate of growth. It used to be said that India's growth rate was very poor. It is true that in the last decade and a half it has improved substantially. But still, we are talking about growth rates that do not come up to the levels, which until recently were being achieved in East Asia and you know while the East Asian countries do have severe difficulties, we should not assume that these difficulties are permanent. I think it is going to take them longer to recover than was thought six months ago. But still the expectation is, that in a matter of few years atleast, these economies which have a lot of very fundamental strengths, will get back to rapid growth. Certainly China has barely felt any deceleration of growth so far.

To my mind, if India is to hold her own, in terms of the relative size of India's economy within Asia, growth rates of 7% to 8% are really essential. This is not just in order to remain important in Asia. Though, that may be an attractive objective when we think of national policy, it is also important if we really want to bring about any significant reduction in poverty in this country. Everything that we know about, our own past experience tells us, that when our per capita growth rate in the 70s was not more than 1-1½%, nothing much happened to poverty. It remained pretty much stationary with year to year fluctuations depending on the harvest. And when in the late 70s through the 80s, per capita growth increased to 3½%, we began to see a steady decline in poverty. This is all documented in proper numbers and by many research workers. But still the decline in poverty in India is very gradual. It is not dramatic; it is not what has been achieved in East Asia. The answer to that is very simple. We haven't had the kind of dramatic growth in per capita income that has been achieved by some of the countries in East Asia. These are the countries that have seen per capita growth rates of 6%, which is possible if the economy grows at 8%. So really what we need is to move to a growth rate somewhere between 7% and 8%. The 7% and 8% is a very big increase if your are fixated on what Professor Rajkrishna used to call the Hindu rate of growth of 3½% or 4%. But you know the fact is that in the 1980s we grew at 5.6%. In the 8^{th} plan period we grew at about to 6.9% and except for the last year, the previous three years we had an average growth rate of 7-½%. So we have been improving our growth performance.

We are now at a position where, talking about 7 and 8% is not some kind of an impossible dream. It is certainly something that can be done in the next ten years. Just as in each of the previous decades, slowly perhaps, we have made progress. But if we are going to grow at 7 and 8%, what that really means is that agriculture will grow at 4%, services will grow at about 8% and industry will have to grow at about 12%. This kind of accelerated growth can only take place if we are able to bring about a major investment expansion and modernisation and injection of new technology into the country. This is going to have a very heavy import requirements. We should assume that imports in India will have to grow at a rate significantly faster than the rate of growth of GDP. So, if GDP in real terms is growing at 7 and 8%, this is only feasible if imports grow a little bit faster. The reason I say this is because of our earlier period of squeezing imports and pushing for an extreme degree, compared to other countries, of self reliance, India's share of imports in total GDP is among the lowest in the World. India's import to GDP ratio is about 11%. The figures I have for other countries will give you some idea of what the relevant standards are.

We are talking about situations where for example China has a ratio approximately 19%. Forget about countries like South Korea which are up to 30%. The majority of the developing countries of the middle income category, which is the countries which we want to emulate and get to. They will all have import ratios which would be closer to 20% if not higher. For the smaller countries it can be very high. But for the larger countries very high import ratios are not desirable or feasible. But you are still talking about ratios closer to 20%, than to 10%. I mention this simply to say that if you do any medium term projection therefore and you talk of India becoming a richer country at a higher per capita income with a faster rate of growth, it must be assumed that India's import share of GDP will increase.

So how are we going to finance this increase in imports? Once we get over the mental block that we need imports in order to grow, the next question is how do we finance this? There are no very clever ways of solving that problem. There are two things that you can do. One is you can leave the imports grow and see that the current account deficit widen a bit and then try and finance the current account deficit and the other is that if you really need those imports, then you need a production structure which can generate the kind of exports needed to pay for those imports.

Now let's look at these two alternatives. If you talk of the current account deficit in India, the present current account deficit is a little below 2% of GDP. Can we really allow this to increase and find ways of financing it? The short answer is not very much. Before the East Asian crisis many experts would have told us that India can easily afford to finance a current account deficit of 4% of GDP, providing we can finance it by more foreign investment and long term debt. After the East Asian crisis, I would venture to suggest that most people would think that India should be aiming at keeping its current account deficit somewhere between 2 and 3% and going to 3% only to the extent to which the deficit can be financed by more foreign investment. The reason for that is, our debt position, although not a problem, we are not a seriously indebted country, is certainly not comfortable. Our debt service ratios have declined substantially from about 27 / 28% five years ago down to some thing like 20%. But they are not yet in the range, which is very comfortable in the eyes of international financiers. Therefore it is very important that whatever India does, India's approach to debt management is seen to be prudent. This doesn't mean that we don't incur any debt at all. I mean, obviously, if our exports are going to grow, then our ability to service debt is going to increase and as the ability to service debt increases, we can take on a little more debt. So it is consistent with the total volume of debt increasing gradually over time, but the increase must be modest and that actually limits the extent to which we can rely on external debt to finance additional imports. This leaves us with foreign investment and that is one of the major elements that the government has been pushing. Previous governments have pushed it; the present government has said that they want foreign direct investment to be doubled in a two year period. In 1997-98 there was just under $ 4 billion and therefore the assumption is that we are aiming at something close to $ 8 billion, two years from now. But you know 8 billion is nice and it would be difficult to get, it can be done. But, I don't think that this kind of leeway is sufficient to finance the kind of import growth we need. This, then turns me to the second leg of this whole challenge before us and that is whether we can have rapid export growth to match the kind of import growth that we need.

Now one of the things about India's performance on exports, over a very long period, this is a truly sad story. I mean in 1950 India's share in World exports was 2%. In the flush of independence, if somebody had asked us what are we going to do about our share of World exports, I have not the slightest doubt that 90% of the people asked would have said, of course, we are going to increase our share of World exports. But the truth is that between 1950, when our share of World exports was 2%, and 1985 our share of World exports declined to about ½%. Now this was the result of a policy that really did not help India to integrate with the World. In my view, in retrospect and in the view of most people, we over did the push towards import substitution and self reliance, neglecting the fact that there were tremendous opportunities to be had in World markets, which other countries were able to benefit from to an extraordinary degree. I think, the important thing is that we should not make that mistake again. What do we do, in order not to make that mistake again?

Well, the first thing we do is we do not become daunted by the task. It always looks very difficult at any given time, to say we are going to have a huge increase in exports. You are going to increase your export share. The normal instinct is to say, well, you know if World exports are going to grow at 'x'%, then surely you can at best maintain your export share. This is not actually true. The history of any ten year period, is not a history where everybody maintains export share. It is a history where there are winners or losers, the winners increase their share and the losers reduce their share. I think the comparative performance of China and India between, let us say, 1978 and the mid 90s is a very good example of what I am talking about. In 1978, China's exports were roughly the same as of ours. Today we export about 33 billion dollars and the Chinese export about 190 billion dollars. So you had a situation, where as, we have increased our exports by approximately 20 billion dollars, they have increased their exports over the same period by approximately 140 billion dollars or some thing of that order. They face the same external environment. They face the same World market and they were not significantly different from us in terms of production quality or human resources or any of those things by the late 1970s. So the name of the game is, it is possible, if you really want 7 to 8% growth.

It is possible, just you have to ask yourself what is it that needs to be done to make it possible for Indian exports to flourish, what is it that Indian Exporters need in order to recover a little bit of the share that they had in World market. Let me just give you an idea of what that implies. I mean, if today, since 1985, between 1985 and 1996, you might say, the second half of the 80s, where a little bit of reform was done and the first half of 90s, where a lot of reform was done, our share in World trade has increased. It has increased from ½% to .62%. That is not a big increase, but it is a turn around in what was actually, virtually a 40 year saga of decline. Now the point is, that if turn arounds can take place, they can be accelerated. We need to look at what changes are needed in our own policies to make sure that, that acceleration takes place.

If you ask Economists, what do we need to get exports going? They will give you a list of 3 or 4 remedies. Some of them will be more difficult than others and some will be more controversial than others. May be the most controversial of the remedies that the Economists will give is that if you want exports to increase then you must get away from running a protected economy. This is, perhaps, potentially a controversial issue. It is something on which, I believe, we need a better understanding, domestically amongst professionals, between government and industry, so that there can be an appreciation that this fundamental fact that you cannot have export competitiveness, if at the same time you are going to run an industry which is heavily protected. Once we realise that this is the problem, then we can start the process of making a phased transition. In a sense the reforms have done exactly that. In 1991 we were without doubt, the most protected economy in the World.

We had the widest coverage of Quantitative Restrictions (QRs) on various products. We also had pretty much the highest tariff rates. What the reforms have done over this period is to slowly bring down both types of protection. In the area of quantitative restrictions, they have been removed on everything except consumer goods. The previous government, viz. United Front government entered into an agreement with our other W.T.O. partners to eliminate the remaining quantitative restrictions, at that time about 2,700 items out of a total of 11,000 tariff lines, which were restricted. It was agreed, that these would be eliminated in a six year period. The first step to do that was taken in January of 1998, shortly after the new government came to power, the next major step was taken and 350 items were removed.

So, despite the change of government, we remain on course in the path of removing quantitative restrictions on trade. Only a week ago, a much bolder step has been taken for a more limited region that is out of the remaining 2,200 tariff items, line items, which remain subject to quantitative restrictions, 2,000 of these have been freed for the SAARC countries. That is a very small source for competition, but it is a different beginning and what you now have is a situation where for the whole World QRs will be removed by the year 2003. For

SAARC region they will be removed with effect from August 1. On the tariff front also we have made a very substantial progress. I think the average tariff rates in India today are about 1/3rd the level that they were in 1991. So, that is definitely significant movement. But we have to remember, compared to other countries we are still much more protected and our tariff rates are actually much higher than most other comparable countries. What is more, during this period, other countries have also been reducing tariffs.

So it is one of those cases, although we have made progress, we need to move faster, because others are moving faster. What do these tariffs do? Any economist will tell you. The imposition of tariffs basically raises the price of product above the World price of the same product, which is good for the producer, who is producing the product, in the short run, bad for the consumer who is consuming it, but what it does is, it produces a sequence of demands for protection. Because, if my inputs are going to be protected, because you want to help the producer of those inputs, then I want to be protected because otherwise my inputs become costly and how can I compete and this leads to a layering of protection at higher and higher levels. The end result is that the cost structure of the economy is simply not competitive for the purposes of exports.

In order to export in such an environment, you need subsidies. And that is frankly what we were doing before 1991, I mean there were any number of reasons why Indian costs were high and exporters will come back and say to the government, now you must subsidise us and the government then tax the Indian people in order to subsidise exports and this was actually very clumsy, it does not enable you to recover all the cost disadvantage and what is more in the kind of world we are moving into, is just not going to be legal. This is an important change that is taking place in the World.

The World has come around to a consensus that there should not be high customs duties anywhere. And therefore any attempt to continue with a high custom duty regime and then to off-set it by regime of subsidies becomes very vulnerable to attack through the method of levying anti dumping duties which we are experiencing in many cases. Now it may be that we have a point and it may be that we really do need to subsidise but the current consensus around the World is that, such a policy will become subject to continuous attack and therefore will not be an effective way of generating export competitiveness. So the answer really is unavoidable.

We have to move to a regime of much, much lower protection. The government has recognised this and you have seen a dramatic instance of that in what is recently been done for the area of software. Prime Minister had announced that software and information technology are areas of the highest priority, the government had said that we want to make India a super power in the area of information technology in the 21st century. And in order to create the pre-conditions for doing that the basic steps that have been taken are that information technology equipment, connectivity and facilities are being made available to this industry at international prices. This is the first basic assumption, we have seen a lot of reductions of duty in the last few days, we have agreed to advance by two years, the Zero duty regime which was agreed to in WTO as a part of ITA1 agreement some years ago.

So whereas we had time, before we had to come to zero duty, we have voluntarily announced that we are going to do it two years earlier than planned. The point I am making is that, what is good for software, is valid also for other industries. If we really want to generate an industrial structure, where each entrepreneur will face costs, that are comparable to the costs around the World, then we will have to recognise that our levels of protection cannot be very different from those that prevail elsewhere. One other factor here is that we must not have structure of protection with huge variations. Whatever modest protection there is, it should be as far as possible even, with very limited variation, because it is extremely difficult to devise ways of giving special advantages, once you start giving special protection in any one position.

Having said this, I put this out as a global challenge. It is a global challenge, because, if you want 7 to 8% growth, you will need a level of exports of the kind we have not seen before, but which other countries have seen. The point that I am making is that one of the fundamental reasons why we don't have that kind of exports and haven't had that kind of exports, is that we have not had the sort of internal structure of production for domestic industry, which would make the industry effectively competitive. We have got it in some industries, I think the software industry is an excellent example of that and their performance is really quite breathtaking. We are talking about the firms which are showing 50% growth in profit, huge growth in exports. They are targeting 5 billion dollars worth of exports in a couple of years and completely gung-ho about the environment they face. They are doing that because they know that they are being provided a basis for competing which enables them to translate competitive strength into good products. So that is the first challenge.

How do you bring this about? I know that industry would be very concerned about it, I think if you were to take a poll amongst industrialists and say let us all agree that we need to move to very modest level of protection in 'x' years. They will all say yes, providing 'x' is 10 or 15 years. But we must remember that you know we are already in a gradualist phase. As Keshub said, in 1979 we were all Stalinist; by 1985 we began to talk about economic reform. Then Prime Minister talked about opening up the economy. The first moves towards liberalisation took place. But even then it was not till 1991, that tariffs began to be reduced. And today in 1998, we still have the highest tariffs of all developing countries. So by any stretch of the imagination we have spent a lot of time in the transition. The issue really is, how do we create a consensus? Because, we need a consensus.

It is not going to happen unless there is a general consensus that this policy is good. Not just for exporters, the consensus must be that this policy is good for industry. I for one, profoundly believe, that it is good for industry. We under estimate the ability of industry to restructure. But one thing you can be sure about, you will not restructure if it is not put under competitive pressure. If you put it under competitive pressure, and that pressure is reasonably calibrated, I see no reason why Indian industry cannot do what other industries do. Whether 'x' years is 3 or 4 or 5 is a matter of debate, but I sincerely hope that it shouldn't be more than that.

How to build a consensus to achieve that result, in my view is one of our major challenges. Secondly, let me also mention that exports is not just about producing goods with the right quality and the right price. You also need to be able to get the goods out there in the market place in time. And quite frankly this is the second major, very major constraint. If you look at the ratio of what the retail price of a product is and what the actual commodity value of the product is, there's really a very large difference. Lot of value gets added on. And lot of that depends on getting it absolutely right in the right place at the right time. There is no point in selling, getting cotton goods in to the United States some time in August when they are all going into the fall collection. Unfortunately, a lot of our exports suffer from the most elementary kind of procedural problems. Exporters tell me and I am totally convinced about this, that if you want to export then you need a World class infrastructure.

By infrastructure, I mean roads, I mean ports, I mean telecommunication, I mean quality of power, I mean superior banking system, and most of all I mean modern customs procedures. This is going to be a second major challenge, how do we achieve it. I won't go into the whole issue of infrastructure. It is too well known. Clearly we have to do a lot in the public sector. Clearly we have to do a lot in the private sector, because public sector by itself will not be able to do the job. We have seen a lot of very useful, but still hesitant, sometimes confused steps which has meant that our efforts to bring in private investment into this sector have not been as effective as they should have been. Nevertheless, I venture to suggest that major learning process has taken place.

A lot of what went wrong in the first three or four years was that we seriously under-estimated the complexity of bringing in the private sector into a regulated environment such as infrastructure. Hopefully, we have learnt. One example of why we have learnt is that, we now have some examples of private sector projects that have got off the ground. You know sceptics were not wanting, 3-4 years ago, to say that this whole effort to bring in the private sector into infrastructure is complete disaster, not a single project will come up. That at least is not true. There are private sector power projects. There are private sector ports. We all know that there are private sector telephones; there is a private sector airline. So it is possible. The only thing is, it is not happening as fast or as smoothly as it can and it is not happening in the quantities that it should.

Well, the only hope is since we have seen that it is possible, it should be possible in the next five years, to do a better job, so that it happens faster than it has happened in the past. I think one of the big challenges here in the infrastructure area, which I just want to mention, is that you know there is a tension between the quality of infrastructure that every one thinks average India needs and the quality of infrastructure that exporting India needs. Since we can't have two kinds of infrastructure streams, the tension is there because we are going to be pushed into putting in place a much higher average quality of infrastructure, if we are going to be a more open economy. It is quite possible that vast majority of the people do not need a very efficient telephone system. But as long as you want to have a decentralised software industry, with lots and lots of people all over the country hooked on to Internet, there is no way of having an overlay with a high quality infrastructure for one fellow and a low quality infrastructure for the other. So the difficulty will be at a relatively low level of income, we will have to put in place a quality of infrastructure much better than the majority of people actually likely to benefit from, in the short run. That's going to be costly and how to get that done is going to be a problem.

Third major issue, again a global challenge, is what is the role of foreign investment in all this process? Because one can open up the economy to trade without necessarily opening it up to foreign investment. What should be our line on this subject? I have already mentioned that as far as the balance of payments is concerned, foreign investment as a source of financing the balance of payments, is a preferred source to external debts. That is partly because the rest of the World, if they find a country, in which there is lots and lots of direct foreign investment, get a very positive feel about the country, whereas if they find a country that is borrowing to the hilt, they get a very negative feel about the country. And as long as bankers rule the World, we cannot ignore what they think is good or bad. From the balance of payments point of view, obviously foreign investment is important. But I think it is not just the balance of payment. We must be very clear about it. Foreign investment is a very important vehicle for the injection of technology. It is not the only way of injecting technology. One can buy technology and I think wherever Indian firms want to buy technology rather than tie up with some one else in order to become competitive, they should have the freedom to do so.

So freeing up import of technology should be an important element in our agenda. But I don't think all technology can be bought. The market for technology is not perfect. There is lots and lots of proprietary technology. There is lot of technology that will only come along with foreign investment. And that is why all over the World attitudes to foreign investments have changed dramatically. They have changed India also. And through three different governments, the signal that is being given today is that India welcomes foreign investment and it is eagerly looking for it. Looking for it more eagerly in some areas, may be like infrastructure and other high technology items, in export areas, and so on but nevertheless open to foreign investment across the board. That is the message that we are putting across and I think there has been some success in this area.

You know it is always easy when you look at India's performance to denigrate whatever has happened. Many of us actually enjoy doing it. But I think we have to remember that in 1990, the total foreign investment in the country was only 130 million dollars. I can remember any number of people arguing, that it is absolutely impossible to get lot of foreign investment in, there are so many other constraints, those fellows will never come, etc. etc. But the fact is that last year foreign direct investment did go up to around 3.6 billion dollars. That is a big increase from 130 million. Trouble is, most of the times, when people comment on it, they always compare it with China or somebody else, where it is ten times larger. That is not the point. The point is that there has been a change that's taking place and that change can easily gather momentum. But more than just the money, it is likely to lead to a substantial, deep improvement in technology in the industries into which it comes. Technology is only one side of the picture, equally important for us in the years ahead, is the marketing implication of foreign investment. And this really is directly connected with a very fundamental change that has taken place in the World economy and that is the rise of the globalised firm.

So called multinational corporation in 1970s was essentially viewed as an American company engaged in mining or some thing in Latin America and evoked one kind of image. The modern multinational corporation is viewed as a corporation operating seamlessly across country borders, sourcing things from one subsidiary to sell to another and essentially locating its production decisions across the World through a web of inter-connected enterprises which may be either wholly owned or partly owned. Thirty per cent of World trade today is intra-firm trade. In other words, it takes place through a sale by either one part of a firm or a related firm, to another firm in the same group. If that is the pattern of the growth of trade and developing countries want to link into that pattern it becomes unavoidable that we should provide an atmosphere in which this web can be stretched equally across India, as other countries That is really where a lot of the scope for exports will take place. It is not the old fashioned world, where you produce all the components, then produce an output, then sell it. You may very often be exporting components of a product all over the world and importing the product from some where else. A form of trade, which is a more genuine type of self reliance than an autarchic approach. Where we first satisfy everything we want. It has to be general, because it is not a question of simply saying these are our priority areas.

If you want to export, if your export potential lies in say consumer goods industries or components of consumer goods industries, then it becomes important to have these connections between our firms and their firms and it is quite possible that when a major automobile firm internationally comes to India, develops a vendor net work, then the certification that those vendors get by selling to such a parent firm, enables them to access other markets, where the same firm is producing the same product. This marketing role of foreign investment forces us into a completely different approach to foreign investment than we have had in the past.

Finally let me say that one other aspect, which I do regard as a global challenge, which in some ways is perhaps the most controversial right now and that is how do we handle the trends that we have seen in international capital markets?

Until about 1979 there really wasn't that much of international capital mobility, I think the United Kingdom even only got full capital account convertibility round about 1979, before that there used to be all kinds of capital restrictions . So, capital mobility across the World is relatively recent. What has happened since then? With the removal of capital controls around all the developed world and many parts of the developing world and the growth of banking technology supported by information technology, the ability of large volumes of capital to move across national boundaries is truly breathtaking. I won't give you any of the numbers, but if you look at any number of the growth of the financial trading, it goes into trillions of dollars, whereas it was much smaller in value only 10 years ago or 15 years ago. How does a developing country, which is opening up, react to this kind of explosion in international financial markets?

I say this is controversial, because the approach that the government has followed and I think it is the correct approach, is that whereas we are accelerating the integration as much as possible of the Indian economy with the rest of the world on the real side, opening up to trade, opening up to technology, opening up to foreign direct investment, and little bit also to portfolio investment with all kinds of little restrictions. We have not actually opened up the economy to free movement of capital, by free movement of capital, I mean, the ability of any one anywhere to invest anything in India, the ability of any one in India to borrow from anywhere abroad. In the days when the going was good many Indian businessmen whom I met used to attribute our desire to restrict their ability to borrow, attributed it to a peculiar benightedness resulting from long years of living in Government and not appreciating that you know businessmen must have full freedom to borrow in whatever currency they like, etc. I hope when they think back on it, now, that they are more aware of the nature of the currency risk and now that they see what has happened in East Asia, many of them will see the merit of a policy which put some restrictions on external borrowing. I think that the lessons of East Asia are very clear; they do show that number one, financial markets move very much more rapidly than goods market.

I mean, if somebody gets a wrong idea, a false idea, about India's attractiveness to foreign investment, there is no chance on earth of an excessive inflow of foreign investment, you will not get 20 billion dollars coming in, may be it will go up by a few hundred million, the time taken for foreign direct investment to respond is automatically a stabiliser. That is not true of financial capital. It is very easy to move billions of dollars very quickly both in and move out and capital account convertibility means that Indian business must also have the right to hedge its bets and move its money out, if it feels it want to. I think the lesson of East Asia is, that you need to have much greater preconditions in place and much sounder financial systems, before you can expose the economy to the risks of a highly volatile financial world market. I think it is also true based on East Asia that the ability of the sort of fellows, who move large sums of financial capital, to judge the risks accurately in developing countries, is actually quite low. And therefore there are failures of the market which are not the fault of the borrowing country.

It could be the fault of the fund managers who are moving large sums of the money around, but whatever the cause, it is the borrowing country that ends up paying the cost. Because if you have a crisis, then the entire country and its entire corporate sector gets tainted. Faced with that situation, the approach the Government policy has taken is very cautious and I think this could be a controversial issue in the sense that people could say, perhaps if you really want to liberalise, you should liberalise on the capital account. I for one don't agree with that view and I think after the East Asian crisis, there is growing consensus that it is a good idea to open up the real economy. But it is a good idea to be a little cautious on how you go on the financial markets, you should open up, but you should open up gradually at a pace where the kind of shock that you may be subjected to is always within your capacity to handle. I think what we have been doing so far is roughly in line with this dictum. We should continue this process, but we must do so in a gradual manner.

I have talked about many things in the course of this lecture and I am sure that they don't answer all your questions, but my object was to really to say that we are going through a very exciting period of economic policy change. It is a period which is seeing lots of things changing in the country. It is the period in which during the last six or seven years we have had lots of good results. Right now business is preoccupied with what is a short term downturn. It may be a serious down turn, but I do believe that it is a short term downturn and it should not distract us from keeping the medium term and longer term goals right. Main thing is that if we are liberalising and opening up, then we have to design our policies to reflect the compulsions of the Global economy, very strong compulsions. We have made movement in these areas, we probably need to make more, but there is good reason to believe that if we have done so well so far, with a bit of luck and lot of good planning, which is a dirty word according to Keshub, but policy planning is all right, may be the rest of the transition can be achieved. But it will only be achieved, if in audiences like this, there is a real perception that the controversies associated with these changes are adequately addressed and people are convinced that the changes are actually for the better.

Thank you