

***Thirty First Foundation Day Lecture of Indian Institute of Management, Bangalore  
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**on**

**Policies for Development in a Globalising World**

I feel greatly honoured to be asked to deliver the thirty first Foundation Day Lecture at the Indian Institute of Management Bangalore. The IIMB belongs to that very small set of Indian institutions that have achieved the distinction of being an internationally recognised quality brand. This is an achievement of which both the faculty and students, can be justifiably proud.

It is also a special pleasure to visit Bangalore again – my first visit after returning to India after a few years abroad. During my stay in the US I became personally aware of the tremendous international brand recognition achieved by this city as the home of India's IT software and biotech industries. Bangalore has surely become a symbol of what India can achieve given the right environment. I do not exaggerate when I say that Bangalore was in the news more often than New Delhi! It even achieved the rare distinction of being promoted from being a mere proper noun to a verb, when someone in the US, having lost his job due to outsourcing, made a large amount of money by marketing a T shirt with the slogan "*My job's been Bangalored!*"

Since both the IIMB and Bangalore are examples of successful globalization, I thought it would be appropriate to devote this lecture to the larger issue of what should be the key development priorities for India in a globalizing world. The Planning Commission is currently engaged in a Mid Term Appraisal of the Tenth Plan and we hope to provide detailed answers to this and other questions, as part of the Appraisal. However, I would like to use this opportunity to share some preliminary thoughts on this issue.

Let me first comment on the nature of globalization and on how attitudes towards globalization have evolved especially in the past decade or so. There are six distinct economic processes underlying what is commonly called the globalization of the world economy. These are (i) the expansion of international trade in goods and services (ii) freer flow of technology (iii) expansion in foreign direct investment (iv) freer movement of other capital flows (v) freer movement of persons across national boundaries and (vi) the development of international institutions of governance suited to the globalized world.

None of these processes is entirely new. They have been at work to varying degrees since the end of the Second World War and used to be described by more mundane terms such as "international economic integration". Sometime in the 1990s, what used to be called "international economic integration" came to be described by the more dramatic label "globalization". The switch in terminology arose from a recognition that the combined effect of all these forces, aided by technological developments, especially in information technology in 1990s, had made interaction across national boundaries so seamless that it needed a more dramatic description. The word globalization was coined.

Perceptions about globalization and its effects vary, and have gone through a definite cycle in the past ten years or so. The upswing of the cycle occurred in the first half of the 1990s, a period characterised by a highly optimistic mood in industrialised countries. Politically, the collapse of Communism in Eastern Europe at the end of the 1980s and of the Soviet Union in 1991, and the enthusiastic adoption of democratic systems and market oriented policies by these countries, contributed to an air of triumphalism in the West. The change was viewed as epoch making, heralding what Francis Fukuyama had called the "end of history". These events coincided with the start of a prolonged boom in the U.S., which was fed by extraordinary productivity gains from new technology especially the application of IT. The benefits of globalization were expected to flow to developing countries also through access to export markets in industrialised countries and an integration into global supply chains, while also promising a limitless supply of capital to all "well managed" economies.

This mood of triumphalist optimism did not last very long. The East Asian crisis towards the end of 1997 provided a rude shock and this was followed in quick succession by the currency collapse in Russia in 1998, Brazil in 1999 and Turkey and Argentina subsequently. These crises, and the severe economic downturns they caused, focussed attention on the vulnerability of emerging market economies, and the risks posed by globalization, especially in the financial markets. The failure of the international financial institutions to warn about these vulnerabilities, and their subsequent failure to restore stability quickly, eroded confidence in the quality of institutional support underpinning economic integration.

The economic mood in the industrialised world also changed contributing to an evaporation of the earlier optimism. The prolonged boom in the U.S. economy ended in 2001 with the collapse of technology stocks and the downturn in economic activity. As unemployment began to increase in the industrialised world, there was a backlash against globalization in the industrialized countries and slogans of “fair trade” became common currency. The political mood also changed as the triumphalism associated with the “end of history” gave way, by the end of the 1990s, to worries about terrorism as a new and shadowy threat to democratic and open societies everywhere. These concerns were greatly magnified by the terrorist attacks of September 2001 in the United States.

Given this extreme swing in perception in the world at large, it is not surprising if the average man or woman in India is plagued by doubts about the nature of globalization, what impact it will have on ordinary people and what it implies for our policies. Before turning to these issues, I would like to emphasise that the issue is not whether one is “for” or “against” globalization. Globalization is not a specific policy, or even a defined set of policies, that one can be for or against. Rather, it is a process taking place in the world around us, driven by international developments which are largely outside our control.

The question we should ask is what are the policies we should adopt given that globalization is a reality. How can we maximise the potential benefits from globalizing while minimising the risks? Allow me to share some thoughts on this subject.

The first point I would like to make is that while globalization has undoubtedly created a totally different external environment, and we must try to choose policies which enable us to derive the maximum benefits from it, it does not mean that dealing with the global environment must be the only, or even the central, focus of development policy. We will be better able to cope with globalization if we have a strong economy. That is why the National Common Minimum Programme has outlined a broad objective of achieving 7-8% growth per annum. It will be our endeavour, in the Planning Commission to speak out the implications of achieving the goal.

To achieve the objective of high growth and a strong economy we need to focus on many areas in the domestic policy agenda which are not primarily aimed at deriving benefits from the external environment and also to devise policies to deal specifically with the external environment.

Three areas at present that are critical for the domestic agenda independent of what we do externally are the provision of essential social services (i.e. primary education and health) the need to restore dynamism to agriculture and the need to strengthen infrastructure. All three are essential whatever approach we adopt towards globalization. The third – strengthening infrastructure – is particularly critical if we want to derive the full benefit from globalization also.

Let us consider the social sectors first. Health and education are important ends in themselves. They are also in the longer term inputs into the Growth process in the sense that we cannot imagine that we will achieve strong economic growth if we do not have healthy and educated population.

There is little doubt that among the major problems facing our economy are the glaring deficiencies in education and health. Adult literacy, which is a commonly used, though hardly ideal, measure of educational achievement, is still only 62% in India compared with 98% in China, Thailand and Indonesia. It is a sobering thought that our literacy rate today is still below the level achieved in South East Asia twenty-five years ago. The statistics on school enrolment are better, with enrolment in primary schools for both boys and girls above 90%, but the real problem here is that 40% of the children enrolled in primary school do not complete primary school. The enrolment rate in secondary schools is 57% for boys and 40% for girls. This compares with 66% and 60% respectively in China, 75% and 73% in Thailand and 58% and 56% in Indonesia. Clearly our relative performance in the secondary school stage is better, but the deficit in the primary school stage is quite unacceptable.

The position regarding health is equally disturbing. Consider for example two familiar health related indicators the infant mortality rate and the maternal mortality rate. Our infant mortality rate in 2001 was 67 (per 1000 live births) and had been stagnant at that level for several years. The comparable figures for China is 31, for Indonesia 33, for Vietnam 30 and for Thailand 24. Similarly, India's maternal mortality ratio (per 100,000 live births) is 407 compared with 56 in China, 213 in Indonesia and 95 in Vietnam. The very high level of maternal mortality reflects the lack of facilities for assisted births in large parts of the rural areas which is an indicator of the low quality of general health services.

The conclusion is inescapable. We have not provided essential public services in primary education and health to the mass of our population and the deficiencies are particularly marked in rural areas. A healthy and educated population is not only an end itself, it is also an essential precondition for achieving higher growth in output and therefore incomes.

This is clearly an unacceptable outcome and I am happy to say that the Government has taken steps to provide additional resources to both education and health. The 2% education cess has provided the additional resources needed to fund primary education and mid-day meals on an enlarged scale. However, I must emphasise that resources are only part of the problem. It will also be necessary to bring about organisational improvements in the delivery system which could help to increase the efficiency with which resources are spent. There is no doubt that we need more and better equipped primary schools and we also need more teachers since our pupil teacher ratio in the public schools system is too high. However the public education system also suffers from very high ratio of absentee teachers and even when teachers are not absent, the quality of teaching leaves a great deal to be desired. How to overcome this challenge is in some ways the greater challenge. Perhaps the only practical way of doing this will be to enhance the degree of involvement of Panchayati Raj institutions in designing, implementing and monitoring performance in this area. It will also be necessary to make the provider of these services – whether teacher or medical workers – more accountable to local authorities which are in the best position to reflect the views of the intended beneficiaries.

Another important, and largely domestic, area which demands priority attention is agriculture. The Tenth Plan GDP growth target of 8% per annum was based on the assumption that we could achieve agricultural growth of around 4%. This was a reasonable target and has been achieved in many other fast growing countries in East Asia. However, a review of recent experience suggests that we are far from achieving this target. In fact, agricultural growth, which was around 3.4% per year from 1980 upto the mid 1990s, has decelerated subsequently to around 2.0%. This deceleration is undoubtedly at the root of much of the reported dissatisfaction with the pace of progress in rural areas, and the many instances of acute distress in some areas.

Measures to restore dynamism to Indian agriculture will receive high priority in the Mid Term Appraisal. The agenda for corrective action in this area is complex. There is general agreement that it will be necessary to reverse the steady decline that has been witnessed over several years in public investment in basic rural infrastructure relevant for agriculture.

We need to invest more in irrigation, rural roads and schemes for watershed management. We also need to improve credit delivery in rural areas, strengthen extension services which have deteriorated almost everywhere and revitalise agricultural research.

Looking ahead we also need to evolve an agricultural strategy that would help agriculture to diversify away from an excessive reliance on foodgrains and towards higher value added horticultural crops. This is necessary even from a domestic perspective but it is also relevant from globalization since India could potentially become an exporter of certain fruits and vegetables. Diversification of agriculture poses its own problems some of which would be of special. Marketing of perishable horticultural produce requires very different marketing arrangements from cereals. We need to build a value chain from the farm to either on agro-processing industry or directly to the retail consumer and this chain must take account of the need for post harvest technology, cold chains, refrigerated transport, grading and modern marketing. This is clearly an area where there is scope for a much closer involvement of the corporate sector to provide value enhancement for the farmer through contract farming arrangements. This calls for changes in many areas including the current laws relating to the marketing of agriculture produce. It may require new form of co-operation between the corporate sector which provides the seed and technology and the extension services. A few pilot projects have shown good results, but these experiments need to be generalised and scaled up.

A third critical area constraining our growth is the quality of infrastructure. Infrastructure development is obviously important for growth in general, and it is especially important if we want to achieve competitiveness in world markets since this requires infrastructure of comparable quality. We have done much less than we should have in this area, and corrective steps are urgently needed.

Anyone who has travelled in China and South East Asia knows that India suffers from an enormous infrastructure deficit. I have already mentioned the need for massive investments in rural infrastructure, mainly irrigation, rural roads and watershed development. We also need a parallel effort to upgrade our industrial and urban infrastructure.

The power sector in almost all states is characterised by financially unviable utilities which recover only 80% or so of the average cost of the power they supply. This is partly because tariffs charged to certain categories of customers are too low and partly because of large theft of power, usually with the connivance of the distribution staff. Financial unviability in turn means inadequate investment in both generation and distribution. The net result is that they provide power of unreliable quality and at high cost especially to industrial users. This has forced many users to establish their own captive generation capacity to ensure a steady supply of power, albeit at high cost. There is an overwhelming need to reform this sector. The Electricity Act 2003 provides the outlines of such reforms including especially the establishment of statutory State Electricity Regulatory Commissions to fix tariffs, phasing out cross subsidisation, unbundling generation, transmission and distribution and allowing open access to bulk consumers. Properly implemented this provides a road map for a return to viable power utilities.

Our road and railways infrastructure is also inadequate. Our ports are clogged and our airports are increasingly unable to cope with expanding domestic and international traffic. Unless these problems are overcome, we cannot expect to achieve our growth targets or establish international competitiveness.

Urban infrastructure is another dimension of infrastructure development which is grossly neglected. Success in achieving our growth target of 7-8% growth per year will inevitably put a strain on our major cities, especially those located in areas most likely to lead the economic expansion. None of these cities is institutionally and organizationally equipped to cope with the demands that will be put on urban infrastructure including especially road transport, traffic management, urban water supply and sewage disposal. Part of the problem

is that the management of our cities is not based on adequate empowerment of the cities and financial capacity based on a combination of property taxation and user charges.

Bangalore exemplifies the challenge posed by urban infrastructure. The city has benefited enormously from the software boom and has demonstrated the tremendous benefits that can be realised from globalisation given an educated labour force an acceptable telecommunications infrastructure, and a base of technically competent private entrepreneurs. It has the promise of retaining its leadership role and emerging as one of Asia's premier cities. But it has yet to demonstrate that it can stay ahead of the curve in providing the infrastructure support needed to sustain its boom town image. Bangalore has the enormous advantage of being an early winner, but in this highly competitive world it is necessary to work hard to stay ahead.

I am sure the State government is aware of the problem and is taking steps to ensure that Bangalore retains its position as a beacon for private investment both domestic and foreign. This is not simply a matter of making investments in one or other facility to deal with bottlenecks as they arise. It is necessary to restructure the system of urban governance and empower cities to look after themselves.

Recognising the importance of infrastructure in India's development, the Prime Minister has established a Cabinet Committee on Infrastructure under his Chairmanship to give high level attention to infrastructure related issues. We hope to use this forum to expedite decision making in this critical area.

The resources required to close India's infrastructure deficit are enormous. An estimate made some years ago was that we need to invest approximately \$150 billion over a ten year period. Updated to today prices the amount would be closer to \$200 billion. Resources on this scale cannot be provided by the public sector alone and that is why the NCMP recognises the need to encourage private public partnership to bring in private resources into infrastructure development to the maximum extent possible. However, one must be realistic about the scope for attracting private investment. It is relatively easy in telecoms, airports and ports. It will be possible in power, once the reforms of the State Electricity Boards are underway but meanwhile a large part of the services would have to come from the public sector. It is also possible in roads where traffic density is high enough but there may be need for some public sector support through viability gap funding. There are other types of infrastructure such as rural roads, irrigation, watershed development etc. where private investment is unlikely to come forth.

All this means that a very large part of infrastructure investment will have to come from the Public sector either in the form of direct public investment in areas where the private sector is unlikely to venture, or the public contribution to public private partnership. We are trying to ascertain how we can mobilize the resources needed to meet these needs. One possibility, which is being discussed with the Finance Ministry, is to find ways of increasing the fiscal deficit beyond the levels permissible under the FRBM Act, for the specific purpose of providing funds for critical infrastructure development projects, but linked to a process whereby the additional deficit would be neutralised by effective use of foreign exchange reserves.

Let me now turn to some of the policy responses specifically needed for exploiting the potential benefits of globalization. The most important advantage which globalization offers today lies in the opportunity for expanding exports of goods and services. We have done well in the area of information technology related services, as the prosperity of Bangalore testifies, but we have not shown comparable dynamism in exporting manufactured products. And yet, growth of labour intensive manufactured exports, provides an opportunity for expanding productive employment which is a critical objective at present.

This is clearly an area where we could learn from China's outstanding success in establishing itself as a reliable producer of manufactured consumer goods for mass markets in the industrialised countries. In 1990, India's total exports were \$18.5 billion and China's total exports were \$62 billion or a little over three times India's. Today, India's exports are about \$60 billion, whereas China's exports are \$438 billion, or seven times as large as India's.

Keeping the total exports of India and China at \$500 billion, if the two countries had retained the same relative shares as they had in 1990, India's exports would have been \$120 billion and China's \$380 billion. The extra \$60 billion in exports for India translates into extra employment of about 5 to 6 million persons, which is more than 20 percent of the total employment in the formal sector.

What does it take to become a successful exporter and thereby benefit from globalization? Experience of successful exporters point to the need for active government policies in several critical areas. One of these is providing quality infrastructure which I have already discussed.

In addition to providing quality infrastructure, we must ensure that our domestic production structures are adequate to ensure global competitiveness. Developments in retail markets abroad have created mass consumer markets where most simple consumer goods are sold through large departmental stores and discount chains. These retailers source consumer goods from all over the world, but they typically demand supplies in large quantities and conforming to strict quality specifications. Some of our policies, such as the reservation of certain areas for the small scale sector, have prevented us from exploiting world markets. These policies were expected to promote employment in the small scale sector, but over a longer period they have prevented us from penetrating export markets which could have generated a much larger volume of productive employment. Successive governments have, over the years, removed items with export potential from the reserved list. This process needs to continue and hopefully, this will help in future.

Export competitiveness also requires continued progress in restructuring trade policies away from the earlier approach followed in India and in other countries which protected domestic producers behind tariff walls. While this helps the individual producer being protected, it has the inevitable result of raising the domestic cost structure of the economy making exports uncompetitive.

Trade liberalisation is a process that has been underway in almost all developing countries. However, its pace has been much slower in India. Quantitative restrictions on imports were removed in stages beginning in 1992 and finally abolished only in 2001. Tariff levels for industrial goods have been reduced from an import weighted average of 80% in 1992 to around 20% in 2004-05, but these tariff levels are still among the highest in the world.

Successive Finance Ministers have announced that it is our intention to bring our tariff levels down to East Asian levels. To do this, we would need to bring our average tariff level down to a third of the present level. Since I am speaking in Bangalore, it is appropriate to mention that the one area where the country has performed exceptionally well is in the software and IT sectors, where tariffs on inputs and capital goods were kept at low levels.

Policies towards foreign direct investment are extremely important in gaining competitiveness in a globalised world. China's example of the impact of foreign direct investment is relevant in this context since almost 50% of Chinese exports are associated with FDI. In our own case, the role of FDI in modernising a sector can be seen from the experience of the automotive sector. It was the entry of Maruti Suzuki which initiated the modernization of the sector twenty years ago. Subsequently foreign investment brought in other contemporary motor vehicles and the resulting upgradation of the auto components sector has generated strong export capability in this area. Most recently, the competitive

environment has seen the entry of a purely Indian designed vehicle which is even being exported.

Once again, China's example indicates that we have not exploited the scope for FDI inflow fully. China attracts around \$60 billion of FDI whereas FDI in India, on a comparable basis, is about \$ 5 billion. The Chinese economy is three times the size of the Indian economy, which suggests that India should be able to absorb \$20 billion. The Common Minimum Programme states that "India needs and has the ability to absorb two to three times the level of FDI than at present." This translates to a target of \$15 billion per year, which is a very reasonable target given what China has achieved.

Yesterday the Cabinet cleared the proposal to establish an Investment Commission in the Finance Ministry. The Commission has a broad mandate to explore the scope for encouraging private investment both domestic and foreign. One of its tasks will be to make recommendations which could lead to the realisation of the foreign direct investment potential of the country.

Before leaving this subject, let me emphasise that by stressing the importance of foreign investment I am by no means saying that successful exploitation of opportunities in global markets can only come from multi-nationals. Bangalore is surely the last city where one can make this statement since companies such as Infosys and WIPRO and BICON, all admired in their fields are Indian Firms. Similarly, in the pharmaceuticals sector, Ranbaxy, Dr. Reddy's laboratories, Ciple etc. are Indian firms. I am only saying that we need to create a competitive environment, including opening up the sector to both trade and foreign investment, if we want to ensure that efficient firms thrive and grow. Properly done, it should lead to the emergence of Indian firms that define themselves as acting in the global arena. Firms that cannot compete with FDI in their own home market are unlikely to be able to do so in the global market place. Our companies in the software sectors, biotech and pharmaceuticals have demonstrated that we can compete and there is no reason why this should not be true in many other sectors.

Does globalization and opening up the economy pose risks? Of course it does and it is important to know the risks and take action to minimise it.

Many critics of globalisation point to the devastating effects of the East Asian Crisis as evidence of the dangers of the external liberalisation. The fact is that the East Asian Crisis was not caused by either trade liberalisation or liberalisation of FDI. It was caused by premature liberalisation of the capital account, especially short term capital, in the face of weaknesses in the banking system. India's liberalisation has deliberately avoided these pitfalls. We have consciously limited short term debt and followed a reserve management policy that has been abundantly cautious. Our reserves today are far above the level needed to manage the external payments situation, including any possible threats from short term capital out flows. Indeed that is why we are considering ways of using the reserves to build much needed infrastructure.

Does market volatility in export markets pose a risk? This is indeed an important issue. Exporting for world markets in today's environment involves both market risk and technology risk. A change in technology, or in tastes, or the sudden emergence of a new low cost source of supply in some other emerging market country could lead to a sudden loss in export orders. However, this factor can also go in our favour. The extra-ordinary market share carved out by China in so many simple manufactured goods offers an opportunity for India to persuade international buyers to shift at least part of their demand to India, provided we can match China's quality and prices. What is a market opportunity for us, is clearly a market risk for China.

The main lesson I draw from this is that the globalization of World trade provides large potential benefits but also some risks. It is for countries to decide when they want to be on

the risk reward frontier. As business school students you know that it is difficult to imagine high rewards without some risks. An important implication is that firms need to be flexible and nimble to survive in this environment. It is for this reason that many analysts argue that flexibility in labour laws is important. The government recognises this, but also recognises that this is a difficult and sensitive subject. We hope to build a consensus on this issue through discussion with all concerned.

These are only some of the issues which the Planning Commission hopes to address in the Mid-Term Appraisal that we are currently working on. As students of management you will recognise that what we are engaged in is a typical SWOT analysis. We will review the country's strength and weaknesses, our opportunities and our threats. Out of this should come a reshaping of our development strategy. We need to leverage our strengths, re-inforce ourselves in areas where we are weak, aggressively exploit our opportunities especially in areas where we have strengths, and finally take precautionary steps to deal with threats. I am told this is good business management strategy. It is also good planning.

Thank you