

# ~~Administrative Staff College of India~~

~~Hyderabad, India~~

## ~~Second Golden Jubilee Lecture~~

~~by~~

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~~P. Chidambaram\*  
15<sup>th</sup> December 2007~~

### ~~High Growth: What it Means, What it Entails~~

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~~—~~I accepted the invitation of the Administrative Staff College of India (ASCI) with mixed feelings. Naturally, I was honoured that ASCI, one of our premier teaching, training and research institutions, should have considered me suitable to deliver the second lecture in the Golden Jubilee Lecture series. Elation, however, quickly gave way to trepidation because the first lecture in this series was delivered by a person of great eminence, Dr. ~~Manmohan Singh,~~ and I do not even pretend that I can match the Prime Minister's erudition and wisdom. There was another reason for my sense of trepidation: because it is the legendary Shri M. Narasimham who is the Chair of the Court of Governors of ASCI. Among other things, Mr. Narasimham is known as a stern taskmaster and I can only pray that this lecture meets with his approval!

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## Growth: Occupying Centre Stage

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2.—The subject that I have chosen for this lecture is one that has come to occupy centre stage in current public discourse. It is the subject of high growth. No five-year period in the history of India has witnessed an average growth rate of GDP of 8.6 per cent a year. The average growth rate between 1901 and 1947 was 0.8 per cent a year. That is the most telling comment one could make upon British rule: the British did not rule India; they plundered our resources to benefit the cotton mills of Lancashire and the steel mills of Sheffield. The period subsequent to 1947 was indeed different, but not~~The period subsequent to 1947 was indeed different, but not by a large degree.~~

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\* Finance Minister, Government of India. This was the talk given by Mr. Chidambaram as part of the Second ASCI Golden Jubilee Address delivered on 15 December 2007 at ASCI.

by a large degree. The average for the first 30 years was 3.5 per cent a year. In the 1980s, thanks to some tentative steps, the growth rate increased to 5.6 per cent a year. It is only in the 1990s—leaving out the crisis year 1991-92—that the growth rate responded to the radical policy changes and rose to an average of 6.2 per cent a year.~~The average for the first 30 years was 3.5 per cent a year. In the eighties, thanks to some tentative steps, the growth rate increased to 5.6 per cent a year. It is only in the nineties—leaving out the crisis year 1991-92—that the growth rate responded to the radical policy changes and rose to an average of 6.2 per cent a year.~~In fact, for the eleven-year period 1992-93 to 2002-03, the growth rate averaged 5.8 per cent a year.

3.—The growth rates until 2002-03 cannot be characterized as high growth rates. They were indeed higher than in the previous years but, in my view, barely satisfactory. They were not adequate to attract large investments or to throw up abundant resources or to make a dent on poverty. It is only a growth rate of more than 8 per cent a year that can cause a transformation in the structure of the Indian economy and lead to a qualitative change in the lives of the people. Even in a short period of five years, we are beginning to see the beneficial effects of high growth. Let me list a few:

- The buoyancy in tax revenues is directly attributable to high growth. In the three years since 2003-04, gross tax revenues of the ~~C~~entral ~~g~~overnment have increased by 19.9 per cent, 20.1 per cent and 29.3 per cent. In the current year too, tax revenues are growing at a brisk rate so far.
- More jobs have been created during the years of high growth than in any other period. It has been estimated that, between 1999-2000 and 2004-05, the number of persons who joined the workforce ~~---~~ that is people who were able to find employment ~~---~~ increased by 48 million.
- High growth, driven by increasing domestic investment, acts as a magnet for foreign investment. Gross ~~F~~ixed ~~C~~apital ~~F~~ormation (GFCF) has been 26.3 per cent, 28.1 per cent and 29.5 per cent in the three ~~---~~ year period from 2004-05 to 2006-07. GFCF in 2007-08 is expected to be more than 32 per cent.
- High growth has accelerated the movement towards fiscal stability. In June 2004, ~~the~~ ~~g~~overnment was faced with a revenue deficit of 3.6 per cent and a fiscal deficit of 4.5 per cent at the end of the previous financial year, 2003-04. Therefore, when the UPA ~~G~~overnment notified the Fiscal Responsibility and Budget Management (FRBM) Act that had been passed earlier, no one believed that it would be possible to adhere to the FRBM targets: that the revenue deficit would be wiped out by 2008-09 and the fiscal deficit would be brought down to 3 per cent or less by 2008-09. Today, there is a high degree of confidence that the FRBM targets ~~would~~ will be achieved, as mandated, in the year 2008-09.

4. ~~---~~ What are the reasons for the high growth witnessed in recent years? Broadly, there are four reasons. ~~The~~ ~~F~~irst, ~~reason~~ ~~is~~ ~~that~~ we opened our economy, introduced market reforms, eliminated licensing and control, and exposed every player to competition. The opening of the economy has resulted in productivity gains in both capital and labour. The second reason is the liberalization of the external sector. Trade was made free of controls, and foreign direct investment was welcomed.

Imports of goods and services have moderated price increases and forced domestic industry to become more efficient. ~~The third, we took reason is the carefully-~~ sequenced and measured steps towards liberalization of the financial sector. Significant reforms were undertaken in banking, insurance, pensions and capital markets. ~~a~~ Although, I would hasten to add that the unfinished agenda in this sector remains large and needs to be addressed promptly. The reforms in the financial sector have led to more optimal allocation of resources, better price discovery, adoption of international disclosure norms and accounting standards, and more efficient management of risks. The fourth reason is the enhanced public expenditure. While the balance may have shifted toward revenue expenditure, the expenditure on education, health care, rural roads, drinking water and rural employment has put more money in the hands of the people and contributed to the higher consumption of goods and services and, consequently, higher growth.

5.— Intuitively, it is possible to assert that the reasons that have contributed to high growth are likely to remain unaltered and, if they do, then high growth is also likely to continue. That would indeed be so in a static situation. However, the economic environment is a dynamic environment and what is good or adequate at a point of time may turn out to be poor or inadequate at a different point of time. For example, is it possible to remain content with the level of competition in different sectors of the Indian economy? Is there enough competition, say, in the mining sector or the petrochemical sector or the pharmaceutical sector? Let me take another example. Is it possible to say with certainty that the degree of autonomy now available to public sector banks would be sufficient to enable them to enhance the size and scale of their operations? Given the present structure of ownership, can public sector banks find adequate capital in order to satisfy norms of capital adequacy for their growing business?

6.— A period of high growth is indeed a rare opportunity. This is the first time in India's history that we have the opportunity to achieve and sustain a high rate of growth over a fairly long period of time. Many observers and many studies have pointed out that it is possible to maintain the present momentum of high growth over the next ~~twenty~~ 20 -years. We must therefore seize the opportunity with both hands. At the same time, I must caution that high growth brings with it great responsibilities.

The people have responsibilities, governments have responsibilities. India has not yet arrived; we have just begun the journey. Our goal is to abolish abject poverty and become a middle-income country in the medium term. Hence, there is no room for populism or extravagance. It is only a responsible people that will elect responsible governments that will manage the economy in a responsible manner that can ensure high growth over a long period of time.

### **Challenges: Firstly, Savings: The First Challenge**

7. — On that note of caution, I wish to address certain sectoral challenges that arise out of a high growth rate. The first, and obvious, challenge is to savings. In order to sustain high growth and in order that such growth is largely financed by domestic resources, it is necessary that domestic savings should be adequately high and should increase as the economy moves to a higher growth plane. It is a happy augury that domestic savings have improved from 23.7 per cent of GDP in 2000-01 to 34.7 per cent of GDP in 2006-07. What is of great significance is that public sector savings which ~~was~~ere negative at 1.7 per cent of GDP in 2000-01 has~~ve~~ become a positive 2.0 per cent of GDP in 2005-06. Private corporate savings (8.1 per cent) as well as household savings (22.3 per cent) continue to remain high. It is important to maintain this trend of rising domestic savings. ~~and,~~In my view, it would not be too ambitious to aim for domestic savings of 40 per cent of GDP by 2011-12, the terminal year of the Eleventh Plan. In fact, the draft Eleventh Plan envisages an average annual savings rate of 34.8 per cent through the ~~p~~Plan period; and that is neither too ambitious nor unattainable.

8. — In order to promote savings — and for other reasons too — it is necessary to bring more people into the formal financial sector. The poor also save, except that their savings are not part of the formal financial sector. As a result, the poor are not able to leverage their savings or earn a reasonable return on such savings; ~~¶~~ Their savings are not secure; and those savings are not intermediated efficiently and turned into investment. Financial inclusion is therefore an important goal. Eventually, it is my hope that every household in this country will have a bank account. Meanwhile, we must experiment with new models of institutions. The self-help group (SHG)

movement has proved to be a phenomenal success. Public sector banks have financed 3 million self-help groups so far, and the number is growing every year. SHGs have promoted thrift. We must replicate the success of the SHG movement in other bodies such as joint-liability groups, chit funds, micro-finance organizations, etcetera etc., and bring them into the mainstream of the banking sector. We must also harness technology—and such technologies are available today—to spread the concept of “branchless banking”. The possibilities are virtually unlimited: mobile banking, wireless banking and cellular telephone banking are among technologies that are proven and popular. I am glad to note that our banks have begun bold experiments with new technologies to expand the reach of the banking sector. However, financial inclusion should not become a ‘public sector bank’-centric subject of discussion. We must take the subject beyond public sector banks and promote greater competition in banking services among different service providers.

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### The Challenge to the Financial Sector Challenge

9.—The second challenge is the challenge to the financial sector in general and to the banking sector in particular. In order to sustain an average growth rate of 9 per cent a year, the economy would have to mobilize vast resources. Bank credit alone will need to grow at about 24 to 26 per cent a year. Besides, investors will need to raise equity and quasi-equity resources. Research and development will require resource support of a different kind from investors who are willing to take higher risks. Some investments need funds with short tenors; others—especially infrastructure projects—with long tenors. Hence, all segments of the financial sector would have to be tuned to fire on all cylinders, be it the capital market, banking, insurance or pensions. Each one of them is important, and each one of them is crying out for more reforms.

There is, however, one common need for all these segments, and that is capital. For example, it has been estimated that Indian banks will need to raise Rs. 1,00,000 crore as additional Tier-I capital over the next three years. Given the current life insurance penetration of 4.8 per cent and life insurance density of US\$ 38.4, even to double those numbers over the next five years, the life insurance industry will need to increase its capital by about Rs. 15,000 crore. The same arguments would

apply to the health insurance and general (i.e., non-life) insurance industries as well. India is still at the first step towards creating a pension fund industry, and building such an industry ~~would~~ require a large amount of capital. We have a well-regulated capital market. ~~B~~but the modernization of that market and the modernization, including technological upgradation, of different kinds of market participants ~~would~~ also require vast amounts of capital. These industries cannot raise the huge additional capital required unless they are perceived to be well governed and well regulated. Therefore, we need to pass new laws or amend existing ones. We need to introduce new measures for risk management. In retrospect, I think we have lost valuable time. ~~B~~But we must make up for lost time and get on with the job of creating a world-class architecture for these markets. It is unfortunate that even after ~~the~~ Government has made it clear that public sector financial institutions will continue to remain under public ownership, objections are raised on ideological grounds to the modernization of these industries and markets. I am obliged to point out that any further delay in addressing the unfinished agenda in the financial sector will severely constrain the growth of these industries and adversely affect the high growth rate to which we aspire.

### **The Infrastructure Challenge**

~~10.~~— This takes me naturally to the third sectoral challenge, and that is the challenge to the infrastructure sector. I shall dwell only on two aspects of ~~the infrastructure~~ ~~this~~ challenge. The first is the financing of infrastructure. An assessment made by the Planning Commission for the Eleventh Plan indicates that investment (or gross capital formation) in infrastructure at 2006-07 prices ~~would~~ need to increase from 5.0 per cent of GDP in 2006-07 to 9.0 per cent of GDP in 2011-12. It means that the investment in infrastructure at 2006-07 prices ~~will~~ ~~not~~ need to increase from Rs. 2,58,580 crore in 2007-08 to Rs. 5,71,315 crore in 2011-12. Simply adding the resources required annually will result in a humongous sum of Rs. 20,01,777 crore.

How do we intend to find these resources? Broadly, one-half would have to come from non-debt funds and one-half from debt funds. The estimate of debt funds is Rs. 9,96,291 crore. Of this, the banking sector alone ~~will~~ ~~not~~ have to provide Rs. 4,23,691 crore. We have also estimated the amounts that ~~can~~ ~~not~~ be raised from

external commercial borrowing (ECB), non-bank finance companies (NBFCs), pension funds and insurance companies. Nevertheless, there is still a financing gap of Rs. 1,70,752 crore, which is about 17 per cent of the debt resources required and about 8.5 per cent of the total resources required. If the price of growth is high, the price of infrastructure is higher. It is only a world-class financial sector that would be able to provide the resources for the infrastructure sector, and there is, as I speak, a considerable distance between the current architecture and the desired architecture. Let me end this part with a sobering thought: the price of inaction is higher than any other price. If we do not address the challenge to the infrastructure sector, we will continue to muddle our way through overcrowded roads, choking seaports, congested airports, chronic power shortages and the like.

11. Building infrastructure is not a function of resources alone. It requires determination and skill that seems, sadly, absent in our system of governance. The United States built a world-class national road network under the Eisenhower programme in the years immediately following the end of the Second World War. In recent years, Japan re-built the city of Kobe that had been literally razed to the ground following a devastating earthquake in 1995. China seems to have the capacity to build anything in record time—the tallest building, the largest stadium, the deepest port, the biggest dam and what not. I must admit that our system of governance—eminently suitable, no doubt, for a variety of purposes—is singularly unsuitable for executing large infrastructure projects within the estimated cost and time. According to data gathered by the Ministry of Statistics and Programme Implementation, as on March 2007, there are 301 projects, each costing Rs. 20 crore or more, that are delayed for periods ranging from ~~1 one~~ month to 196 months and a cumulative cost overrun of Rs. 49,867 crore. No purpose will be served by priding ourselves on the “checks and balances” that are in place. At the end of the day, a project that is incomplete and with no deliverables or a project that is no longer financially viable will be akin to issuing a cheque on an account with no balance. Hence, the need to invent a new model for executing infrastructure projects. Public—pPrivate pPartnership is the current favourite. We have had limited success with the *concessionaire* model in the case of roads and port berths. We are trying out a different model in the case of ultra—mega—power projects. Experimentation will

continue, but I wonder when we would be able to summon Japanese skills and Chinese determination.

### **Agriculture: ~~T~~he Critical Challenge**

~~12.~~—The fourth sectoral challenge concerns agriculture. A high growth rate is possible only if industry and services grow at very high rates, possibly double digit rates. Indeed, that is what has happened in the four--year period ending 2006-07. During this period, the average growth rate of the industry sector has been 9.4 per cent and of the services sector 9.7 per cent. In the first half of the current fiscal too, the growth rates have been 9.8 per cent and 10.4 per cent, respectively. By contrast, the average growth rate of agriculture during the four--year period was only 4.7 per cent. This is not an uncommon feature. It is sad but true that the agriculture sector cannot grow at a rate equal to that of industry or services; it is also sad but true that the share of agriculture in ~~the~~ total GDP will decline over time. The appropriate policy response would be to ensure that there is a decline in the proportion of the work force that is dependent on agriculture and there is a shift from employment in agriculture to employment in the other two sectors. Unfortunately, this has not happened in India. Even as the share of agriculture in total GDP has declined from 30.3 per cent in 1991-92 to 18.5 per cent in 2006-07, the proportion of the work force dependent on agriculture has virtually stagnated at 52 per cent.

~~13.~~—The reasons are obvious. Firstly, agricultural workers do not have the skill sets to take up jobs in industry or services. Secondly, the rate of job creation in industry and services has not been sufficiently robust. It is therefore necessary to address both aspects of the issue. Policies must be redesigned to promote sectors that create a large number of jobs in the shortest possible time. These sectors ~~would~~ include small and medium enterprises (SMEs), trade, transport, construction, communication, entertainment and financial services, such as micro--finance and micro--insurance. Simultaneously, we must launch an ambitious programme to impart new skills to agricultural workers. According to NSSO data, only 5 per cent of the population in the age group of 19 to 24 years has acquired some skills through vocational education. The corresponding figure for Korea is 96 per cent. The gGovernment has taken up upgradation of all Ggovernment--run ITIs in the country. A new programme has been

launched to provide vocational education involving 20,000 schools and with an intake of 25 lakh students by 2011-12. Another plan is being drawn up for an ambitious nationwide Skill Development Mission. However, the new initiatives can succeed only if there is close cooperation between ~~G~~government and the private sector. At present, the participation of the private sector is less than active, ~~and~~ ~~i~~It remains to be seen how many will actually come forward to take over the management of ITIs or to contribute to the proposed Skill Development Mission.

### **Challenge and Opportunity**

~~14.~~—Agriculture, of course, is not the last challenge. There are many more. There is the challenge of higher education, improving the gross enrolment ratio (GER) and funding research and development. There is the challenge of fiscal policy, tax administration and ensuring tax compliance. There is the challenge of targeting subsidies to the poor and removing non-merit subsidies. There is the perennial challenge of eliminating opportunities for rent seeking ~~a~~ ~~nd~~ ~~of~~ punishing the corrupt. The list is virtually endless. I just decided to stop at four. It is not enough to yearn for high growth. We must acknowledge the huge responsibilities that accompany high growth and we must be willing to accept those responsibilities.

~~15.~~—Ladies and ~~G~~gentlemen! A historic opportunity beckons India. We seem to be at the right place, at the right time and in the right century. Opportunity and responsibility are inseparable twins. I have spoken enough. It is now over to the people and their elected representatives. Thank you for your patience and courtesy.

~~16.~~—~~Thank you for your patience and courtesy.~~