

Duvvuri Subbarao*
C.C. Desai Memorial Lecture

Elephants Too Dance: The India Growth Story

November 24, 2007

1. ~~Shri Narasimham, Chairman of the Court of Governors of the Administrative Staff College of India, Dr. S.K. Rao, Principal of ASCI, and distinguished guests. It is indeed a great honour for me to be invited to give this lecture in honour of late Shri C. C. Desai. Shri Desai was a distinguished civil servant, a noted parliamentarian, a committed industrialist, a successful diplomat, and above all, a man of deep scholarship. The stereotype view of a civil servant today is that of a one-dimensional personality who does not look beyond his or her narrow domain of work. To my generation of civil servants who have willy-nilly shaped the above stereotype, multidimensional achievers like Shri Desai provide inspiring role models. If one were to identify a single defining characteristic of his very rich life, it would be his unique attribute of entrepreneurship. Whatever be the field--administration, politics, industrial development or diplomacy--Shri Desai demonstrated entrepreneurship and made it his life's pursuit to nurture and develop entrepreneurship all around him.~~

2. ~~Thank you for coming for this lecture. It is indeed a great honour for me to be invited to give this lecture in honour of late Shri C.C. Desai. I am not saying this simply to pay homage to a tradition; I am saying this from the depth of my heart, because I feel truly honoured.~~

3. ~~Over the last seven months that I have been Finance Secretary, I have had quite a few invitations to speak in the public domain. Except where required by the call of duty, I have hedged all those requests, mainly for two reasons. First, I felt diffident out of an apprehension that I had nothing original or value adding to~~

~~say. Second, I was deeply conscious of the fact that I was on a steep learning curve and that I should wait till I cut my teeth on the job. But when Shri Narasimham so kindly invited me to give this lecture, I felt deeply touched and honoured. After all, if I am going to break out of my shell, what better place to do it than my home ground, and what better audience than my friends and well-wishers who will be kind to me regardless of what I say or how I say it. So, thank you all for coming here today.~~

~~4. Late Shri C.C. Desai was a distinguished civil servant, a noted parliamentarian, a committed industrialist, a successful diplomat, and above all, a man of deep scholarship. The stereotype view of a civil servant today is that of a one dimensional personality who does not look beyond his or her narrow domain of work. To my generation of civil servants who have willy-nilly shaped the above stereotype, multidimensional achievers like Shri Desai provide inspiring role models. If one were to identify a single defining characteristic of Shri Desai's very rich life, it would be his unique attribute of entrepreneurship. Whatever be the field, administration, politics, industrial development or diplomacy Shri Desai demonstrated entrepreneurship, and made it his life's pursuit to nurture and develop entrepreneurship all around him.~~

~~5. In many ways, the emergence of India as an engine of world growth over the last decade owes to the flowering of entrepreneurship. Indian entrepreneurs have proved that, given a chance, they can not only perform, but also succeed, at the global level. What better way, therefore, to honour the memory of an individual so quintessentially entrepreneurial than to centre this lecture on the India growth story. Hence, the topic of my lecture today -- "Elephants & Too & Dance: The India Growth Story".~~

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*Finance Secretary, Government of India. This was the talk given by Dr. Subbarao as part of the Twentieth C. C. Desai Memorial Lecture delivered on 24 November 2007 at ASCI. The views expressed in this lecture are those of the speaker and do not necessarily represent the views of the Government of India.~~

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India on the Growth Path

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6. —I am not a remarkable story-teller; but I have a remarkable story to tell. It is a story that gives us much to celebrate. The economy has clocked an average growth of 8.5 per cent % growth per annum over the last four years on an annualized basis. Poverty levels have declined too, no matter that there is an impassioned debate on the extent of poverty reduction. —Our external payments situation remains comfortable, the foreign exchange reserves are robust, fiscal consolidation is on track, and the inflation situation is turning around, albeit slowly. The investment climate is promising, the manufacturing sector is growing on the back of entrepreneurial resurgence, and our comparative advantage in the knowledge economy is fuelling the boom in the services sector.

7. —Social indicators have improved too. A child born today can expect to live 25 years longer, hope to be more educated, and lead a healthier and more productive life than a child born at the time of independence. Indeed, if we can sustain an average annual growth rate of 8+ +%per cent, the child of today will see the per capita income of the country multiply more than fourfold by the time she grows up to be 21.

Challenges Ahead

8. —Yet there are many challenges on the way forward.

- We need to sustain the present rate of growth, if not accelerate it to 10 per cent per annum.
- We need to translate growth into poverty reduction more efficiently. For poverty reduction, growth is necessary but not

sufficient. We need to generate poverty-reducing growth—i.e., growth *to* which the poor contribute and growth *from* which the poor benefit.

- We need to improve on social indicators too; India still ranks a low 126th in the UNDP's Human Development Index, in the bottom third of the league of nations.
- We need to move up the value chain by managing multiple transitions—from farm to non-farm, rural to urban, analog to digital, manual to tech-driven and most of all, from an insular domestic focus to an outward global outlook.

Can the Growth Momentum be Sustained?

9.—By far the single most commonly asked question of India is: —Can we sustain the present growth momentum? Opinion on this spans the entire spectrum.

10.—At one end are the run-away optimists who maintain that India is the new miracle economy on the block;—that we are on a virtuous cycle of higher savings and investments, and faster growth. Some analysts even claim that our domestic savings rate, currently estimated at around 34.7 per cent % of GDP for 2006-07, is indeed an underestimate; They argue—that it is in fact nearly 38 per cent% of GDP; and, together with a foreign savings rate of 1.5-2.0 per cent% 2.0%, the investment rate is already nudging 40 %per cent of GDP. —They then contend that, with the productivity of the economy improving, a growth rate of 9+ per cent + % is almost automatic.

11.—At the other end of the spectrum are those of a more cautious disposition, admittedly of distinguished academic credentials, who would rather rein in such wild optimism. They issue several warnings;

- ~~They warn T~~that India's present blistering growth rate of 9% ~~per cent~~ cannot be sustained largely because it is consumption driven and not investment driven.
- ~~They warn T~~that India is racing ahead of its non-inflationary speed limit, and the current growth acceleration reflects a cyclical boom rather than a structural shift to a higher growth trajectory.
- ~~They warn T~~That the economy is overheating because of demand outpacing supply, which will fuel inflation, or in an open economy situation, widen the current account deficit.
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12. On the basis of these arguments, they contend that the underlying growth rate of the economy is no more than 7.5% ~~8.0 %per cent~~.

13. The overheating issue was at the centre of a vigorous debate a few months ago when the WPI inflation crossed the tolerance level of 6 ~~per cent~~%. With inflation subduing subsequently, the debate has somewhat quietened. ~~b~~But the claims underlying these positions still constitute a live, if also, an emotive issue.

14. To meaningfully join this debate on whether India can sustain the present growth momentum, one needs to address two questions: (i) ~~What-ich factors~~ triggered India's recent growth?; and (ii) ~~Are~~ those triggers still on full steam? The scope of this lecture does not permit me to join this debate. I will only say that India's shift to a higher growth trajectory is the result of two powerful forces: first, the economic reforms initiated in 1991; and, second, the relentless pace and sweep of globalization over the last two decades.

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15. My position on whether India can sustain the growth acceleration is as follows. The Indian economy has the potential to sustain this pace of growth. It is true that the initial spurt in growth around 2003 ~~04~~ was triggered by rising incomes, easy liquidity and already built ~~up~~ production capacity. The output gap is now closed, and the growing demand is fuelling an investment demand. There

is ample evidence of increased capital expenditure in the economy. I am aware government statistics often do not enjoy credibility. So, let me draw from the more credible CMIE data ~~which-that~~ shows evidence of significant acceleration of capital expenditure, much of it in fresh capacity creation. So what has really happened, as indeed it should have, is that the ~~_~~consumption boom has been followed by an investment boom. As someone said, what the economy witnessed during the last ~~2two-3three~~ years is possibly the first business cycle that India has experienced, evidencing in a way the maturing of the Indian economy.

~~16.~~—Having said that, we must also acknowledge that there is nothing inevitable about remaining on the high-~~_~~growth trajectory. The way forward lies in identifying the constraints to growth and resolving them so as to unlock the latent growth potential. It is to identifying these challenges going forward that I now turn. I will list five challenges; ~~a~~Addressing ~~_whichthem~~, I believe, is critical to India maintaining its growth momentum.

1st Challenge: Stepping Up Agricultural Growth

~~17.~~—The first challenge is stepping up the growth of the agricultural sector to a sustained ~~4%_per cent~~. We have come a long way from the chronic food shortage and occasional famines that marked our pre-independence and immediate post-independence history. That we have achieved food self-sufficiency is a remarkable achievement. Yet, recent developments, ~~_~~ marked by erosion at the margin of food self-sufficiency and ~~the~~ firming up of global food ~~_~~grain prices, ~~_~~ are cause ~~of_for~~ concern.

~~18.~~—Some analysts argue that agriculture cannot be a concern from the overall growth perspective because it accounts for only ~~18%_per cent~~ -of GDP. This argument is ill-~~_~~informed. True, agriculture accounts for only ~~18%_per cent~~ -of our GDP, but it still accommodates ~~60_%per cent~~ of the labour force. Besides, at

our level of economic development, agriculture has very vital demand and supply linkages with the other sectors of the economy.

19.—As the Prime Minister often says, what we need is a second Green Revolution aimed at improving the productivity of land and labour by building both forward and backward linkages. This will require more, and more efficient, investment in credit delivery, water management, improved farming practices, rural infrastructure and development of the food-processing industry.

20.—So, the first challenge for sustaining the pace of our growth and, importantly, for making it more inclusive is to step up the pace of agricultural growth.

2nd Challenge: Expanding Employment Opportunities

21.—The second major challenge to sustaining growth is to expand employment opportunities. One of the main criticisms of our recent growth performance is that this has been a ‘jobless’ growth. Less dramatic analysts have maintained that the employment elasticity of recent growth has been low, which is to say that the number of jobs created is less than what should have been for this pace of growth.

~~22.— One of the main criticisms of our recent growth performance has been that this has been a ‘jobless’ growth. Less dramatic analysts have maintained that the employment elasticity of recent growth has been low, which is to say that the number of jobs created is less than what should have been for this pace of growth.~~

23.—This criticism does not pass empirical scrutiny. The performance on the job front has been better than is commonly acknowledged. The latest NSS Survey shows that employment growth has exceeded population growth for the first time

in our post-independence history. I must qualify that statement though with two caveats. First, while it is encouraging that job growth has exceeded population growth, it is not sufficient. Given the demographic profile, the labour force is growing and will continue to grow faster than population growth. Also, more and more women will join the labour force. Furthermore, if agricultural productivity improves, the agriculture sector will disgorge 100-150 million labour, who will have to be found jobs in other sectors of the economy.

24.—The second caveat is to note that much of the employment expansion in the recent period has been in the informal sector where productivity is low. Some estimates show that as many as 150 million labour are trapped in low-productivity employment.

25.—Where are the jobs going to come from? Not from the agriculture sector for the reason mentioned above. Not from the services sector ~~too~~ as its ability to generate jobs to absorb people with low skills is, as experience has shown, quite limited. So, much of the employment has to come from the manufacturing sector.

26.—I need to make a comment here on the importance of the manufacturing sector to our economy. Development [history](#) tells us that, as economies develop, they shift from agriculture to industry, and then graduate to becoming post-industrial service economies. Until a few years ago, we in India used to take pride in the fact that India has defied this traditional development paradigm by ‘leapfrogging’ directly from agriculture to a service economy, bypassing the manufacturing sector. It is now clear that our defiance, if that is what it was, was not condoned. We now know that an economy of India’s size cannot grow on a sustained basis without a productive and competitive manufacturing base. Happily, our entrepreneurs have risen to the challenge as evidenced by the increase in total factor productivity, particularly in the manufacturing sector over the last few years.

27.—The services sector too is job intensive; ~~B~~but our main concern here, as I said before, is the poor training of our engineers and the poor skill endowment of our labour. —Of the 350,000 engineers we turn out every year, not more than 75,000 are employable. That we are rapidly running short of quality software personnel is now widely known. What is not so widely known, but equally true, is the fact that we are rapidly running short of even skilled technicians. The Prime Minister's Skill Development Mission, which aims to bridge the vast skill gap by improving the quality of instruction in ITIs and vocational training institutes is, therefore, crucial for improving the employability of our labour.

28.—My discussion of the challenge of job creation will be incomplete if I do not address the issue of 'demographic dividend'. In recent years, the demographic dividend argument has gained increasing currency. —The argument goes as follows: Demographics are in India's favour because the working age population is growing faster than the overall population. It is claimed that this expanding young population will earn, and will save, thereby contributing to higher savings and ~~higher~~ investment, and ~~then~~ consequently higher growth. Perhaps we are carrying this 'demography-is-destiny'² argument too far. There is nothing inevitable about the demographic dividend. Demographic dividends will flow if, and only if, we are able to find jobs for the growing labour force. What compounds the problem is the fact that the fastest increases in population and labour force are taking place in five large lagging states where the record of jobs creation has been less than satisfactory.

29.—To summarize, the second challenge to sustaining India's growth momentum is to expand employment opportunities and improve labour productivity.

3rd Challenge: Improving Service Delivery

30.—Let me now turn to the third challenge, which is to improve service delivery. That good governance is at the heart of economic growth, poverty reduction and even political legitimacy is now conventional wisdom. In practical terms, good governance means improving service delivery. As the *Economist* magazine said, it seems incongruous that someone in India has a cell phone, yet has to wait for hours for drinking water. It is incongruous that someone has a colour TV at home but no access to a toilet.

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31.—For improving service delivery, we need to spend more on the twin merit goods of primary education and basic health. There are any number of studies that establish a positive correlation between low levels of poverty and improved indicators of health and education. We need to spend more on education and health. But we also need to spend more efficiently, because better education and health are a function not just of the quantum of expenditure but also of the quality of that expenditure.

32.—Let me illustrate this by an example. The ~~C~~Centre and ~~S~~states in India today spend a total of 4.1% per cent of GDP on education. The goal is to raise this ratio to 6% per cent of GDP. We should certainly do that. That is necessary but not sufficient. Note that countries in our neighbourhood—China, Sri Lanka and Thailand—all spend less than 4% per cent of their respective GDPs on education. Yet all of them have literacy levels in the range of 90+ per cent as compared to our 65% per cent. The same goes for the health sector ~~too~~. So, what matters is not just the quantum of expenditure, but also the quality of expenditure as measured by outcomes. ~~Just~~ ~~To~~ again illustrate, according to a 2006 report by Pratham, an NGO focused on education, only 17% per cent of children in classes

~~1-I~~ to ~~8VIII~~ have the ability to read a word and only 26 ~~%per cent~~ are able to recognize numbers.

~~33.~~—While on the subject of quality of expenditure, I need to make a reference to ~~the~~ FRBM—~~the~~ Fiscal Responsibility and Budget Management Act. Under the FRBM mandate, the Centre and as of now 26 of the 29 states have accepted the obligation of fiscal responsibility. This means they are required to scale down their fiscal deficits—~~to~~ 3% ~~per cent~~ of GDP in the case of the Centre and to 3% ~~per cent~~ of the respective GSDP in the case of the states; ~~and~~ ~~They are also obliged to also~~ completely eliminate the current ~~—~~budget (what we call revenue) deficit by 2008-~~09~~.

~~34.~~—So far, fiscal consolidation is on track. There are concerns though that the quality of public expenditure has been compromised by the pursuit of these targets; that in order to compress expenditure, desirable, productive expenditure has been sacrificed while not much effort has been made to prune unproductive expenditure. I admit this is a sweeping generalization. Nonetheless, it is important to bear in mind that improving ~~the~~ quality of public expenditure, as measured not by higher inputs; but as measured by improved outcomes, is vital for service delivery.

~~35.~~—History has shown that the well—spring of successful societies is innovation. In order to succeed in a globalizing world, India has to focus on becoming an innovation—driven economy. And the first requisite for innovation is better service delivery—~~a~~ challenge that we must address head on.

4th Challenge: Bridging the Infrastructure Deficit

~~36.~~—The fourth challenge on my list for sustaining the present growth momentum is bridging the infrastructure deficit. The infrastructure needs of the economy are large because of the demands generated by economic growth, rise in

population, rapid urbanization, as also the need ~~for to make ing~~ up for the accumulated backlogs. If you poll 100 people, knowledgeable about India, on the constraints to growth, it is a fair bet that at least 90 will have infrastructure building on their list. If awareness of this constraint is indeed a criterion, we are doing quite well. I get invited to at least one seminar on infrastructure every week in some part of India or, oftentimes, outside India. The challenge is to translate this growing awareness into concrete results on ground.

~~37.~~—The latest Discussion Paper of the Planning Commission estimates that we will need to spend \$495 billion on infrastructure during ~~the 11th-Eleventh p~~Plan ~~p~~Period 2007-12. This means doubling capital expenditure from the current levels of 4.5% ~~per cent~~ of GDP to about 9.0% ~~per cent~~ of GDP, ~~—~~a daunting challenge by all accounts.

~~38.~~—~~The G~~government is aware that it cannot raise resources of this order, especially given the demand on the limited resources for increased expenditure on social sectors. Hence, the growing reliance on public ~~—~~private partnerships or PPPs. Despite the high profile that PPPs are gaining, we are still on a steep learning curve and have to address and resolve a number of critical issues in order to make ~~PPP~~~~s~~ ~~them~~ successful. Indeed, as we move forward on the infrastructure front, two critical questions arise: (i) Do we have policies in place to inspire the trust and confidence of potential investors? ~~—~~and (ii) Does the economy, both the public and private sector ~~s~~ ~~put together~~, have the capacity to raise resources of this order?

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5th Challenge: Managing Globalization

39.—Let me now turn to the fifth and final challenge on my list for maintaining the recent growth acceleration, which is that we must manage globalization effectively and efficiently. Globalization, which in many ways is the defining mark of our time, is a topic of contentious debate as also high-profile protests. The scope of this lecture does not permit me to address in detail all the issues surrounding globalization.

~~40.—Globalization which, in many ways, is the defining mark of our time is a topic of contentious debate as also high profile protests. The scope of this lecture does not permit me to address in detail all the issues surrounding globalization.~~

41.—What I do want to emphasize though is that our economies are no longer defined by political boundaries; and geography, as they say, is no longer destiny. Globalization has lifted barriers and unleashed the movement of ideas, goods, services, capital and people across borders. It has opened up incredible opportunities, but has also exposed us to ruthless challenges.

42.—Globalization is more than just about economics; it is also about culture, society, politics and people. It is, of course, about the ratio of exports to GDP. But it is also about *Chak De India* topping the movie sweepstakes in London, it is about Laksmi Mittal becoming the steel tycoon of the world, about youngsters in Indore chatting on the internet with their peers in Indianapolis, about Hyderabad i Biryani in Houston and pasta in Patna. Indeed, many hopes and fears about globalization are shaped by these non-economic aspects.

43.—Globalization as an economic force is here to stay. It is too potent a force to be comprehensively reversed, although there may be some short-term blips. As Nayan Chanda says in his book, *“Bound Together: How Traders, Preachers, Adventurers and Warriors Shaped Globalization”*, globalization was, is, and will always be inevitable. No revolution in human history has been totally benign. So

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it is the case with globalization. It comes with benefits and costs. We cannot wish away globalization; we cannot shut our doors and remain indifferent. The only option is to manage globalization in such a way as to maximize the benefits and minimize the costs.

44.—Contrary to popular perception, India is quite a globalized economy. Our two-way trade is now 35% -per cent of GDP, ~~a~~ and if we add ~~in~~ invisible flows and the two-way movement of capital flows ~~too~~, the ratio goes up to nearly 100% per cent of GDP. We were able to weather the East Asian meltdown of the late 1990s because we were then at the fringes of globalization. Now, as the above numbers show, we are more fully integrated, and in many ways quite vulnerable to the butterfly effect. The butterfly effect, as the theory of chaos says, is that the flapping of the wings of a butterfly in the Amazon forests will have an impact on the weather pattern in Mumbai. So, whatever happens in any financial market around the world has an immediate impact on us, as indeed evidenced by how ~~the~~ Mint Street in Mumbai reacted to the US sub--prime crisis.

45.—How do we manage globalization? In the short term, we need to manage our external sector more actively. Many analysts say that what India is facing today is the dilemma of the ‘impossible trinity’ in bold and sharp relief—~~the~~ the problem of managing capital flows, the exchange rate and interest rates s all at the same time. There ~~is~~ are excess capital flows into the country, reflecting the strong growth potential of the economy going forward. Those flows are putting an upward pressure on the rupee. The appreciation of the rupee is hurting exports.

46.—So, here is a flavor of some of the ‘impossible trinity’ questions that we need to address. Do we allow the rupee to find its parity in the market without any intervention or do we prevent its appreciation, no matter the fiscal cost? Do we reduce interest rates to spur investment or keep them high to mop up excess liquidity? How can we keep interest rates low, ~~and~~ yet encourage savings? How can we keep interest rates s high and yet remain competitive? How do we prevent

the rupee from becoming a one-way bet? To what extent, and in what ways, can we restrain capital flows without hurting the growth momentum? How do we rein in the fiscal costs of sterilization? How, and by how much, do we support exporters against rupee appreciation?

47.—These questions, admittedly rhetorical, describe the short-term challenge. The medium-term challenge of globalization is to improve the productive capacity of the economy.

48.—Why is productivity so important to manage globalization? Note that we got off the block first in the knowledge economy because of our superior technical manpower and knowledge of English. But other countries are fast catching up, and our comparative advantage will be threatened unless we are continuously ahead of the curve in terms of knowledge, quality and productivity. Already, there is distressing talk of jobs being ‘reverse-Bangalored’ and of India ‘off-shoring off-shoring’. —These—heartwarming triumphs and fierce threats represent globalization in its full glory and in its sharp ugliness. Globalization offers incredible opportunities, but it also ruthlessly punishes laggards. The only way we can remain in the race in a globalizing world is to address the challenge of productivity and move up the value chain.

Five Challenges

49.—To summarize, therefore, the five challenges that India needs address in order to maintain the growth acceleration are:

- (+) Stepping up agricultural growth:
- (++) Expanding employment opportunities:
- (+++) Improving service delivery:
- (++++) Bridging the infrastructure deficit:

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Elephants Too Dance

50.—As a people we are understandably eager for our economy to sprint like a tiger rather than amble like an elephant. Yet few animals have an elephant's stamina. And elephants do not always amble; they dance too. And when elephants start dancing, they can go on for a long, long time—, provided the stage is clear.

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