

Y V Reddy: India at 60 in a changing world – the next 20 years

Address by Dr Y V Reddy, Governor of the Reserve Bank of India, at the London School of Economics and Political Science, London, 15 October 2007.

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Mr. Chairman, distinguished speakers and friends

On behalf of the Reserve Bank of India (RBI) and on my own behalf, I would like to express our deep appreciation to LSE and, in particular, to Mr. Howard Davies, the Director, for his initiatives in establishing the India Observatory (IO). RBI is doubly privileged to be associated with the IO, as a partner, since it is in honour of Dr. I.G. Patel, one of my distinguished predecessors, and also because the economic policy departments in RBI hope to benefit immensely from the new research network. Further, deepening the relations with LSE is of special significance for India since London is the most prominent global financial centre.

India at 60, is both old and young. It has a great heritage and history of more than three millennia, yet the independent India is very young, aspiring to remove poverty and bring dignity to all of the billion of its people by achieving an inclusive and rapid growth.

What has been the record of India's performance in 60 years?

Independent India exhibited more impressive price stability than most of the developing economies. The inflation rate was, on an average, in single digit for 43 out of 57 years since 1950, and on most occasions, the provocations for higher inflation rates were external or domestic shocks, such as oil prices or monsoon conditions. The record of RBI in maintaining price stability, in terms of what is currently known as "core inflation", is thus noteworthy.

On growth rate also, the record is one of a self-accelerating growth, which was, to some extent, enabled by RBI. The average annual GDP growth in the decade of 1950s was 3.6 per cent, in 1960s it was 4.0 per cent, in '80s it was 5.6 per cent and in '90s, excluding crisis year 1991-92, it was 6.3 per cent. The problem decade was the '70s and the problem year, due to the Gulf crisis, was 1991-92, when the GDP growth rates were 2.9 per cent and 1.4 per cent respectively. In the new millennium, the GDP growth rate accelerated to 6.9 per cent and in the last four years (2003-04 to 2006-07), it averaged 8.6 per cent.

The impressive growth performance since 1990s was possible due to the strong foundation of an indigenous industrial base, domestic entrepreneurial class, knowledge enhancing institutions, and improvement in vertical social and economic mobility during the decades 1950s to 1990. The recent growth dividend is not just a miracle of the marketisation, but is built on decades of conscious nation building since independence, and the extension of RBI's mandate during the period, inter-alia, to building of institutions and improving their delivery capabilities.

In terms of financial stability, India remained resilient to a series of crises faced by several emerging markets, because of careful pacing and sequencing of economic and financial sector reforms. In the external sector, India has come out with a clean track record, having met all payment obligations in time, even by pledging gold, a cherished national reserve of sentimental value, when it became necessary in 1991 due to liquidity crisis. Yet, both sectors have not only become reasonably efficient and resilient but are also in alignment with global best practices.

In the current debate on macro-imbalances of global economy, India does not figure at all as a contributing source, since our Saving-Investment as well as domestic-external demand balance in the economy are by and large appropriate.

RBI's policies increasingly recognise global developments, but their adaption to such developments, in the Indian context, is tailored to the prevailing status of institutions and markets, immediate relevance and the evolving needs of the country. As an example, the function of financial supervision continues with RBI, but in 1994, this function attained a semi-independent status through the establishment of an overseeing authority in the Board for Financial Supervision – but within RBI.

What is the outlook for the next 20 years?

Prospects for next 20 years, in our view, are bright for all the reasons and the record of performance that I have given. Yet, there are several challenges that are to be met in the medium term, as articulated in the recent Annual Report of RBI, which reflects the views of eminent Directors on its Board. Permit me to list these challenges briefly. These are growth of agriculture sector, improvement in physical infrastructure, fiscal empowerment to enhance coverage and quality of education and health, improvement in governance and further reforms in financial and external sector.

The financial sector reforms are aimed at further development of financial markets, especially bond market, enhancing integration of these markets and further improvement in the banking sector. In particular, determined emphasis on financial inclusion, financial literacy and credit counselling is appropriate and, therefore, should continue. In the external sector, the approach is towards fuller capital account convertibility, with focus on the enabling conditions for minimizing the risks and maximizing the benefits.

Are we reasonably confident that we can meet the challenges and maintain the present growth momentum with stability?

There are grounds for optimism and these include democratic values, financial system stability, skilled manpower, technological capabilities, demographic dividends, large and growing entrepreneurial class, and penchant for innovation. The single most critical determining factor for the future would, by all accounts, be the improvements in governance that impacts personal security, property rights, business environment, and above all, a sense of fairness in the conduct of public policy.

India and LSE

Before concluding, I would like to recall that many distinguished Indians benefited from education at the LSE. The most prominent, of course, are Dr. B.R. Ambedkar, the architect of the Indian Constitution and an eminent economist, and Mr. K.R. Narayanan, a reputed diplomat and former President of India. In a way, India might have, perhaps, repaid its debt through Dr. I.G. Patel, who steered the LSE, as its Director, during a critical period. Now, India and LSE are entering a period of productive partnership, in which RBI is privileged to play an active role.

Let me thank all those assembled here for participating in the launch of the India Observatory in the LSE.