Y V Reddy: India – the global partner

Introductory remarks by Dr Y V Reddy, Governor of the Reserve Bank of India, at the World Leaders' Forum, Columbia University, New York, 15 April 2008.

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Dean Coatsworth, Professor Bhagwati, Professor Radon, students, faculty and alumni of Columbia University, and members of the wider New York City Community.

I am grateful to President Bollinger for extending me an invitation to participate in the prestigious World Leaders Forum at the Low Memorial Library. Distinguished past speakers at the Forum include, I am informed, President Clinton, President Putin, The Dalai Lama and Noble laureate Joseph Stiglitz. I am greatly honoured by the invitation and look forward to the informal dialogue with the highly respected Dr. Jagdish Bhagwati.

By way of an introduction, I will present select aspects of the engagement of independent India with the global polity and economy.

While India became independent on 15th August 1947, it became a Republic on 26th January 1950, with the adoption of a written Constitution which is governing the nation. Dr. B.R. Ambedkar, the architect of the Indian Constitution, had the benefit of education at the Columbia University where he obtained a Ph.D. Prof. John Dewey inspired many of Dr. Ambedkar's ideas about equality and social justice. Prof. Edwin Seligman, himself a friend of Lala Lajpat Rai, the legendary fiery freedom fighter of India, became a mentor to the young Ambedkar. Dr. Ambedkar also benefitted from his research and education in London. These are examples of how India's freedom movement and the Constitution, that binds our governance today, have benefitted from partnering with the global scholarship, in general, and with the special relationship with Columbia University and the United States, in particular. Incidentally, the Columbia University conferred an honorary degree on the first Prime Minister of India, Pandit Jawaharlal Nehru, on his first visit to the US soon after our independence.

An important characteristic of the global society is the sheer diversity of races, religions, cultures, ideologies and languages. India has the distinction of reflecting, in itself, the great diversity of the global society. For example, India is a home to the largest number of people practising Zoroastrianism – who are also known as Parsees. Two of India's provinces are governed by communist parties. In fact, we are a unique federation where the boundaries of existing provinces are redrawn and new provinces are created, to accommodate aspirations, while remaining strictly within the provisions of the Constitution. We have several national languages in which governments' businesses are conducted. Every currency note that you see in India has the denomination written in seventeen languages with different scripts. In brief, independent India believes firmly, in dialogue, accommodation and assimilation of multiple identities of people.

These characteristics enable the Indian people and the Indian corporates to live and work harmoniously alongside other nationalities.

India's record as a responsible nation in honouring its commitments is well known. Specifically, independent India has never reneged on its monetary obligations to the rest of the world and has not sought any noticeable rescheduling of its payment obligations. In 1991, we had a liquidity crisis in currency, mainly due to the war in Iraq and the breakdown of trade with USSR, but we preferred to pledge gold, initiate a massive import compression and start a reform process with assistance from the IMF and the World Bank. The entire burden of crisis and adjustment was successfully borne by the domestic economy.

In the current environment of financial turbulence, and also a possible unwinding of macro imbalances, India plays a stabilising role with a modest current account deficit in most of the recent years, at around one per cent[1] of GDP, and a market determined exchange rate. India has not been contributing to the global macro economic imbalances, though it has a stake in how the issues get resolved in the near future.

Currently, there is a debate on the role of Sovereign Wealth Funds. India is in receipt of investments from several of them either directly or indirectly, and hence, is interested in the current debate. For its part, the country's foreign exchange reserves amounting to about US$ 300 billion continue to be managed by the Reserve Bank of India, typically as per mandate similar to those of other central banks around the world and consistent with the IMF guidelines. However, the Indian corporates, based on account of their own commercial judgements, take investment positions and merge or acquire other undertakings in other countries. Public policy neither provides incentives nor disincentives for such market based initiatives by the Indian corporates.

India's external sector has displayed considerable strength and resilience since the reforms in 1991 – despite several domestic as well as global political events and supply shocks in food and fuel. Interestingly, India's external trade in goods and services as a percentage of GDP is more than that of the United States (at 48 per cent and 29 per cent respectively), and is, in a way, indicative of the extent of India's trade integration with the global economy. India is fully convertible on the current account, but we do have requirements of repatriation and surrender of export earnings to ensure that capital account transactions do not take place under the guise of current account. Capital account is almost fully open to non-residents, well regulated financial institutions, and corporates. In regard to residents, capital account is almost fully open to resident corporates and partially open to individuals and financial intermediaries. In brief, we partner with the global economy fully on the trade and the current account while there is progressive liberalisation of the capital account, consistent with the progress in reforms in the real, fiscal, and financial sectors.

The current turbulence in financial markets and institutions – particularly in the USA, has raised enquiries about the possible contagion. The money, government securities and foreign exchange markets have been stable in India and, in our view, they may not be vulnerable in terms of direct and first-round effects. However, the Indian equity markets, which often reflect global trends, have been volatile in the recent months and that has some impact on changing sentiments. We have a bank-dominated financial sector, and banks have a strong capital base.

In response to the global developments and the rapid growth in money supply, credit, and asset prices in India, we have since 2004 increased, in regard to banks, the risk weights and the provisioning requirements, and decreased or rationalised the exposure limits to select sectors. These were combined with prudential stipulations on off-balance sheet items and relationships between banks and non-bank finance companies. Several safeguards have been built in terms of prudential guidelines and access to repo markets to guard against liquidity-related problems to banks. Above all, withdrawal of monetary accommodation commenced in 2004 and has been gradually fine-tuned, remaining sensitive to early signs of overheating, while related prudential measures were addressing exposure of banks to risks in assets. Hence, in our assessment, the Indian financial sector is likely to be less affected by the contagion than most other EMEs, in respect of first-round or direct effects.

A few words about the state of the Indian real economy may be in order. The annual growth in real GDP since 2003-04[2] has averaged 8.7 per cent. Investments and savings as percentage of GDP have been in excess of 30 per cent since 2004-05[3] thus indicating a

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1 0.4% in 2004-05; 1.2% in 2005-06; and 1.1% in 2006-07.

2 2003-04 to 2007-08.

3 2004-05 to 2006-07.

potential for continued growth in output and productivity over the medium term. Similarly, like most of the rest of the world, India has, by and large, experienced benign inflationary conditions averaging around 5.2 per cent since 2004-05[4]. However, at this juncture, both domestic output and prices are under some pressure due to recent global developments with regard to the prices of food, fuel and metals, and the turbulence in the financial markets.

Our main challenges are eradication of poverty, efficient use of water, reviving growth in agriculture, improving physical and social infrastructure, upgrading human skills and, above all, fiscal empowerment coupled with the increasing real sector flexibility. Our strengths mainly are the demographic dividend, the stability of the political system, and the emergence of a very broad based and growing entrepreneurial class, which has a penchant for innovation. In overcoming the challenges and taking advantage of the strengths, our engagement with global economies, in particular with the United States, is bound to play a very critical role.

We are optimistic about a continued mutually beneficial engagement with the global economy. Indians are providing services in various parts of the world – U.S.A., Middle East, U.K. and East Asia. Their services range from the less skilled, at one end of the spectrum, to the very highly skilled professionals at the other end. Their annual contribution by way of remittances is about three per cent of GDP now. These are in addition to export of services, especially software which are of the same order. Indians are among the most significant foreign students to attend the universities for higher education in USA, UK, Australia, Canada, Singapore, China, etc.

Following sustained higher growth in India, a reverse process of brain flow has also commenced by way of foreign nationals and expatriate Indians expressing their interest for pursuing more fruitful ventures in India. As a result, corresponding trade and private business linkages have also started growing. To illustrate, recently a globally active bank has launched a product in India – “Account for Expatriates” – for providing value-added services for the rapidly growing expatriate community in India.

This engagement with the global economy has matured into a self reinforcing process as benefits are perceived by many and they are percolating to a large number of people in India.

Given the diversity of India in respect of social, political and financial systems, public policy considerations demand that India’s integration with the global economy be managed through a participative and consultative manner, and in a gradual fashion.

I look forward to an engaging, educative and enlightening interactive session. Thank you.

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[4] 2004-05 to 2007-08 (till week ended March 22, 2008).