

K C Chakrabarty: Challenges and opportunities in a trillion dollar economy

Address by Dr K C Chakrabarty, Deputy Governor of the Reserve Bank of India, at the Associated Chambers of Commerce and Industry of India's (ASSOCHAM) National Banking Conclave, New Delhi, 17 June 2011.

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Shri Pranab Mukherjee, Hon'ble Finance Minister, Government of India, Dr Narendra Jadhav, Member, Planning Commission, Shri Dilip Modi, President, ASSOCHAM, Shri R. N. Dhoot, Senior Vice President, ASSOCHAM, and MP, Rajya Sabha, Shri J. M. Garg, Central Vigilance Commissioner, Dr Thomas Mathew, Jt Secretary, Capital Markets, Ministry of Finance, Shri M. Narendra, Chairperson, ASSOCHAM National Council for Banking & Finance and CMD, Indian Overseas Bank, Shri T. M. Bhasin, CMD, Indian Bank, Shri M. V. Tanksale, ED, PNB, Shri N. Seshadri, ED, Bank of India, Shri D. S. Rawat, Secretary General, ASSOCHAM, distinguished guests, ladies and gentlemen.

It is a pleasure and privilege to be here at the National Banking Conclave on the theme "Challenges and Opportunities in a Trillion Dollar Economy". As you are aware, the Indian economy reached the trillion US dollar GDP milestone in 2007 and joined other countries of the trillion dollar club, namely, the US, UK, Japan, Germany, China, France, Italy, Spain, Canada, Brazil and Russia. In fact, over the period 1960 to the late 1980s, India's GDP in US dollar terms doubled every nine years, on an average. Since then, the period for doubling has declined to around 5 years, coinciding with the initiation of wide-ranging structural reforms. With India's GDP at current market prices during 2010–11 already placed at around US dollar 1.7 trillion, it is expected that the Indian economy would cross the US dollar 3.4 trillion mark by 2015–16, *i.e.*, well within the span of the ensuing (Twelfth) Five Year Plan. Therefore, as policy makers and business leaders, we should be thinking about exploiting the opportunities and preparing ourselves for the challenges of managing a multi-trillion dollar (and not a one trillion dollar) economy!

Although some argue that India catapulted to the trillion dollar league in 2007 on account of GDP valuation based on sharply appreciated exchange rate that resulted from huge inflows of foreign exchange, most others consider this as an emerging sign of take-off that could accelerate the growth momentum going forward. Last year, economists at Morgan Stanley and other long-range forecasters predicted that India's growth will start to outpace China's within three to five years and continue at a faster rate than any other large country over the next 20 to 25 years. Hence, I believe, and others do so too, that the Indian economy is set to experience double digit growth during the coming two to three decades.

While the future growth outlook of the Indian economy looks promising, the challenge is to make it more inclusive. At the grassroots level, India continues to be a poor and less developed country in spite of years of financial and other support provided by the Government to equity enhancing distributional programmes and the spectacular turnaround in investment and growth. According to a Planning Commission Report on the methodology of estimation of poverty issued in 2009, the all India poverty head count ratio was at 37.2 per cent in 2004–05 compared to 45.3 per cent in 1993–94. *Prima facie*, while the slow pace of reduction in poverty due to high population growth rate, large workforce still dependent on agriculture and illiteracy continue to obstruct the growth potential, the paradigm that these disabilities can be nevertheless be turned around into a winning proposition is also surely within the realm of possibility.

In fact, many of the disadvantages which the Indian economy faced in the past has already been waned and turned out to be advantages. To illustrate, a disadvantage that has plagued

most developing economies including India has been that of scarcity of capital. This scarcity has hindered the investment and growth prospects of these economies in the past. This, however, is no longer a disadvantage. With most countries including India opening their doors to foreign investment, the question is no longer of scarcity of capital but the rate of return that we can pay on this capital. Hence, capital is no longer a constraint in the era of liberalization and globalization if we are able to pay the required return and are able to attract the capital flows into our economies especially in the form of foreign direct investment.

Further, high population growth was another disadvantage faced by many developing countries while making efforts to improve the GDP in per capita terms. However, with the emergence of skills and knowledge as new engines of economic growth, higher population growth is more of an opportunity than a constraint. According to Census 2011, 56.9 per cent of India's total population belongs to the age group 15–59 years. Importantly, only 7.5 per cent of the population belongs to the age category "60 years and above". This shows that India is yet to experience the problem of aging. Further, it is predicted that India will see a sharp decline in the dependency ratio over the next thirty years, which will be a major demographic dividend for India. Moreover, it is estimated that not only India's demographic trend would remain favourable for the next three decades but also remain better than other BRIC economies.

We have to, however, realise that these advantages will not transform on its own to higher economic growth. In this regard, appropriate interventions would be required to reap maximum benefits from this favourable demographic dividend by investing in education and skill development. In the Union budget for 2011–12, Indian Government has allocated Rs. 52,057 crore for the education sector, which is 24 per cent higher than the 2010–11 education expenditure. However, expenditure on education as per cent of GDP is relatively low in India when compared with some of the developed nations as also with some developing countries (Table). Among the G-20 countries, India not only has lowest educational indicators, but the public education system is also poor when compared with other BRIC countries and some of the emerging market economies. In 2009, World Bank expressed the view that acute shortage of skills especially in the area of civil engineering shadows the growth prospects of the Indian economy. According to Prime Minister Dr. Manmohan Singh, "around 10 per cent of the relevant age group is enrolled in any institute of higher education as compared to 40 to 50 per cent in most developed countries". Banks play a facilitating and enabling role in this endeavour by extending education loans and they have a great responsibility to ensure that no deserving student is denied an education loan. However, just providing education loan is not sufficient. Industry and bankers would have to work together to ensure that the employability of such students is high and that the people with the right type of education and skills are available for the industry.

Table:
Expenditure on Education

Country	Spending on Education as per cent of GDP	Country	Spending on Education as per cent of GDP
Switzerland	5.8	South Africa	5.3
United States	5.7	Thailand	5.2
France	5.6	Chile	4.2
UK	5.3	Brazil	4.2
Malaysia	8.1	India	4.1
Mexico	5.3	Russia	3.8

Note: Government education expenditure as per cent of GDP (2000–2002)

Source: United Nations Human Development Programme

We need to recognize that the knowledge, skills and productivity of our growing young and dynamic work force forms the backbone of our economy. This would not only require effective implementation of developmental and poverty alleviation schemes at the bottom of the pyramid, but also the recognition that these new factors of production, namely, knowledge, skills and technology which have the ability to unleash the productive frontiers of the economy in the most efficient and dramatic way. Notably, these new factors of production which can liberate human enterprise from the binding constraints of land, labour and capital are the engines of growth in the knowledge economies of the western hemisphere, along with countries like Japan and Israel both of which are otherwise scarcely endowed with land and labor. Technology is the surest and the most appropriate way of bringing inclusion in respect of any product and / or service. Technology has revolutionized every industry in the world by extending faster and cost-effective delivery of products and services, ensuring affordability to those who otherwise could not, and simultaneously, ensuring viability and profitability of producers. This has other positive spinoffs. If the cost of products and services is brought down leveraging technology, inflation also would come down. That would lead to a softer interest rate regime which would enable sustainable growth.

Taking cue from examples of western hemisphere, India should try to become a knowledge economy to promote inclusive economic growth. The progress from agrarian and/or industrial economy to that of knowledge economy is based on the ability to acquire ownership of knowledge and to use it to create or improve goods and services. Workers in the knowledge economy are especially distinct in so far they know what they are doing, how the work is done and why they are doing the work. They also excel in their fields of knowledge and are often better at their jobs than their superiors. The respect for knowledge workers leads to most desired outcomes through change management as experimentation and innovation are encouraged and rewarded. Thus, we must strive assiduously to convert our young work force into potential power house of productivity and growth.

Having said that, it would be impossible to achieve these objectives in the absence of poverty alleviation. Extreme poverty and deprivation often discourage the urge of the poor to participate in programs that do not provide immediate support to their livelihood. To encourage the poor to participate in these initiatives, therefore, requires that developmental programs, at the starting point, should focus on providing opportunities for people to earn a living and increase their incomes over time. The program can be followed up by providing people the means for enhancement of their capabilities to exploit available opportunities. Finally, effective mechanisms for protection against a temporary or permanent loss of livelihood should supplement the overall program to achieve the goal of inclusive growth.

Presently, a number of intervention programs are conducted by the Government that focus on employment creation and the flagship NREGA is one such significant initiative. One could not, of course, belittle the excellent work being done by non-government organizations engaged in supporting livelihoods in several poor underdeveloped hinterlands. In the financial sector, the Reserve Bank has crafted well known programs to achieve planned, structured and sustained financial inclusion such as adoption of Business Correspondent and Business Facilitator Model, preparation of Board Approved Financial Inclusion Plans, requiring banks to providing a minimum of four banking products and services including no-frills accounts with overdrafts, and is committed to furthering the scope of these initiatives.

Collective and multipronged efforts to promote inclusive growth supplemented by some earnest investment in human capital are the only ways by which we can move towards becoming a knowledge economy. The second stage assimilation of knowledge, skills and technology can be obtained from education by means of brain-gain. The virtual modes of education through ICT and linkages to national and international information hubs can provide the benefits of information availability without the need to be present at in certain space or time. The benefits of brain-gain are realized from the wide-spread availability of domain knowledge from remote locations which can transform business productivity at minimal cost. The e-Choupal experiment of ITC, for example, showcases the possibility of

improvement in quality of produce and improved realization of returns from farming due to availability of better information on market prices. The helpline of the Ministry of Agriculture with experts on board has been similarly instrumental in solving day to day problems of farmers. Further, internet based e-education portals for students offer boundary-free learning experience. These portals provide virtual classrooms and guidance from professional instructors on different subject areas and can have widest possible reach regardless of brick and mortar structures.

While the initiatives being taken are laudable, there is a crying need for reforms in our educational system which requires to be toned up to impart education that is focused on the demands of the new millennium. Effective delivery of educational inputs in a large economy like India requires a critical mass of volume and quality. In this regard, the Government programmes such as Sarva Shiksha Abhiyan (SSA) in the elementary education sector and Rashtriya Madhyamik Shiksha Abhiyan (RMSA) in the secondary education sector helped in achieving the universalisation of education to a very large extent in terms of access to schooling and improvement in gross enrolment ratio. Even then there is a pressing need to further increase school enrollments, along with improvements in the quality of education. This may be extremely important in harvesting the fruits of investment. In this regard, the enactment of Right of Children to Free and Compulsory Education Act, 2009 and the operationalisation of Article 21-A of the Constitution of India, are expected to address the issues of drop out, out of school children, quality of education and availability of trained teachers in the short to medium term. Further, a proposal to set up a National Commission/Council for Higher Education and Research to prescribe academic quality and advancement of knowledge in higher educational institutions is under the consideration of the Government.

Yet another well known problem is the mismatch between quantity and quality of education. According to the research published by the Observer Research Foundation (2010), India recorded 10.4 per cent increase in the number of graduate engineers in 2008 compared with 9.9 per cent in China, 5.9 per cent in South Korea, 3.9 per cent in UK and -1.0 per cent in the US. However, despite the increasingly higher numbers of engineering graduates produced by the technical institutes in India, almost 30 per cent of fresh graduates remain unemployed even one year after graduation. In 2005, a McKinsey-NASSCOM study indicated that only a quarter of India's technical graduates and 10-15 per cent of general college graduates are of employable quality in the off-shore IT and BPO industries. Further, NASSCOM estimates that the educational system produces nine half-literate graduates for each graduate of passable quality, reflecting the low quality of education. However, despite discounting of the quality of education, when it comes to the number of engineers per million people, India has only 214 with South Korea having the highest number 1435. While Japan has 765 engineers per million people, China has 340. The research also showed that doctorate degrees were less than 1 per cent of graduate engineering degrees in the country. The percentage of doctorate degrees compared to engineering degrees was much higher in most of the other countries, e.g., 9 per cent in the US, 10 per cent in the UK, 8 per cent in Germany and 3 per cent in South Korea. Comparing Indian institutions with the well known international centers the study also observed that most Indian institutions had not progressed beyond undergraduate teaching institutions into graduate teaching and research institutions. Clearly, therefore, we need a lot of catching up to do both in numbers and quality in order to realize our goal of creating a knowledge economy with equitable and productive employment opportunities for the youth. Besides forwarding the inclusive growth program massive investments in education are also required by the government with participation of the private sector which should target at the development of occupational skills based on knowledge and technology. The participation of private sector is needed to implement educational programs that have occupational relevance in contemporary enterprise.

To sum, in the new era of growth with knowledge, skills and technology as engines, without knowledge workers it will be extremely difficult to shift the production frontier of any

economy. Without adequate investments in education and skill development, we will not be able to transform our growing young population into knowledge workers and it will result in a disaster. We thus have to work on the trinity of the issues of Inclusion, Technology and Education to propel India to a 10 Trillion Dollar Economy and beyond, else we will not be able to sustain even the current growth. I hope that industry representatives and bankers present here would deliberate on these issues and work together to ensure sustainable growth. Thank you.