

# India's Economy — The Challenges Ahead\*

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*The new economic policies have caused a total change in the way in which India does business. Together with a more competitive climate, the responsibilities placed on industry and its managers have become much greater. There are challenges facing managers together with hope for more initiative and creativity, leading to success for industry and for the whole nation.*

## Your Work will be in the 21st Century

Let me say first of all that I feel deeply honoured and privileged to be invited to give the Convocation Address at XLRI which has already distinguished itself as one of our premier management institutes in the country. It is particularly touching to be doing so in this city, which after all symbolizes one of the earliest solid achievements of Indian industry. I must confess that when I was asked to speak I thought it was quite an awesome responsibility to have to talk to a graduating management class. A class which after the first 4 or 5 years of on the job training will in fact be living the bulk of their working life in the first quarter of the 21st century. One feels hesitant to talk to people who will be doing most of their work in a century different from the one in which most of us have been doing ours. However, I was tempted to accept because I thought it would be worth digressing here and there on how very different the next 25 years for you, new graduates, are going to be from the last 25 years for all of us. One reason for this is that this is a period of tremendous change not just in India but in the world. It is a change in a sense which will affect you particularly as you move into positions of management whether in government or in business, because it is going to be a world which is much more globally integrated than anything that we have known. And, the best way of assessing that is not to look at day to day tensions but to try to see how different the present situation is from what it was 25 years ago. 25 years ago you had a bipolar world with a great deal of tension and most developing countries were still locked into a position where it really was not clear where they were going to be heading or how effectively they would be able to overcome the limitations of their lack of development.

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## A Radically different World

Today, you have a world in which some of those bipolar tensions have disappeared. Other tensions have crept in, but the big bipolar tensions are gone. All developing countries, and this is a remarkable thing, since the mid-80s are undertaking far-reaching economic reforms. This is true of Latin America, it is true of the former Communist countries in Asia, it is true of our other Asian neighbors, it is true of ourselves and of course this is also true of countries in what was the former Soviet Union. They are all re-orienting their systems of economic management, gearing up to a world that is going to be much more integrated. This is going to have implications for how business is conducted in all countries. Thus, there is today, probably an unprecedentedly low level of barriers to trade in the world. In another week or two if the Maastricht agreement goes through, GATT's Uruguay round will have put in place a completely new framework of rules and regulations for international trade for the future which will cover not only traditional areas of trade, that is goods; but will also introduce international agreements to expand trade in the area of services, including financial services in due course. These are all areas into which some of you are going to move in the future. It is a world, dominated by the phenomenon of globalization where commercial networks have become global, transnational corporations operate around the entire world, technology flows are universal and firms have become globalized in terms of

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marketing, brand names, technology. When I was a student at the university, if we went around the world we were not likely to see the same consumer brands in Japan as in England and America. The situation is totally different today. Finally, even the world of finance has become globalized as we ourselves have seen in India where in the last six months, a large number of companies have been raising funds in international markets.

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Finally, underpinning this network of trade, economic and investment integration is, of course, a revolution in telecommunications and informatics, which has introduced linkages, instant communications, shortened time lags, and created demands for flexibility and introduced frameworks of interaction, which I think will make the next twenty-five years incomparably different from what the last twenty-five years have been.

### **Nations Too Have Changed**

Naturally, these changes have forced changes in countries too. I referred earlier to the changes that have taken place in developing countries since the mid 80s. We have been somewhat late in responding to this changed environment, although we did begin to think about changing at about the same time. Being an open and democratic country in which change cannot be introduced from above but has to be brought in through an extensive process of consultation and consensus building, it has taken longer in India to make these changes than it has taken in the rest of the world. The fact is that we are now living in a world where we are competing with other countries where these same changes that are now going on in India have been initiated years ago and have probably been going on at a much faster than they are in India today. Anyone, who travelled to East Asia in the last fifteen to twenty years, will certify that if you went from Delhi to Jakarta or Bangkok, and certainly to Kuala Lumpur in the seventies you would not have felt that you were moving away from a less developed part of the world. You would rather have felt that the infrastructure facilities, what go under the name of modernisation, were somewhat lower in some of those cities than in Delhi. This is not the position today. As a matter of fact, the change that is taking place in our neighbourhood is really quite dramatic and it is a change that affects the competitiveness of our economy.

### **National Growth and Global Competitiveness**

The kind of world that we are moving into is essentially a world in which it will not be possible for a country to reach its full economic potential if it is not able to compete globally with others in the same position. This is something which observers outside very often say. We tend to be impressed by what is happening here at home and the amount of change that is taking place. In fact, that change is quite remarkable in the last three years and considering the size of the country, the extent of change has been dramatic. But it would be no exaggeration to say that our competition has to be with where others actually are today. If you look at it from that point of view, we would have to say that the process of change has just begun. We are very far from the end of the process and, as a matter of fact, it would be necessary to continue these changes if the country is to reap the full benefit that we expected.

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The compulsion to change needs to be fully understood and it can be understood only if one recognizes that there is no economically viable way in which a country can expect to develop isolated from the world. Some of the uncertainties which are expressed at times in India seem to be based on the assumption that perhaps there is some other way of doing things, that we can actually proceed in our own way. But the truth is the compulsions of global integration today make it virtually impossible for any country to reach its fullest potential without fully integrating with the world economy. That doesn't mean that we are going to become rich overnight. This will remain a poor country for a long time to come. And, that has implications for how we manage change. But it does mean that in the areas where we are competing it will not be possible to compromise on standards and this is really what those of you will be responsible for managing government or industries or non-government organizations and financial institutions will have to

bear in mind. In the areas where we are competing, we will have to compare ourselves with the best. This means that we cannot insulate ourselves from technological developments elsewhere. It is not just something that exporters have to pay attention to. There is a tendency at times to think that integration only means exporters must be internationally competitive; but others don't really have to be concerned. The fact is that exporters depend on an entire production structure. Hence the suppliers of the exporters have to be internationally competitive, the infrastructure on which exporters and their suppliers depend, particularly the telecommunications and power infrastructure has to come up to the kind of standards necessary to achieve quality production, timely delivery and competitive prices.

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### **Fiscal Responsibility**

The financial system on which exporters depend has to be able to service them in a manner which enables them to function effectively in world trade. It is precisely to bring about these changes that our economic policy has been reoriented in the last three years. In fact, one of the interesting things about what is being attempted is that it is not a correction that affects only one part of the economy. The economic reforms underway attempt nothing short of a comprehensive reform affecting a large number of different sectors.

The new global reality also has major implications for government. We will not be able to achieve what we want if government cannot function in a manner that is fiscally responsible, because everything we know about countries that succeed tells us that it is a requirement for good economic performance that the macro-economic situation should be well managed, that prices should be kept under control, that the balance of payments should not get out of gear and this in our situation will depend very critically on the Central Government as well as the State Government's ensuring financial discipline. If financial discipline is not ensured then essentially it means that inflation will go out of control, the balance of payments will not be managed and interest rates will rise too high — things that people invariably complain about, when they think about an economic situation that has got out of hand.

For the government, to bring about financial discipline it means that we have to think differently about what exactly the role of government should be. We have to get away from the notion that all problems are solved by increasing expenditure. We have to bring in a modern tax system that is conducive to economic efficiency, that ensures that rates of taxation are moderate and therefore do not take away economic incentives. We also need a tax administration that is efficient and that can in fact collect taxes which in turn depends on a great deal of economic activity. Very often we find a major problem that anytime you tend to extend taxation, the tax people invariably say that our accounting systems are not such that we can subject new units to taxation. In other words, taxation should be restricted only to the modern sector. This is really not going to be possible, because if you want fiscal discipline, and a broad basing of the tax system, then instead of having an over taxed modern, organized sector with everyone else escaping taxation, thus distorting the situation, we will have to move to a system with moderate taxes which cover everybody. This is a major change which in the last two or three budgets the government has tried to bring about and we will require more budgets in order to complete the task, because basic changes in tax systems take several years. They cannot be achieved overnight.

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### **Private Initiative**

There is today new scope for achieving even social results through private activity a field where, in fact, we are very deficient. I am referring to areas such as health and education, particularly in the rural areas. I am also referring to the economic infrastructure, and areas of manufacturing, where in the past we used to push a great deal of government money into the public sector. We

can- not afford to sustain this situation through further injection of budgetary resources. We have to get across the signal that the public sector must become an efficient user of resources. It must generate the resources for its own expansion and those units that are efficient will prosper while those that are inefficient will be subjected to the discipline that will force them to do well or to close down. This is a basic change in the way we have run things so far. We can no longer tolerate a situation where a large, non-performing economic sector makes heavy drafts on budgetary resources, which would otherwise go to meet other needs of the economy such as the social and economic infrastructure.

As far as industry is concerned it will have to deal with a much more competitive situation than it has faced in the past. It has been an unfortunate fact of the past several years that Indian industry developed behind high protective walls. In fact, compared to other developing countries, we have had what is widely regarded as one of the most closed of economies. We are opening it up, but other countries are opening up much faster. We have to accept the fact that this process of reducing protection for industry is essential if we have to move to a new era where industry will focus on internal productive efficiency and better use of available resources effected through better management.

A major change is being brought about in the area of foreign investment. Compared to most countries we used to be very much more closed. The system is now opening up. It is a reflection of the perception of global integration, where in fact foreign investment and the operations of transnational corporations have become a very important engine for the transfer of technology and for the development of marketing links. There is a very large scope for expansion in this area and there has been a sea change in government policy. The early results of this policy are already evident, but its full effect will still take some time, because changes that are introduced take time to disseminate, so as to make the change credible. The process is under- way.

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### **The Financial Sector**

Finally, an area of major importance for the future functioning of the economy is the area of the financial sector. None of the changes that we are trying to bring about in the economy can really be effectively managed if the financial sector is not modernized, because economic restructuring is about changing economic signals pushing resources into areas that are more efficient, into sectors that are more competitive, to support firms that are more capable of expanding. This can only be done if the financial sector is capable of responding to these signals. Today, we have a banking system which has greatly expanded quantitatively; but qualitatively there is no doubt that it leaves a great deal to be desired. The banking system has been heavily regulated, with tight interest rate regulations, prescribed directions of credit and a large volume of resources being pre-empted by the government for its own use.

As we move into a newer situation, where the government has less need for borrowed resources, we will be able to free up our banks so that they can more effectively deploy their resources, lower their interest rates function more autonomously in pursuit of economic efficiency. Some of these changes have already been initiated; but as many people complain the process has barely begun. However, some of the changes introduced will take a couple of years before we see a full transformation to the new norms. The question people ask is whether really the changes will actually be brought about and completed? We shall have the answer in next two or three years when major changes in the economic system and the system of financial management are to be introduced.

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## Short Term Disruption Inevitable

All these changes are going to have an impact on all of you as you go out into the world of business, simply because business is going to be very different from what it was in the last 25 years. There will undoubtedly be problems. Any change involves some disruption and some uncertainty and you are seeing today evidence of that uncertainty in some of the reactions to the changes. In the public sector, there is a sense of uncertainty because of the loss of budgetary support; in the private sector there is a sense of uncertainty because of the reduction in protection and the question whether Indian industry is ready to compete with lower protective walls; among labour there is fear of unemployment in case industry is badly hit by the new changes.

Along with these doubts, there are also genuine uncertainties. There are also a lot of bogus fears of the kind that we see exemplified in various rallies and protests that are being launched on the Dunkel Draft and the GATT negotiations. The fact is that some of these uncertainties are understandable and they exist in all countries where changes are made. We ought, to my mind, to take heart from the actual experience of the recent past and to see whether there is any reason to fear those changes. My own feeling is that if you look at the experience of the past few years there is really no reason for these uncertainties. All the evidence suggests that the Indian economy is now at a stage where it is fully capable of responding to the new economic environment.

Thus, only three years ago we had an economic situation where our foreign exchange reserves had dropped to about a billion dollars. Three years later, after having liberalized imports, removed import restrictions; lowered tariffs and more or less freed the rupee we are in a situation where imports are not flooding in; reserves are more than fifteen billion dollars, exports are rising at 21 % and industry which has been going through a bit of a recession is finally beginning to turn around. What one needs to make such changes effectively is for the government to stay in power, because none of these changes can be implemented in the short run; at least they will not yield results in the short run. Much wider public debate is necessary so that false fears and uncertainties are put at rest and there is a genuine appreciation of the facts on the ground and some consensus emerges in this debate on what changes are necessary and the pace at which they should be brought about.

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## Impact on Managers

These changes are going to have a major impact on the new managers of the future. I would like to touch on this because in some ways the more competitive environment in the years ahead is going to create a situation in which managers will ultimately come into their own, whether you look at the public sector or the private sector. In the public sector, the old non-competitive situation made the manager very much subject to the whims of an over-regulating government bureaucracy. Precisely because the system could be protected from its end results, inefficiency could be tolerated and budgetary support was always available. It was not necessary to have an environment which gave maximum flexibility to and also put the responsibility on the managers themselves. In the new environment the situation is completely different. In regard to the public sector, the government has now made it amply clear that budgetary resources are not free goods; no-body in the public sector can in future count on open ended access to budget resources, particularly when our educational budget and our health budget need so much more by way of funds. This is the situation which will tilt the balance away from bureaucratic control towards giving greater flexibility and accountability to the managers who run the public sector, because they will be operating in a more competitive environment and it will be up to them to ensure that the public sector functions. In the private sector you will have an identical situation. The effect of competition is going to be to create an environment in which the professional manager will come into his own. The earlier protected environment tolerated perpetuation of family control and the quest for profits from rents resulting from licensing.

In the new environment competition and efficiency and end results are the only things that will really guarantee the expansion of a company. It is an environment which I think graduates of

XLRI will find much more congenial in the years ahead than what prevailed in the years which are behind us.

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### **Hopes for the Future**

With these changes I have every reason to expect that we may be entering into a period where the gap that has developed between India's performance and the performance of some of our neighbors in Asia could be closed. The record on this is quite interesting. During the 1970s or so India's growth rate used to be only 3.5 to 4 per cent. During the 1980s when we first introduced liberalisation, although in a very gradual and tentative kind of way, the average growth rate of the Indian economy went up to 5.5 per cent. This was much better than our historical average, but it was not as good as what had been achieved in other countries of Asia, countries like, [China, Thailand, Indonesia, Malaysia, Korea, Taiwan, and now even Vietnam which are growing at much faster rates. There is no reason to think that India cannot accelerate her growth beyond the 5.5 per cent that we have already achieved in the 1980s and try to reach a growth rate of 6.5 per cent or so during the 1990s. This is still below the growth rate in East Asia, and it is only one percentage point higher than what we achieved in 1980s. But the crux of the argument is that with these changes in policies which have introduced an environment far more conducive to greater economic growth and efficiency it is possible to accelerate India's growth at least from 5.5 to 6.5 per cent. The transformation that this will make in India will be enormous. In a large country where population growth will surely be below 2% (it is probably now only two per cent and we can expect that it will gradually go down), a growth rate of 6.5 per cent would mean a per capita growth of incomes of 4.5 per cent or so. This, by any historical standards is a very high rate of growth of per capita income and it is just the kind of growth rate which can trigger off a large number of positive virtuous circles, the kind of circles that lead to self-sustaining growth at even more rapid levels.

The crux of the argument is that with these changes in policies which have introduced an environment far more conducive to greater economic growth and efficiency it is possible to accelerate India's growth at least from 5.5 to 6.5 per cent. The transformation that this will make in India will be enormous.

I mention all this because it is very difficult when you face the graduating class from a first rate institution, to say something earth shaking. I am told, all of you already know where you are going to be working. It is nice to spell out only longer term perspectives, since you do not have any short term uncertainties at all. I would just like to leave the thought with you that as you move into your new jobs, you should keep your eyes open for the tremendous changes that lie ahead. It is useless to look back and try to learn lessons from the past; because this is one situation where the past will not be a good guide. The rules are different. The situation is different. Personally I think you will find them much more challenging and much more rewarding. I have no doubt that all of you will rise to the challenges and if you do, the rest of us will certainly benefit, because I think today the role of managers in bringing about changes has actually been enhanced. We are now talking about a much more decentralized system of decision making not a centralized, planned environment. The new environment is one in which innovation, flexibility, micro-economic decisions taken in individual firms, in individual institutions are going to pave the way for new ways of doing things for the whole nation.

I would like to end my address by offering my congratulations to all graduating students, in particular to those who have distinguished themselves and won prizes. I would simply add one thought: I know from past experience of my own class that the total number of people in a class that distinguish themselves in life is much greater than the number that won prizes. There are many more among you who I know will distinguish themselves in the years ahead.