Signposts to sustainable growth

INTERVIEW WITH PANALIAPPAN CHIDAMBARAM

MINISTER OF FINANCE, INDIA

P CHIDAMBARAM has long championed the cause of economic liberalism, believing that countries that are open to competition have succeeded in reducing poverty. He is a graduate of Presidency College, Chennai, receiving a BSc, and he also received a BA in Law from the Law College, Madras University. He was elected to the Lok Sabha in 1984 and has represented Sivaganga in Tamil Nadu continuously since then. Since 1985 he has served in the Ministries of Commerce, Personnel, Public Grievances and Pensions, and Home Affairs. He served as Finance Minister initially between 1996-98. He was re-appointed as Finance Minister in May 2004.

Shortly after taking office as India's Finance Minister, P Chidambaram responded to those who doubted whether a Congress-led government could carry through both its promised social programmes while maintaining economic growth by stating that: "Once the growth rate kicks in, everything will fall into place". That essentially pragmatic approach reassured financial markets and investors, and with GDP growth rising to 9.4 per cent last year Chidambaram can say, on the economic front at least, "Yes, this has happened".

He points out that India's economy has been transformed since it embarked on a course of economic liberalisation and reforms introduced by the then Finance Minister, and now Prime Minister, Manmohan Singh. Whereas previously the so-called 'Hindu economy' had struggled to rise above annual growth rates of 3.5 to 5.5 per cent, average growth in the four years beginning 2003-04 has been 8.6 per cent and has been increasing. For the current Five Year Plan, the government is aiming to achieve sustainable growth rates of between 9 and 10 per cent.

"If that growth target for the 11th Plan is achieved and maintained," he says, adding "and I am confident it will be, then by 2020 India will become a middle income country with greater urbanisation and poverty virtually eliminated (as per current definition)." Moreover "with an expansion of the middle class", he says, "general prosperity will become more visible." So, while specific programmes may be targeted at eliminating poverty, improving health and education, and thereby strengthening India's human resource, it is the economic motor that will be powering the process.

Fast-growing levels of investment (although still far short of China's) are a further indicator that current levels of growth are sustainable. As Chidambaram points out: "The upturn in growth is reflected in a rise in the rate of investment, which moved up to 33.8 per cent of GDP in 2005-06 from a level of 22.9 per cent in 2001-02, and is estimated to have gone up further to 35.1 per cent in 2006-07." Furthermore, rising incomes have not only fed into enhanced levels of consumption but also into savings. "Gross domestic savings", he notes, "have increased from 23.5 per cent of GDP in 2001-02 to 32.4 per cent of GDP in 2005-06."

While India's investment/GDP ratio has risen recently, it too lags behind China and some other Asian nations. The government would like to see this rise further, and particularly foreign direct investment in key areas such as infrastructure and certain manufacturing sectors. Chidambaram admits that "certainly we need to do better." Yet he is keen to stress that, "the most important point to take note of is that India's investment growth in the recent years is driven largely by private investment." That sets it apart from China and some other developing economies in Asia and "is by itself a source of great strength."

"At the same time" he adds, "in order to make the growth process sustainable, we are focusing public expenditure towards critical areas like health, education, environment and social infrastructure. Furthermore, India will continue to reap a 'demographic dividend.'" He points out that the number of people of working age between 15 and 64 is expected to reach 67 per cent of population by 2025. Moreover, the median age of the population will be much lower than any other major economy. He notes that compared with European nations (46 years), the United Stares (39 years), Canada (44 years) and China (42 years), India is expected to have the lowest median age population of 32 years by 2030." The 'demographic dividend' will feed into higher investment because, as he explains "the larger number of working population, given the saving habits of the people together with increasing income levels, will continue to provide large domestic savings to sustain our investment levels."

Furthermore, within an increasingly globalised economy, India is emerging as one of the world's preferred FDI destinations, and this, as Chidambaram observes, "will supplement domestic savings." While there is some concern that previously investment has been over-concentrated in certain sectors, such as services, real estate development and construction, Chidambaram believes the relative under-investment in industrial production is becoming less of a concern. "The industrial sector has responded to the policy changes we have made", he says, "and to its credit has risen to the challenges of greater domestic and international competition." And since, he adds "industrial growth has also been broad based, the growth impulse will get transmitted to all sectors of the economy."

With the economy growing at such a hectic pace, keeping inflation under control was always going to be a challenge. But Chidambaram argues that fears

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of 'runaway inflation' have been grossly exaggerated. "Inflation, measured in terms of the wholesale price index", he notes "was 3.79 per cent as of August 25th, 2007". That is already a considerable improvement on the recent peak of 6.69 per cent in January.

According to Chidambaram, "inflation has decelerated from its highs in 2006-07 because of four main factors: supply side improvements in some essential commodities like wheat and sugar; the strengthening of the rupee leading to a decline in rupee prices of imported goods; monetary and fiscal measures initiated by the Reserve Bank of India and the government; and administrative measures including imports of commodities like wheat and pulses through the public sector agencies."

With growth reaching record levels and the authorities maintaining a close watch on inflation, other reforms are necessary to ensure that India will fulfil expectations, so that over the next 30 to 50 years it will be the fastest growing of the BRIC economies, outpacing Brazil, Russia and even China.

One question that frequently crops up among both domestic corporate leaders and international companies concerns the pace of economic reforms – whether that applies to the rate of privatisations, deregulation, or changes in investment laws that impose a ceiling on foreign ownership of enterprises in certain sectors such as retailing.

Although Chidambaram affirms that "the economic rationale of the reform process is central", he also acknowledges that "the process itself is inherently political." He argues that "this (political) aspect should not be lost sight of if we are interested in making growth that follows from reforms sustainable." Moreover, in what is the world's largest democracy, the economic measures need to be well articulated and conveyed to the people in a manner they understand. Working within such an environment, Chidambaram argues that a gradualist approach to reforms is the more realistic option over the long term.

Another hurdle to taking a positive investment decision that is often cited, especially by potential foreign investors, is India's inadequate infrastructure, and there is currently much debate over how these shortcomings should be addressed.

Chidambaram recognises "the need to provide world-class physical infrastructure – roads, railway, airports, seaports, power and telecommunication in order to meet the requirements of a fast growing economy. A country of the size and complexity such as India needs to employ more than just one model to build infrastructure on an ambitious scale. And we are doing just that."

He says that "in areas where the private sector has a comparative advantage, that is the preferred route. At the same time, we are aware that in some areas, especially in the social sector or certain geographically difficult regions, public investment may be the only answer until a critical mass of private initiatives are built."

The challenges are enormous, the new investment necessary having been estimated at more than US$320 billion over the five years of the Eleventh Five Year Plan (2007-12). Around US$130 billion of new investment is needed in power infrastructure alone. The modernisation of India's huge railway network calls for another US$66 billion, US$49 billion for national highways, US$11 billion for seaports and US$9 billion for civil aviation. The latest report advises that the target for infrastructure development be raised to US$475 billion at current prices. However Chidambaram is confident that India is capable of absorbing such large investments in infrastructure, with the encouragement of public private partnerships seen as the best route to ensure that additional capacity can be achieved at a reasonable cost.

Enormous opportunities are therefore opening up for leading international players to join in the building of India's new infrastructure; or in terms of financing, to follow the example of Citigroup and Blackstone which recently joined with two Indian companies, IDFC and IIFL, to launch the US$5 billion India Infrastructure Initiative.

Support from both multilateral institutions like the Asian Development Bank and World Bank has also been committed, along with bilateral support from the Government of Japan and others. Bringing on board the technical and financing capabilities of private enterprise will take this a stage further. "In the case of public infrastructure", Chidambaram adds, "the PPP route is already in place." F

The city of Mumbai: Financial engine of India's economic reform programme