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Finance Minister Yashwant Sinha on India's Changing Role in the World Economy

Working Paper Number 24

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Country Close-Up: India

Country at a Glance

Population:	1 billion
Area:	1.2 million square miles
Government:	Federal republic
Official languages:	English, Hindi, and 16 other Indian languages
Major imports:	Oil and oil products, capital goods, uncut precious gems
Major exports:	Textiles and apparel, gems and jewelry, software
Main trading partners:	Imports: U.S., Belgium, Japan, Saudi Arabia Exports: U.S., European Union, Japan, Hong Kong

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Finance Minister Yashwant Sinha on India's changing role in the world economy

Interview by Ravi Ramamurti

Executive Overview

Yashwant Sinha became India's finance minister when the government of Prime Minister Atal Behari Vajpayee took office. The Finance Ministry is the most powerful economic ministry in India, with responsibility for a very wide range of domestic and international matters. The ministry mobilizes resources for development through direct and indirect taxes; draws up budgets for the central government for current expenditures and public investment; and keeps a close watch on macroeconomic growth and stability through policies that affect credit, prices, and exchange rates. The Finance Ministry handles India's economic relations with foreign nations and international institutions like the International Monetary Fund. Its officials are represented in the highest-level committees on foreign investment in India. It regulates external commercial borrowings by Indian organizations and oversees the Indian capital and stock markets, and is also responsible for transferring resources to state governments for development. For more than a decade, the Finance Ministry has been at the forefront in leading India's economic reforms and opening up the country to international trade and investment.

Yashwant Sinha is the latest in a series of technocrats to assume charge of the Finance Ministry. After obtaining his master's degree in political science in 1958 from Patna University in Bihar, India, Mr. Sinha taught for two years at his alma mater. In 1960, he was selected to serve in the Indian Administrative Service. After 24 years in India's elite civil service, he resigned to join active politics as a member of the Janata Party. In 1988, he was elected to India's upper house of parliament, the Rajya Sabha. He served as finance minister for three short periods prior to his 1999 assignment. He is currently a member of the lower house of parliament, the Lok Sabha. Mr. Sinha serves as chair of the Joint Ministerial Committee of the World Bank and the IMF on Development. Portions of Mr. Sinha's statement to the 60th meeting of that committee are included in the interview below.

Speaking to a group of businesspersons some time back you said, "Despite the slow pace of our growth in the last 50 years, India today is ready to take off, and the world is waiting for us to take off. The 21st century shall and will be the century of India." What did you have in mind when you said that?

I had a few things in mind. The first was that the world will increasingly come to realize that India has the technical skills not only to participate in the development of frontier sciences, but also to make useful contributions in that regard. The fact is that India has generally been regarded as a land of poverty, illiteracy, squalor, misery—and if I go further back in time, there are folk dancers and rope tricksters as well. But I think it will become increasingly recognized—because of the performance of Indians and India—that India is technologically oriented and has strengths in science.

The second thing I had in mind was that within the first decade or two of the new millennium, it will be possible for India to overcome the problem of poverty, which we have been cursed to suffer from since independence and even before. Unfortunately, we were unable to manage our affairs in

Yashwant Sinha

such a way as to end poverty earlier, but that will change in the years ahead.

The third thing I had in mind was that India will open up and will become a full partner in a globalized world. The billion or so people who live in this country will make their contribution to the world economy, and that will be increasingly realized by the rest of the world.

Finally, I believe that Indians living abroad—the so-called nonresident Indians—will make very significant contributions to the countries in which they live. Indians will become politically relevant in those countries and their visibility will go up and that will add to the prestige of India and Indians generally. Also, as a nuclear-weapons state, India will be recognized as a major power by all the other developed countries, and it will obtain a permanent seat on the United Nations' Security Council. All in all, India will be recognized as a major power and will be on people's horizons and governments' horizons. At present we are a small player as far as the world economy is concerned and are somewhere in the margin rather than the mainstream of world affairs.

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One measure of success towards that objective is India's rate of growth, which has risen—but only from an average of 5.6 percent in the 1980s to less than 6.5 percent in the 1990s. Yet Prime Minister Vajpayee has set a target of 9 percent growth in the coming decade. What will it take to achieve that?

If you look at the history of the Indian economy you find that up to the decade of 1970s we were growing very slowly—3.0–3.5 percent per annum. In the 1980s, we made a paradigm shift, when we started with some rudimentary reforms that had led to a higher growth rate of almost 6 percent—almost double the growth rates of earlier years. However, growth in the 1980s was achieved at a cost—we borrowed too much—and therefore it was unsustainable. One could say that we achieved a higher growth rate without strengthening the fundamentals of the Indian economy. One result was that we faced the balance of payments crisis in 1991, when small problems, like a spike in the international price of oil, threw our economy into a tailspin.

True, in the 1990s India achieved a growth rate that was only 0.5 percent to 1 percent more than the decade of the 1980s, but this growth rate is far more firmly planted than it was in the earlier period. If you look at the history of economic reforms in India, you will find that when we started on the reform path somewhat tentatively in the early 1990s, we first did the easy things, for example, by simply issuing government orders. The more difficult parts of the reform process were not undertaken for political and other reasons When our government came to office in March 1998, we surveyed the whole situation and found that to move the reforms forward, we also had to take more difficult decisions, and bring about many of these changes through legislative measures. That is the task in which we have been engaged.

We have faced more opposition from certain quarters to the reform process because we are now trying to tackle the more difficult parts. We are confident that the road on which we have embarked will lead to greater opening up, greater integration with the world economy, and that this will lead to greater growth. If we want to solve the problem of poverty, as the prime minister has said—that is, to double per capita income in 10 years—then we have to achieve a growth rate of 9 percent in the coming decade. It will not be easy to get to that level from the level of 6.0–6.5 percent per annum, but I think it is achievable. Indeed, there are many friends here and abroad who feel India should be able to grow at double-digit figures. So we are in the process of putting together a policy package to achieve that kind of growth.

One issue that is often raised in the context of India is the relationship between democracy and economic growth. How do you see that relationship, and do you believe, as some do, that one comes at the expense of the other?

There is a general feeling, especially when comparing India with countries like China, that there is such a trade off. The fact of the matter is that democracy has several advantages, even as far as the economic development process is concerned, but it also has several disadvantages, because it puts on the government of the day the responsibility to build consensus for the reform program. The benefits of the reform program take time in coming, but the disadvantages start flowing immediately. So even if one person loses his job, it has far greater adverse publicity than if a hundred others get new jobs. In the case of India—given that 70 percent of our people live in rural areas and are dependent on agriculture and related activities—many of the reforms of interest to foreign observers have no relevance to vast portions of our population. The people in India's countryside want to know what beneficial impact the reforms will have on their lives. This is an area in which we have to keep working hard, so that the positives of the economic reform program touch everyone, and also to ensure that the positives get publicity rather than only the negatives. Unfortunately, negatives make better news.

Then we have a parliamentary process that often appears to delay reforms further. I am at pains to explain to my foreign interlocutors that there is no way this process can be cut short, because India is fiercely committed to democracy. We are very proud of our democracy and we would not like to sacrifice our democratic values for anything in the world. So we will grow at a pace that is consistent with the democratic norms of India.

Foreign direct investment (FDI) can be part of the answer to achieving faster growth in the future. Although inward FDI is presently 10 times greater than in 1991, the annual flow is still only \$2 to \$4 billion, compared with the target you've mentioned of \$10 billion per year. What policy measures is India taking to achieve the \$10 billion figure?

We have taken many steps to attract foreign direct investment, and to make the life of the foreign investor much easier than in the past. For decades, an image has been built of India as a place with bureaucratic hurdles, implementation delays, and a place where one has to visit various bhavans [government offices] in Delhi in order to get approvals. All that is a thing of the past. One important thing we have been doing in this regard is opening up sectors to FDI like never before. No one believed that the insurance sector would be opened up, but we did it anyway. Nobody could have believed that we would adopt such an open, liberal policy about telecommunications, but we are doing that. We have now an Information Technology Act. We are working on a convergence legislation. We are working on a new competition policy. We are working on new bankruptcy laws. We have changed our laws on amalgamations and mergers. We have recently introduced derivatives trading. I can count a whole lot of steps that have been taken at a blistering pace to make the life of the foreign investor easier.

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More importantly, we have put everything today on the automatic approval route. We have, for instance, sectoral caps, that is, limits on foreign ownership in particular sectors. True, a foreign investor cannot come to India and invest 100 percent in any sector, but there are restrictions of this sort in even the most advanced countries. But within the sectoral caps, a foreign investor can invest automatically. All that has to be done is to inform the central bank, the Reserve Bank of India. And even as far as the sectoral caps are concerned, we are reviewing them from time to time and liberalizing them further. For example, we have opened the garment segment of the textile industry to 100 percent foreign investment and done away with reserving it for the small-scale sector.

The problem is that this part of the Indian story is not yet as well known among our friends abroad as it should be. Therefore, whenever I talk to them either here or in another country, they often express surprise and amazement at the changes that have been taking place. They have been emphasizing the need for all of us to go out and tell the story of India more proactively than has been the case so far. That is something we will have to do. In that context, the decision of *The Executive* to do a special focus on India is most welcome.

How do you view the Enron effect? Have the difficulties that Enron Corporation faced in executing India's largest foreign investment to date damaged the climate for FDI?

No. The Enron incident has come and gone. Enron today is our best ambassador. They are saying that despite all the problems that they faced, it was possible for them to do business in India, and that the system, including the Indian judicial system, is a very fair one. Even if the government of the day has a different view from the foreign investor, the judiciary in India can take a totally different view.

How well prepared are Indian companies to face foreign competition? The experience in some other developing countries has been that local firms have often been put out of business by such competition, or, if successful, they have been swallowed up by foreign multinationals.

I think the pace at which we have gone about our reforms has largely avoided this danger. There have been a few cases of takeovers of Indian companies by foreign companies, but by and large Indian companies have been able to stand their ground. I think we have been able to give our companies more time. We haven't done things in a rush, and don't plan to do things in a rush in a way that could destabilize the system. Our policy is not necessarily to destroy what is there and build afresh; our policy is to transform what is there into a more efficient, competitive unit. The winds of competition have been allowed to pervade the Indian economic scene in a manner that has given Indian companies time to adjust. There have been some casualties, but that is part of the process.

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What can or has India learned from China about the economic reform process?

One of the things we have learned from China is the idea of creating special economic zones. We have set up such zones, effective November 2000. The other thing we can learn from China is methods for improving agricultural productivity and rural industrialization. There are also lessons to be learned in the field of export promotion.

What about lessons about negotiating with multinationals—for instance, to persuade them to transfer technology more aggressively?

Our rules and regulations do encourage transfer of technology, so that it can come in initially and then be continually upgraded or enable us to develop local expertise to take the technology forward. By and large, I think our experience with transfer of technology has been good.

Which sectors do you see as the engines of India's future export growth?

I see growth occurring in all three sectors of the economy—the new economy sector, the old economy sector, and what I like to call the older economy sector, namely, sectors like agriculture, small-scale industry, handicrafts, and the like. I expect all these sectors to play their part.

Would you comment on your visit to the United States with Prime Minister Vajpayee in September 2000 and what appears to be a significant change in the United States' attitude toward, and relations with, India?

I think the change in the U.S. attitude started with President Clinton's visit in March 2000. He went back very impressed by what he saw here, and Prime Minister Vajpayee's return visit was able to build upon that perception of India. I think his trip was perhaps the most successful visit of any Indian prime minister to the United States, and has done a great deal of good in the economic field as well as in other areas.

I'd like to turn finally to the role of developing countries in the global economy. You currently chair the World Bank-IMF's Development Committee. What must developing countries do to maximize their benefits from globalization?

Developing countries have already taken a number of steps to increase their share of global trade, particularly in the context of the Uruguay Round. As we enter the new millennium, the basic profile of trade itself will undergo change. Reforms and opportunities have led to financial and economic integration. Advances in technology and communications, and institutional innovations have altered the way business is conducted, apart from the fact that the services sector is becoming increasingly important. These changes have introduced both challenges and opportunities for developing economies.

Developing countries need to prepare themselves to safeguard their interests and ensure that they fully realize the benefits that were expected to accrue as a result of the obligations assumed in the Uruguay Round. They also need to carve out opportunities for trade development. Unfortunately, they are hindered in this task by institutional and capacity constraints. Institutions like the World Bank can target their resources to help developing countries address their requirements, especially in the areas of policy formulation, regulatory reforms, institution building, and trade promotion.

There has been much talk about the need for a new financial architecture to prevent crises like the one in Asia in 1997–98. What changes would you like to see, for instance, in the role of the IMF?

The need for a new international financial architecture has arisen in response to a broad set of developments. Globalization and economic integration have ushered in an era of fresh promise, but they have also posed serious challenges to developing economies. The IMF's present resources are inadequate to imbue market players with the requisite confidence in times of financial crisis. An amendment of its articles should be considered that allows the IMF to issue SDRs to itself to meet the emergency financing requirements of countries in financial crisis. The new financial architecture must also ensure an important role for the private sector to forestall and resolve financial crises. The fund has correctly realized that controls on cross-border transactions, especially at the shorter end, should be viewed more as a prudential measure to limit macroeconomic and financial instability than as restrictions per se. A new financial architecture would also require a governance structure commensurate with the evolving financial system. For instance, emerging economies need to be included in the Financial Stability Forum. There is also a consensus that surveillance by the fund could help prevent some crises if it leads to early corrective steps by the concerned countries. A number of initiatives, such as codes of fiscal, monetary, and financial transparency have already been taken up. Finally, the IMF and the World Bank should ensure that social safety nets are protected and better targeted in countries in crisis.

The new financial architecture must also ensure an important role for the private sector to forestall and resolve financial crises.

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