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INTERNATIONAL POLICIES AND GLOBAL CHALLENGES: AN OUTLINE OF DOMESTIC ECONOMIC POLICIES

INTRODUCTION

A pleasure to share the podium with the American Ambassador. The U.S. and India share much in common, as indeed we do with Australia – we are all democracies, sharing certain fundamental values – the rule of law, a free press, strong and independent judiciaries, multi-lingual, multi-ethnic, multicultural societies.

So we're here today to talk about global challenges post the GEFC and domestic economic policies In an interview to the Financial Times, in the lead-up to the G20 Summit in London, India's Prime Minister said that these were issues that have been discussed for decades and that these issues related fundamentally to the redistribution of power among nations. Referring to the Bretton Woods system, he noted that the international Financial Institutions were established at a time when the world was very different, the challenges facing the global economy were different and the distribution of economic power was very different. Since then, the world has changed dramatically. There is a need to redefine their role to deal with problems of today.

As we look beyond the current financial crisis, we are witnessing the transformation of the existing global economic and financial architecture, where the rules are being rewritten in a way that they have not been for decades.

This represents both a great opportunity and a great challenge for policy makers everywhere, but particularly for Asia's emerging powers.

Long years of globalisation have integrated the economies of all nations and especially of the major powers, to a degree unprecedented in history It has made them dependant on external factors for their continued prosperity, and even in some cases, regime stability.

THE WORLD AFTER THE GEFC: KEY ASPECTS

That we are in a period of transition where rapidly resurgent economies outside the traditional circles of global economic dominance are setting a new pace and direction in economic growth and development, is evident. The divergence of performance between advanced and emerging economies points to an ongoing shift.

Asia has emerged as a powerful engine of growth in the world economy, accounting for more than 30% of world GDP and contributing half the global growth.

The sustained dynamism, shown especially by China since it undertook economic reforms in the late 70s and later by India since the 90s when she opened up to the global economy, has lead to a perceptible shift in global economic activity in terms of trade, investment and capital flows, inward as well as outward. As globalization gathers momentum, Asian economies are proving to be increasingly competitive in attracting businesses engaged in manufacturing and services and are increasingly being seen increasingly not only as huge markets, but also as favoured destinations for high technology manufacturing and R&D.

And as the World Bank has pointed out, the economic rise of China and India has been the single most important factor in reducing global poverty over the past two decades.

Integration of financial markets is one among the several important forces of an increasingly global village, shrunk by modern technologies of instant telecommunications, internet and transport. Trade, tourism, capital and technology flows; out-sourcing, off-shoring of businesses; sourcing of energy, food and other commodities from distant lands; waves of migration of large number of people across borders seeking better opportunities; as also the impact of pandemics, natural disasters, terrorism and climate change all of which have cross border global implications and have led to the realization that lives of peoples on this planet are interdependent as never before.

The integration of financial markets around the world is a relatively recent phenomenon, closely connected to the vast changes in the world political order in recent decades, policies of economic liberalization undertaken by a large number of countries as also the transformational effect of the new technologies of information and communication that have allowed such an integration to go ahead.

Real economic activity – production, investment, employment and trade – is becoming increasingly dominated by financial cycles, both in developed and developing countries. This can sometimes affect economies regardless of their monetary and fiscal discipline or their track record in economic development, to the extent that macroeconomic stability and sustained growth in many developing countries may now depend largely on how international capital flows are managed.

Having said all that, one must underline that the nation-state is still the basic unit of decision making and that the competition among states for power, influence and resources, with the goal of determining or affecting the behaviour of other state and non-state actors, continues: However it continues within the framework developed by the globalised and interdependent nature of our numerous interactions.

THE INDIA STORY *(An outline of domestic economic policies)*

Coming to the domestic economic situation in India, India's growth in the four years preceding the onset of the global financial crisis was around 9%. In 2008, with the advent of the global financial crisis, it slowed down to 6.7%.

Today, India has emerged as the third largest economy in Asia, a trillion dollar economy that has joined the ranks of the top ten economies of the world. In a knowledge- and technology-driven world, India has demonstrated certain unique resiliencies – our strengths in IT and R&D, for instance; the December 2009 index of industrial production surged month-on-month by a record 16.8%. Cumulative industrial growth is pegged at around 9%. The most noticeable feature of India's economic growth is that it is driven primarily by domestic demand.

The turnaround of the economy which started in the second quarter of 2009-10 has been consolidated by a Q 4 growth in 2009-10 to a strong 8.6 %, taking growth for the full year 2009-10 to 7.4. The outlook is brightened by the fact that a normal monsoon is predicted this year. The Indian economy is expected to grow around 8.5%during 2010-11 and to breach the 9 % mark in 2011-12.

However, such growth rate targets are by no means a given and any further negative shock to the global financial system and global inflation could still threaten growth in Indian economy.

The global environment is expected to remain difficult in the years that lie ahead. Our exports have slowed down and we would need another source of demand to offset slower export growth; that demand should ideally come from an expansion in investment in infrastructure and this is precisely what we are in the process of doing.

We are in the process of expanding and modernizing the infrastructure of the entire country, especially in the rural areas, where 60% of our population reside - highways and roads; railways, air and water transport; irrigation, energy and telecommunications; water supply and sewerage systems.

We acknowledge that our these high growth rates over the past few years have been good, they have not been good enough. To abolish poverty in India and to meet our development needs, we need to keep our economy growing at 8-10% every year for the next 20 years. As the literacy levels of our largely young population go up, *(we have 750 million people under the age of 35)* we will have to ensure that their employment needs are also met and we can truly reap the advantage of this demographic dividend for our economic growth.

The challenges that we face are many – the challenges of addressing poverty, illiteracy, unemployment, healthcare for millions; bridging the rural-urban and regional divides; Achieving an inclusive growth that leads to sustainable development. We need to address critical challenges relating to energy, food and water security, and climate change.

The Government has initiated several policies aimed at meeting these challenges. The investment we are making in rural infrastructure and connectivity; clean drinking water; irrigation and sanitation facilities; rural education, health care and social welfare, and in promoting non-farm employment in rural and backward areas should help redress these imbalances, empower people to become active participants in the growth process and facilitate the sustainability of economic growth.

This is especially important in the context of the particular emphasis that India places on ensuring participatory democracy and effective governance at local levels, which encourage ownership of governance processes and social and economic mobility. Civil society action is also flourishing.

The success of the Indian experiment – the experiment of a large economy developing within the framework of an open society and an open economy, committed to the protection of fundamental human rights and the rule of law, as a plural, secular democracy – has relevance to many parts of the world today, especially those countries looking to do the same.

Here I would like to briefly discuss the development and opening up of the Indian financial markets, which would give some idea of the thinking behind the Indian policy makers on these issues. The biggest regulatory challenge comes from the fact that liberal financial markets tend to create concentration of wealth; distributive justice does not figure in the euphoria of growth. From the Indian point of view, the basic aim of financial market development must be to both economic growth and equitable development. In a low income economy like ours, the cost of downside risks is very high, so the objective of maintaining financial stability has to be constantly kept in view as we develop financial markets.

This approach has served to impart resilience to our financial markets. Indian banks have strong balance sheets and are well regulated. So while lack of integration of financial markets saved India from the 1997 crisis, better regulation of the integrated markets helped our financial institutions this time around. Action taken by the Reserve Bank of India well before the crisis to tighten bank credit against real estate and to limit bank exposure on this account, also helped.

The development of our financial markets is an ongoing process and there is still some way to go before our markets are fully developed and integrated, which to my mind is not altogether a bad thing.

CONCLUSION

All this leads us to the key question: What are the implications for the world of an increasingly knowledge intensive and Asia-centric global economy?

Here I would like to draw attention to what Singapore's FM, George Yeo said recently in an interview to Greg Sheridan of 'The Australian'. Talking about the region and the regional architecture, he noted and I quote:

"The single most important relationship is between the US and China. Increasingly, the relationship between India and China is becoming more important. I think eventually a triangular relationship will decide the big issues of war and peace in Asia this century – the triangle consisting of the US, China and India." Unquote

India's relations with the United States are in a new and transformative phase, with convergences in foreign policy priorities, and shared approaches to some of the most complex regional and global challenges of our times – from countering terrorism to working together for energy security, mitigating the impact of climate change to maritime security, nuclear security and safeguarding the global commons, to name a few areas.

With China, there is both competition and collaboration in the dynamic equilibrium of our relationship. Both our countries have always thought in civilizational time-frames. Even as we discuss the unresolved boundary question, we have ensured that there is peace and tranquility in our border areas. China has emerged as India's largest trading partner. We consult each other on global issues such as multilateral trade negotiations, climate change, and in the G-20.

As one writer noted recently*, "In the decade ahead, India will have to provide itself with "the widest possible field of vision" when it comes to China."*

At the global level, India has worked with its international partners to address the complex challenges in reviving the global economy. The GEFC triggered the further evolution of the G20, of which India is an active member. We see the G-20 process as a move towards a more representative mechanism to manage global economic and financial issues. The Group has taken some positive steps in this direction, for instance by committing a shift in IMF quota share to dynamic emerging markets and developing countries.

Here, it is important to note that Asia's representation in global institutions like the International Monetary Fund falls short of the region's weight in the global economy. Asia's role in the world economy needs to be reflected in its influence at international institutions

The re-emergence of Asia in the global economy is having a transformational effect in the way business is conducted across the world. Similarly, just as role of Asia in trade and investment is growing, its role in capital flows is also growing. The further development and integration of Asian with other financial markets should ideally proceed in a phased and calibrated manner, imbibing the lessons from the past, to ensure financial stability and to harness the benefits both for economic growth and development.

The growing financial integration is throwing up challenges relating to national sovereignty and social equity. It is important to recognise that the growing economic and financial imbalances between the main economic regions of the world is unsustainable. It is increasingly risky to assume that market forces can foster the necessary adjustment without significant cost to the world economy.

While strong supervision and regulation of domestic financial systems are an essential precondition for a sound financial sector, in a highly integrated world there is also a need for designing credible rules to enhance global stability , given the strong evidence from the current crisis of the huge risks arising from speculation and sudden reversals of capital flows. Regulating multinational businesses also presents challenges on a far bigger scale than ever before.

The volatility of foreign capital flows raises several important policy questions - Should countries prevent capital inflows that threaten domestic markets due to volatility? Does financial integration lead to greater inequality? If so, what should be done about it? Does financial integration come at the cost of social distress and disruption? If so, how to manage it?

One consequence of the global financial crisis has been to make the 'return of the state', even more compelling; (*witness the response of governments ranging from bans on short selling through the bailout of individual institutions and on to the extension of blanket deposit guarantees and widespread financial support and partial nationalizations, supplemented by substantial fiscal priming*).

The dramatic extension of state intervention in several countries may hopefully mean a greater acceptance of diverse economic models.

Establishment of fair and equitable rules of international trade is another important priority. Structural problems exist in many sectors, particularly commodities produced by developing countries, which suffer from unbalanced supply chains and devastating fluctuations in price. It is vital, when framing the new rules, to have a framework that takes into account the interest of developing countries.

It has often been observed that the rapid shifts in the balance of power among nation-states in Asia are not anchored in institutions or collective arrangements for security. This may actually turn out to be to our advantage. While institutions in other regions seek new roles for themselves, Asia is free to build the open, inclusive, plural and flexible architecture required by changing times.

Will we be able to do it? Time will tell.

Asia has already demonstrated the ability to create new models of rapid economic growth, and of pragmatic coexistence despite differing political and economic structures. The question is whether we can also show such innovation in dealing with the new dimensions of security. A promising beginning has been made in the ASEAN Defence Ministers' Meeting+8 planned for later this year.

On the security architecture for the region, there is a need to evolve a balanced, open and inclusive framework for Asian countries and major non-Asian players to interact and cooperate to address traditional and non-traditional security challenges. The ASEAN Regional Forum has provided a useful model for such cooperation based on dialogue and consensus in diverse areas such as counter terrorism, trans-national crimes, maritime security, disaster relief, pandemics and nuclear non-proliferation and disarmament. ASEAN must remain the bedrock on which this region deals with these issues.

Most importantly, we need to build the habits and experience of cooperation that will enable us to deal with the unpredictable challenges that will certainly confront us. We in Asia are still learning as we go.

Simultaneously, the new global realities require that we revisit and reorganize existing governance models which were put in place over six decades ago. A dynamic global political and security order also requires the urgent reform of the UN Security Council as well. We see our case for permanent membership of the Security Council as valid and legitimate.

It is important to see India for what she stands for in a changing and often turbulent world - as a pluralistic democratic country that has created a successful standard for managing diversity; as a big country that symbolizes the values of inclusiveness, tolerance, and peaceful coexistence.

Accounting for more than 70% of the population and more than 80% of the GDP of South Asia. a fast growing and democratic India is a source of stability and a force for moderation in the region.

As for India, India is at a unique point in its history. Never before has the overall environment been as conducive to our sustained high growth as it is today. We are on the verge of finally living up to our full potential. It is our intention to participate actively and constructively in the process of change taking place in our part of the world.

Thank you.
