



**Asia and Pacific Regional Round Table:
“The China and India Factor: Implications for
Developing Countries in the Asia and Pacific Region”**

PRESENTATION

By Panelist

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**From transcript of speech of
Professor Manmohan Agarwal,
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Thank you, Mr. Chairman I am honoured to be invited to be part of this Round Table. Ladies and Gentlemen, Professor Ahn has already given you a large amount of information about economic performance of India and China. So some of that information which is there also in my presentation I will skip. What I will try to do is to look at the sustainability of growth in India, nature of this growth process and the implications for Asia of this growth process. What is very clear is that in the last 15 years since policies were changed in 1991, the importance of trade in India's economy has grown. India's share of world exports had decreased from about 2 % in the late forties steadily to about 0.4 % in 1991 but since then they have increased to slightly over 1 %. Also as share of GDP, exports had declined to as low of 5 % in 1991 and since then they have increased to 21 %. Similarly, as far as services are concerned, India's participation in world trade and services is even more important than that in goods. India's share in world exports of services is 2.3 % in 2005, which is up from 1.5 % 15 years earlier. And its share of services based on computers, tele communications etcetera is even higher.

As a share of GDP, exports of services increased from 1.5 % to over 7 % over the last 15 years and of IT based services from 0.6 % to 4.6 %.

In the past there have been a number of occasions when the growth process in India has been interrupted broadly speaking, the interruptions have occurred either because of high rates of inflation which have forced the Government to undertake contractionary fiscal and monetary policies or because of balance of payments crises which have also forced adjustment on the Government. Usually the two were born together because the balance of payments crises of the last few years have been caused by high prices of oil so both the inflation and the balance of payments crises are caused by the price of energy.

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Now since the 1991 crisis, however, the main features of the reforms that were ushered in in response to the crises were that India adopted more open policies and as we have seen India's integration with the world economy increased. Also policies were adopted to ensure that our ... resources were more in response to market ...rather than licensing by the government.

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This change in policy reflected partly the experience of China earlier because previously policy makers in India had been reluctant to open up the economy as the ... the world market were not been able to absorb a large increase in Indian exports and the Chinese experience has showed that was not so.

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Now is the growth process, which has started sustainable? And as I have mentioned earlier in the past interruptions occurred either due to inflationary pressures or due to balance of payments crises and at the moment, neither of these two dangers seem to be imminent.

The price of oil has increased substantially in the past years, which has had only a limited effect on the inflation of the economy. Partly because the full rise of the international price of oil has not been passed on to domestic consumers. Even though harvests have also been poor and agricultural growth has lagged which has not led to any sharp increase in inflation of food prices so there has been no particular need for the government to undertake any contractionary monetary and fiscal policies.

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But what about a possibility of a balance of payments crisis, the current account deficit has increased substantially because of the higher prices of oil imports but the current account deficit is more than covered by capital inflows and reserves have risen sharply.

Also in contrast to the situation in 1991, share of short-term debt is less than 10%.

The debt to GDP ratio has fallen in the last 15 years from 30 to 15% and the ratio of debt service to exports has also fallen sharply.

So there seems to be no particular reason to expect a balance of payments crisis.

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Now one of the possibilities as Professor Ahn has mentioned, India has experienced large inflows of portfolio capital. Could outflows of this capital create a problem?

As I said earlier the reserves more than sufficiently cover the short-term liabilities of Indian economy. In addition there are two further safeguards to prevent the possibility of a crisis. If foreign investors try to withdraw their money from their portfolios and sell their stocks and convert it into foreign exchange, they face the risk of both a drop in share of prices and depreciation of the Rupee. So the gains that they would have after converting them into foreign currency would be substantially reduced. So they will be reluctant to carry out large-scale conversions for fear of facing a capital loss.

So my mid-conclusion therefore is that I expect the growth process to be sustained maybe not at the same rate as in the last two years 9 % or so or so but definitely at the range of 7 to 8 %.

What is the nature of this India's growth process? It is a nature of the growth process, which will have an impact on other economies? The share of manufacturing in fact has declined slightly in the last 15 years from 7 % to 15-16% so the growth really has been based on services and next slide please and these services show both an increase on the export side and on the import side

But in contrast to goods trade, where the share of developing countries particularly in the Asia has been increasing in service trade the share of developed countries has been high. So much of India's exports on services are to the developed countries and not the developing countries.

What about the future? Currently India has about 2% of world income and 1 % of world exports. Continuation of current growth trends would lead India to account for about 4 to 5% of world income in 2025 and about 9 to 10% of world income in 2050. At these levels of share of world income and the continuation of the rising share of world trade in India's economy it would mean that India would account about 3 % of world exports in 2025 and about 6% in 2050. So though the importance of India would increase, it would still only be the 12th largest trader in 2025 and the 6th largest trader in 2050.

This gives you some idea of India's magnitude of India's involvement in world trade. If you look at the structure of the composition of India's trade one finds that India's participation in world trade in agricultural goods and various raw materials, metals, ores is very limited.

Much of India's trade is in manufactures, the only exception being in energy. Up to now India imports a lot of oil. It is beginning to import coal and there are various plans to import gas. So much of the raw material, which India imports, is in the energy sector. And few countries in Asia are in a position to benefit from this.

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Now before I conclude there is one other thing I want to mention is foreign direct investment flows. Indian companies of the last couple of years have been investing abroad substantially. But the nature of this investment is again towards the developed countries as Indian large companies are trying to get access either to markets or to global brands or global technology. Very little of this foreign direct investment made by companies is going to developing countries. So in conclusion, I would say that India's growth will continue to be rapid. The importance of trade is also likely to increase, India's trade will continue to be mainly concentrated in manufactures it is diversified so it is not going to be geared toward any particular country, it will therefore be up to each individual country to find the niche in the market which then cater to India.

Thank you very much.

Slide 1

Sustainability of India's Growth Rate

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Slide 2

Outline

- We look at
- 1. India's Growth Performance
- 2. Past Interruptions of the growth process
- 3. Possibility of similar interruptions
- 4. Nature of India's Growth
- 5. Implications for Asia

India's Growth Performance

- India has grown rapidly over the past almost thirty years
- There has been a progressive acceleration of India's growth rate over this period
- This growth, particularly in recent years, has been driven more by the services sector than manufacturing.
- Agricultural Growth has lagged.

India and the World Economy

- Since 1991 earlier trend of decreasing importance of trade in India has been reversed.
- There is increasing importance of service exports as compared to exports of goods.
- Share of world goods exports had fallen from about 2% in the late 40s to about 0.4% in the late 70s, where it remained in the 80s.
- Since 1991 exports have increased to about 1% of world exports, and from 7% of GDP to 21%.

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- India's share of world exports of services was about 2.3% in 2005, higher than India's share in goods exports, having grown rapidly from 1990 when the share was 0.5%.
- Share of exports of services based on computers, telecommunications, etc. Is even higher being 3.6% in 2005 compared to 0.6% in 1990.
- As a share of GDP, exports of services increased from 1.5 % to 6.9% and of IT based services from 0.6% to 4.6%

Interruptions of Growth Process

- On a number of occasions growth has been interrupted in India
- Examples are 1957-58, 1965-67, 1973-74, 1980, 1991-92.
- In most cases the interruption occurred because of a BOP crisis. Exception was 1965-67, caused by poor harvests.
- The crisis was resolved usually by a mixture of adjustment and financing

The 1991 Crisis

- The crisis was caused by a higher price of oil aggravated by a drop in remittances.
- Now a substantial part of the debt in 1991 was commercial and short term rather than official and long term.
- Further commercial loans were not available and India might have had to default if stringent conditions had not been fulfilled to qualify for an IMF loan.

Adjustment to 1991 Crisis

- The response to the 1991 crisis was very different from responses to earlier crisis
- The previous crises had not resulted in a change in the basic policy framework of import substituting industrialisation
- Now India adopted more open policies and also relied more on market processes than licenses.

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- This change reflected partly the changed perception of policy makers based on research and, partly, the experience of other countries, particularly China.

Possibility of an interruption

- The possibility of interruption currently is slight
- The steep rise in oil price in the past year has had only a limited effect on the economy.
- Effect on domestic inflation limited, partly because the full rise not passed on to domestic consumers.
- So no need for very contractionary policies

Balance of Payments Crisis?

- The current account deficit has increased.
- But more than covered by capital inflows and reserves have risen rapidly.
- The share of short term debt is less than 10%.
- The debt GDP ratio has fallen from almost 30% to 15% and the ratio of debt service to exports has also fallen sharply.

Further Safeguards

- More of the capital inflows are FDI rather than debt creating loans.
- Dangers from portfolio flows limited by costs of exiting from stock market and of converting to foreign currency.
- Though a severe crisis would effect all aspects of the financial system, as yet in India the banking system is still somewhat insulated from the equity market.

Nature of India's Growth Process

- Effect on other economies depends on nature of growth process.
- Growth rates of services, manufacturing and agriculture are 8.2, 7 and 2.7 per cent.
- Based more on services. Share of manufacturing declined marginally from 17 to 16%. Share of services increased from 41 to 54%. But services are 54% of GDP in low income countries as a group.

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- Services are also becoming more important in trade. Their share in total exports has increased from 20 % to 37%.
- Imports of services have also grown relatively to goods imports.
- Service trade is more with developed countries than developing countries.

India and World Trade

- Currently India has about 2% of world income and 1 % of world exports
- Continuation of current growth trends would lead India to account for about 4-5% of world income in 2025 and 9-10% of world income in 2050.

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- If India's trade dependence rises further its share could be about 3% of world exports in 2025 and about 6% in 2050.
- It would then be 12th largest trader in 2025 and 6th in 2050.

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- India's participation in world trade in agricultural goods and metals and ores and various raw materials is very limited.
- Only oil and coal are important.
- Their importance as also of gas is going to increase. But few countries in Asia are in a position to benefit from this.

Conclusion

- India's Growth will continue to be rapid though it may not be at 8-9%.
- The importance of trade is also likely to increase, though again not as dramatically as China's
- India's trade will be mainly concentrated in manufactures except for energy imports.
- So primary exporters may benefit little.