



## Montek Singh Ahluwalia: 'Inclusive Growth Does Not Mean Everybody Has to Be Protected'

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*When India's economy opened up in the early 1990s, a small number of people served as the architects of the reforms that led the country to its present economic renaissance. Among them is Montek Singh Ahluwalia, deputy chairman of India's Planning Commission. He works closely with Prime Minister Manmohan Singh and finance minister P. Chidambaram to champion the reform process and ensure that it stays on track.*

*Ahluwalia, who was the first director of the Independent Evaluation Office of the International Monetary Fund, took on his present job in June 2004. Before the IMF, he was a member of India's Planning Commission as well as a member of the Economic Advisory Council to the Prime Minister. Ahluwalia has previously held other government positions including finance secretary, Ministry of Finance; secretary, Department of Economic Affairs; commerce*

*secretary; special secretary to the Prime Minister; and economic advisor, Ministry of Finance.*

*India Knowledge@Wharton spoke with Ahluwalia in his offices in New Delhi about where the Indian economy is going and what lessons other emerging economies could learn from India's experience with economic reform.*

**India Knowledge@Wharton:** Since 2004, India's Gross Domestic Product has grown at an average rate of 8.6%. Can this rate of growth be sustained, and if so, how?

**Ahluwalia:** I have no doubt that it can be sustained -- but when I say that, it does not mean it is going to happen even if we don't do anything. One thing that has happened over many years is that India has gone through a process of economic reform, and that reform has unleashed a lot of productive potential. Many of the macro fundamentals are consistent with a high -- and rising -- rate of growth, which has benefited from the opening up of the IT market and the inflow of international capital. What we have set ourselves as a target for the next five years is an average rate of 9%. Last year we were at 9.4% and there were concerns about overheating. The most recent projection from the Economic Advisory Council is that this year we would be at 9%. Even if it is a little bit lower, we are not concerned about that; no one is projecting growth of less than 8.5%.

In order to bring that to an average of 9% in the next five years, to my mind, essentially requires continuation of the macroeconomic and policy environment that we have had. In addition, it requires a major effort on infrastructure. That is the big constraint. We are also focusing a lot on agriculture, not because it is a very large part of the GDP, but because it is very crucial for India's growth to be inclusive. There is the whole issue of whether we are leaving our rural areas behind as the economy grows. Broadly, if we can take care of agriculture and infrastructure -- both of which are critical focus areas -- then an average growth rate of 9% won't be a problem.

**India Knowledge@Wharton:** It is widely accepted that there is stagnation in agriculture. What can be done to increase productivity?

**Ahluwalia:** We recently published a paper that is available on the Economic Advisory Council website

that lays out what our strategy is: Very broadly, our findings are that there is a large productivity gap even with our existing technology. When we say there is a productivity gap, what that means is that if we can get farmers to adopt better cultivation practices, more rational use of inputs and so on, we can get a yield increase. The name of the game, at least in the short- to medium-term, is to focus on that.

This is easier said than done, because there are issues of knowledge transmission as well as system performance. You can tell the farmers to move to an optimal way of seeding, but there must be trusted certified seeds available. In other words, many things have to be put together. Knowledge transmission is a critical issue. Farmers often are locked into pretty well tried and tested practices, but in the meanwhile, the structure of agriculture is changing and diversifying. If you want to bring in new crops or even introduce new varieties of a crop, you need knowledge transmission about what should be done to get the best yield from the new variety. There, the government has a big role to play. How should we put that together? Some of it involves money -- for better seeds, better seeding equipment and so on. Some of it just involves better use of existing resources. All of that is not uniform for the country because there are so many agro-climatic zones. We need to develop region-specific strategies that are agro-climatically tailored.

**India Knowledge@Wharton:** What are some of the principal barriers to inclusive growth?

**Ahluwalia:** Well, there are several. Obviously agriculture is very important because that is where a very large number of poor people earn their sustenance, so whatever is done to improve agricultural productivity gives them opportunities to increase their incomes. The other important aspect of inclusiveness is that when the growth process takes off, the dispersion of skills across the population [is not uniform]. That is why it is essential to revamp the educational system -- and doing that in a way that improves access is important.

In fact, in order to increase inclusiveness, in addition to agriculture and infrastructure, the two other critical areas we need to focus on are education and health care. As a result of liberalization, the government can get out of a lot of areas. The government need not do any of the things that are better done by a competitive market. In agriculture, for example, a competitive market is important but the role of the state is also very important in providing infrastructure, rural connectivity, rural electrification, investment in irrigation, watershed management and so on. All these areas require a lot of participatory work by the community. In infrastructure, too, the role of the state is crucial. Historically, even in the U.S., infrastructure has been developed by the public sector. We are trying to do it through public-private partnerships.

**India Knowledge@Wharton:** Have such partnerships proved to be effective?

**Ahluwalia:** We have evolved a policy framework in which it is possible for public-private partnerships to be undertaken in airports, airlines, roads, railways, ports, power, telecommunications and so on. In telecommunications we have seen outstanding success, however you look at it. Teledensity has increased very rapidly and exceeded targets; the service quality has gone up. There has also been considerable inclusiveness since farmers and other low-income groups now have access to mobile services. In addition, costs have come down; India's telecom costs are among the lowest in the world. In that area, too, we have seen outstanding success.

In other aspects of infrastructure, we have seen some progress, though probably not as much as it should be. Clearly, it is more than it used to be. In some areas -- such as power -- things have moved rather slowly. But in each of these cases, if you ask whether the public-private partnership [has worked], the answer is 'yes'. The question is whether progress has moved rapidly enough, the way it has happened in telecommunications, or whether it will take more time. That is not possible to say at the moment, because we have just started the process. The jury is still out on that.

Consider, for example, the airlines. Ten years ago, 100% of the domestic airline traffic in India was controlled by the public sector. Now the public sector's share is less than 40%. So that area has expanded hugely, and generally people are happy with quality. A lot of low-cost airlines have come up. Obviously, less than 5% of Indians travel by air -- at the most, it may be 10% -- so it does not exactly affect the common man as much. But it is a success. In airports, for example, four major airports are being constructed currently in the private sector, which should make a big difference in their modernization. In

railways, new private operators are coming up on the freight side. A lot of private sector roads are being built, and ports as well. All these are clear signs of success. Still, we cannot say about the other sectors what we say about telecommunications.

**India Knowledge@Wharton:** Are you concerned about inflation?

**Ahluwalia:** Inflation has been a subject of concern since last year. It went up more than 6%, but it has been coming down because corrective steps were taken in terms of monetary policy. Right now, inflation is only about 4%. It depends on what you regard as a comfortable target. In the Planning Commission, we have said that 4.5% is pretty good. Right now it is below that.

**India Knowledge@Wharton:** What is your view of the appreciation of the rupee and its impact on the economy?

**Ahluwalia:** The Reserve Bank and Finance ministry face a difficult set of choices. This is a balancing act that the Reserve Bank and the Finance Ministry have to perform. It is obviously a reflection of the familiar trilemma. You may want to have a stable currency, an independent monetary policy and capital account convertibility, but you can't have all three. You can only have two out of three things. So you have to give up one. Right now the capital account is not completely open, but it is reasonably open, and the positive feeling about the Indian economy is bringing in a lot of capital. The only way you can absorb this capital is to let the real exchange rate appreciate.

Many people feel that the appreciation has gone beyond what is reasonable and exporters are complaining. This illustrates why it is a difficult balancing act. But what can the Reserve Bank do? It can intervene to stabilize the nominal exchange rate, but that will generate excess liquidity. It can try to mop up the liquidity by sterilizing, but that will impact the interest rate. Whatever it does, there will be some problem. What the Economic Advisory Council has said is that it should operate on all fronts. It should do a little bit of each.

**India Knowledge@Wharton:** One way to assess the impact of capital inflows is to examine its effects on a single sector, such as retail. Global retailers such as Wal-Mart have been making efforts to enter India. What sort of opportunities and challenges does that create?

**Ahluwalia:** In my view, modernizing retail is very important. We are at the stage where some of the inefficiencies in the system -- because we don't have a modern retail sector -- are leading to higher prices and less choice for the consumer. They are also leading to lower prices for the farmer. So we do need modern retail -- and that is coming in.

There is some political risk in allowing FDI (foreign direct investment) in what are called hyper-markets or super-markets, but in these matters, you have to evolve a consensus. There is also some opposition to modern retail itself. We are addressing the issue by saying that we should not be against modern retail; but the government has not taken the decision to open up retail to FDI. FDI is allowed in certain segments of retail -- such as single-brand products -- and there have been some entries there. But a decision has not yet been made about mass modern retail.

It seems to me that the first debate or controversy is about modern retail. We first need to get over that, and then we can look at the question of FDI. The government has commissioned a research institute to do a study and look at all these issues. We hope that will contribute to the public debate.

**India Knowledge@Wharton:** You were one of the principal architects of India's economic reforms. With 20-20 hindsight, is there anything you would have done differently? What can other emerging economies learn from India's experience with economic reforms?

**Ahluwalia:** I would not call myself one of the principal architects. Being involved in this process has been a privilege and tremendous fun.

What have we learned? The first lesson is that, even in a democracy, it is possible to change things in a way that can have major effects. The only problem is that in a democracy, change is slow -- and so it takes time for the impact to be felt. The growth rates we are seeing now of 8.6% and 9% are the result of reforms undertaken almost 16 or 17 years ago. Personally, I wish we could have done it faster. But on

the other hand, in the democratic political process you need to carry the system with you. The question is whether the kind of gradualism that we have seen in India is consistent with an economic takeoff. The answer is very clear: It may have taken a little longer, but it has taken place. That is an extremely important lesson.

The second lesson is that we sometimes underestimate the extent to which our system can adjust to change. When you are making changes, it is easy to say, 'Don't change this, because X or Y is going to get hurt.' That is true of any system. But if the system moves to a higher growth path, many of the people whose lives are disrupted will get absorbed and eventually benefit because of that growth.

The problem, really, is that this does not apply to everyone; there will be some disruption where people will not get absorbed. In a modern society, we need to take care of such people by having a base of social security. We don't have that in India, and a lot of the nervousness about change comes from that fact. We can't tell people, 'You can't make an omelet without breaking eggs' if they are among the eggs that will be broken. On the other hand, if you tell people that the economy is about to move to a higher growth path, and that will create opportunities for them, and you further combine that with some form of social security that can help them adjust to the change, you will be able to carry them with you.

How to combine those two elements is a big challenge. We are beginning to focus on how to deal with it. Inclusive growth does not mean everybody has to be protected all the time; it means that people recognize that if they lose out, they will be treated in a fair way. This is possible if you have a level of social security that protects people from extreme outcomes.

For example, we were speaking about retail. It is clear that compared to a stagnant economy or one that is growing at 3.5% or 4%, retail will grow much faster in an economy where growth is 8.5% or 9%. When retail is growing rapidly, the total space that retail occupies in the economy will expand -- and modern retail will occupy much of that expanded space. Most of the existing and traditional retail will therefore remain, and some of it will actually convert itself into modern retail. But we can't give that guarantee to every single shopkeeper. It is up to the political leadership, the intellectuals, and the actors themselves to realize that. People now recognize that the kind of personalized service that a small retailer gives is not possible for a mega retailer. If you go around the city, you will find that the small shopkeepers are modernizing, but for them to be able to do that, they must get bank loans. Banks are often willing to lend for so-called productive activities, but retail is not regarded as 'productive.' That is completely unjustified. We have to look at the package as a whole.