

IN CONVERSATION WITH DR RAJAT KATHURIA

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EB: Between 2000 and 2012, the emerging economies grew by almost 6% a year on an average. But since then growth has fallen by almost 3%. Do you think it is just a slight bump in the road or have the emerging markets had their run?

I think that the two major impediments to rapid growth in emerging markets have been the financial crisis of 2008, followed by the Euro crisis a couple of years later. There is a view amongst scholars that there is now what is referred to as the 'new normal', characterized by lower global growth.

Historically, we know that economic growth is associated by a marked shift away from agriculture to manufacturing sector and then to services, the latter becoming the dominant sector. All Western mature economies today reflect this pattern. Eventually, however, growth tapers off, because growth simply based on accumulation of inputs is subject to diminishing returns. The only way countries can sustainably grow is through productivity shocks and innovation. This fact does not apply to emerging markets yet as it does to mature markets because emerging markets can grow rapidly as China has, merely by accumulation of inputs.

Even so, China has been an outlier in the entire growth process because no country in history has ever grown at such high rates for such a long period. But even China has witnessed slowdown compared to the heady days of 10% growth. The global growth engine therefore points to a new normal since it is in the nature of things that growth will eventually come down because productivity shocks or productivity changes happen once in a generation. The last productivity shock was the dot com/IT boom. Now we are waiting for the next productivity shock for the world, which may come from robotics. But as far as emerging markets are concerned, they will continue to grow, if not as fast as the previous decade. One does not expect the likes of Europe or United States or even China to grow at 10%. Other emerging markets like India and Brazil that achieved high growth rates in the past will also not be able to sustain such rates in future.

Recall that India had grown at around 9% per annum for 5 years between 2004 and 2008, but our growth rate now is down to almost half of that. Other countries like Vietnam and Cambodia along with African nations are growing fast, but eventually there too there will be a decline. For India, the sharp deceleration is in part self-inflicted. Major but difficult policy reform can take us back to 8% growth rates. We plucked most of the low hanging fruit after 1991. To get our economy back on track, we need structural reform. There is not one thing in isolation that India needs to do but a host of measures are needed. These are fiscal consolidation, institutional and governance reform, improved enforcement and better and faster grievance redressal mechanisms, structural changes, etc. For example, in the course of execution of long term contracts between public and private parties in infrastructure, there are several disputes that will inevitably arise. Our malaise is that we suffer from a non-transparent and painstakingly sluggish dispute resolution process. In a market economy, you get credible commitment and conformity (to rules) when you have credible enforcement. India's policy is less of a problem, it is implementation that is worse.

We also need to create much better infrastructure, which unfortunately costs a lot of money. The 12th plan predicts a trillion dollars are required over five years for infrastructure projects. Fiscally strapped governments like ours do not have the luxury to spend such amounts when the fiscal condition is weak. Therefore, we need the private sector to step in, which they will for the profit motive. But private sector involvement means disputes. So one part of the story is better governance, better institutions, and better dispute resolution. The other part of the narrative is improved, transparent and efficient coordination among various government agencies. For example, every major country today has an integrated ministry of transportation. It means that policies regarding roads, railways, ports, civil aviation and urban transport are not made in silos but are coordinated to reflect the interdependent character of multimodal transport. Our policies, on the other hand, are made in silos with separate ministries for civil aviation, roads, and railways, who interact with each other once in a blue moon.

Besides infrastructure, we have a plethora of other problems like power, water, taxation, etc. Many argue that India is not one market but a group of 28 disparate markets. It is like Europe, but with exacting transaction rules among states. To break down these barriers would require a lot of deft political manoeuvring, which is politically demanding. Thus, the economics we learn in textbooks often seems impractical in the real world dominated by political interest.

EB: Economists believe that the tapering of quantitative easing by the Federal Reserve now will not be as disruptive as last year. What is your view?

Yes I believe that is correct. Back in May, the Fed's attempt to talk the markets to build in the inevitability of tapering triggered a dramatic, negative reaction to the rupee and other emerging market currencies. In response, RBI and other central bankers requested the US take care of the way the tapering of QE is announced. The announcement in May was unexpected but now markets have come to expect that tapering is inevitable and will be initiated.

Since then we have initiated measures to try and moderate the impact of tapering when it does occur. In India, the benefit of low interest rates elsewhere in the world has been dulled by stubborn inflation, high current account and fiscal deficits. Unless and until Indian corporate earnings rebound, the rupee and stock market will come under renewed downward pressure. QE for India has meant portfolio inflows into our capital markets; sharp withdrawals can potentially cause disruptions. Thus, to brace ourselves we need to strengthen our banking system and use domestic savings for domestic investments. We are also liberalizing FDI norms so that foreign investment comes for the long term and is not subject to short term reversals of capital. If we increase our FDI, we can do with lesser FII flows, which is why most economists press for FDI reforms and deregulations. Another way to reduce our current account deficit is to increase exports. If US economy recovers, then we will be able to do that. But eventually we need to desperately improve the competitiveness of the domestic economy. Curbing imports such as gold through higher tariffs are short term measures and will have to be reversed later. Increasing exports through structural reform has to be the sustainable way to improve our external position.

EB: In view of China having revoked its one child policy, its labour force will no longer fall into a 'precipitous decline' as suggested by the International Monetary Fund. What do you think would be the impact of this change in policy?

I think that China's one child policy was a bit extreme to begin with and could be successfully done in a regime that is not democratic. India also needs to restrain population growth, and we have adopted liberal and non intrusive methods like education, awareness about family planning measures, particularly in rural areas. Research shows that education has a strong causal link with lower birth rates.

Coming back to China, there are large interior parts that are relatively underdeveloped. By investing in these areas, China can yet achieve high growth rates. Revoking the policy now means that it will be almost a generation before China's new population enters the labour force. According to the ILO's definition, the productive age of an individual is between 15-64 years, but you don't actually start working before 21 or so.

The other issue that the world is contending with now is "Green Growth". Climate change is a grave concern and it will be unrealistic to assume that China will replicate its high growth in the future. In Beijing, due to smog and high pollution levels, people have to wear masks when they go out. Hence, growth will come at a cost. Green activists claim that it is possible to attain high growth rates that are environment friendly. Others believe that growth will inevitably come at the cost of the environment. At current levels of technology, especially for emerging markets, if

you impose high standards on environment and emissions, the trade off is real. So one has to make choices and sacrifices. These sacrifices, in terms of growth, can, however, be limited by smart policies.

Countries like Japan and Korea are grappling with problems of an ageing population such as pension and healthcare. If the ratio between those working and not working is lopsided, it is a major problem. The government has to take care of this inter-generation transfer through tax policy. USA never had a one child policy but its birth rates declined.

The cost of having a child in Japan and Korea is prohibitively high and so people do not want to have kids. The old family network of grandparents bringing up kids is no longer possible. In countries like Russia, the Government provides incentives to have children (like free education) and yet they have negative birth rates. Emigration is an option in such cases. In Europe, most blue collar jobs are performed by emigrants, as locals aspire for high value-added jobs. Hence, revoking the one-child policy and ensuring high birth rates is not the same thing. Initially, people may have more children due to their new-found freedom, but birth rates may taper off in the long run.

EB: There are a large number of criticisms levied on the ASEAN-India free trade agreement. Do you think that India has more to lose than gain from this agreement in view of the limited market access of India in ASEAN countries that are predominantly export driven?

The agreement will undoubtedly give us more market access, at least on paper. The criticism is that we are not as competitive as they are. Those countries are export-driven and they will benefit more than us. The audit of our free trade agreements (FTAs) with Korea and Japan suggests that our bilateral deficit has actually increased after the agreement, which implies that they are exporting more to us than we are to them. Does this mean that it has not been a success? I think this is a narrow way of looking at it. All countries cannot run surpluses simultaneously. If one country has a current account surplus, there has to be a corresponding country with a current account deficit. In a lighter vein, all countries on earth can have current account surplus only if they trade with the moon! Politically, though, everyone is passionate about running a surplus, even though it is unrealistic.

At a broad level, the experience with Korea and Japan is similar to that with ASEAN: we run a trade deficit in all 3 FTAs. A comprehensive agreement like the one we have with Singapore that includes services and investment will allow us to leverage some of the benefits of such agreements.

One inference from the experience of India's economic partnerships is that we need to become much more competitive. We have a comparative advantage in the services sector, while ASEAN countries advantage is in manufacturing. Service market access is much more difficult than the market access for goods, because at one level, it includes trade in labour. Services trade is going to dominate in the future. And we should not shut ourselves out of the agreement just because we are running a trade deficit with ASEAN. The agreement will force our industries to face greater competition and thereby help apply pressure to improve. Take the example of our automobile industry, which has become quite competitive. We imported parts and components, and eventually, our domestic component industry also benefitted. If you can buy cheaper

imports and thereby become more competitive in the global market, it is good. We can calibrate the opening of our market not as an end in itself but as a means to an end.

For example, a policy that needs serious review is the 'inverted' duty structure in certain sectors. If one has zero or low duty on imports of finished goods (like TV sets), but components like picture tubes attract heavy duty, then we are disincentivising local manufacturing. This is an example of bad policy and we, as a research organization, are trying to provide evidence in favour of rationalizing such inverted structures. If we want the local manufacturing industry to grow, we have to allow them to import efficiently, so that, it helps domestic manufacturing.

EB: Do you think that the finance ministry will stick to its fiscal deficit target of 4.8% and the current account deficit will be contained at USD 70 billion, especially since the elections are around the corner?

All the more reason that they will try to achieve it. Mr. Chidambaram said recently that it shall be 50 billion not 70 billion. The larger question is whether these claims are going to translate into reality or whether they are populist. In the run up to an election, it's all the more imperative for the incumbent government to be able to deliver on their promises. I think that Mr. Chidambaram has a good track record and he will keep his word. He usually does not say things that he will not deliver.

The CAD target is easier to achieve given what has happened: gold imports have been restricted, exports are increasing, and hence the CAD is likely to be maintained within the target. It is more difficult to rein in the fiscal deficit, especially given that there has been a downgrading of GDP growth. But certain things like the telecom auction planned for February, where they are expecting revenue of rupees 40,000 crores, might enable them to. But I think that even if it's not 4.8%, it won't go terribly out of hand.

EB: What are your views about the efforts of the government to promote digital literacy in the country, such as the launch of the Akash tablet and the National Digital Literacy Mission? Do you find them commensurate with the existing challenges?

With 900 million mobile phones, a plethora of applications, increasing use of IT in public service delivery, and Aadhaar cards being given and matched with bank accounts, I think digital literacy is now extremely essential. I feel we are well aware of the need, including for the less advantaged rural areas. Several experiments in which NGOs provided computers in slums, where no child had seen a computer before, show astounding results. So, digital literacy will inevitably cover everyone in the next generation. The challenge is the present. Sam Pitroda's mission of linking 256,000 gram panchayats with a national optical fiber network of minimum 2mbps speed connectivity is a start. You then have Aadhaar cards, then banking access, and so you can build one layer upon another. Infrastructure is however a necessary condition; digital literacy, applications, consumer awareness are all parts of the eco system that need to occur simultaneously for maximizing impact.

EB: What are your views about the upcoming “app” economy in the context of India?

I’m very optimistic about the ‘app’ economy in India. We’re doing a study in fact, in ICRIER, on the app economy. In a country of 1.25 billion people, I think, it is natural that it will have a significant impact. If you ask me this question two months later, I will give you evidence based quantitative response. There are apps for mobile devices, iPads, smart phones etc. Development of apps gives rise to an entrepreneurial activity and of course the spirit that is crucial in a country like ours where 50 percent of the population is less than 25 years of age. Apps create employment opportunities, enable better information flows, reduce information asymmetries and slash transaction costs. But I don’t have a number right now to back this claim.

EB: What are your views on the bitcoin, which is being propagated as the new global digital currency? Do you think it is feasible or is it just a short-lived craze?

I think it’s a short lived craze. Currencies work with confidence and trust. You destroy trust and confidence and the currency will be ruined. Despite decline in the US, the dollar remained the premier currency because people have confidence in the dollar. What is it in the dollar? What is it in gold? It’s trust. Otherwise it’s a worthless piece of paper or metal. The point is that the ultimate test of a currency lies in the confidence or trust that people have. And why do they have it? Ultimately, it’s because the government of the day backs it. The Indian rupee today is more credible than it was in the 60s and 70s, so people are putting their money behind the rupee (metaphorically). Bitcoins don’t inspire the same confidence.

Another reason a currency retains value is because you restrict supply. You don’t just print indiscriminately. If you do, then it will become worthless. That aspect has been ensured since the supply of bitcoins has been capped. But its greatest weakness is that it’s not backed by any government i.e. the legal status of bitcoin is unclear, as is evident from the fact that recently big governments have started to warn people against its use or any other digital currency. Money is an integral part of how a society operates and a stable monetary system is one of the pillars of functioning of a stable society. In a limited sense, bitcoins have worked but you’ll be foolish to put your money in it. It’s never going to be a substitute for currency.

The financial crisis has also made banks much more careful about money laundering. Anti-money laundering rules may be one reason behind the success of the bitcoin. And it could still be successful for a short period. But for the long term, I wouldn’t bet on it.

EB: What would be your advice to prospective economists and young students like the readers of Aapoorti?

You’re studying a popular, great and extremely interesting subject. My advice would be to supplement textbook reading and classroom learning with a lot of other reading, besides the recommended ones. Read current affairs, and try and get to know the world around you. These are very interesting times for our subject. But textbook economics and economics of the real world are quite different. While there is no substitute for theory, look for ways to apply what you’re learning to the real world. Talk to as many people as you can outside the classroom. And if you combine economics with other related fields like political science and law, the enjoyment and value will only multiply.