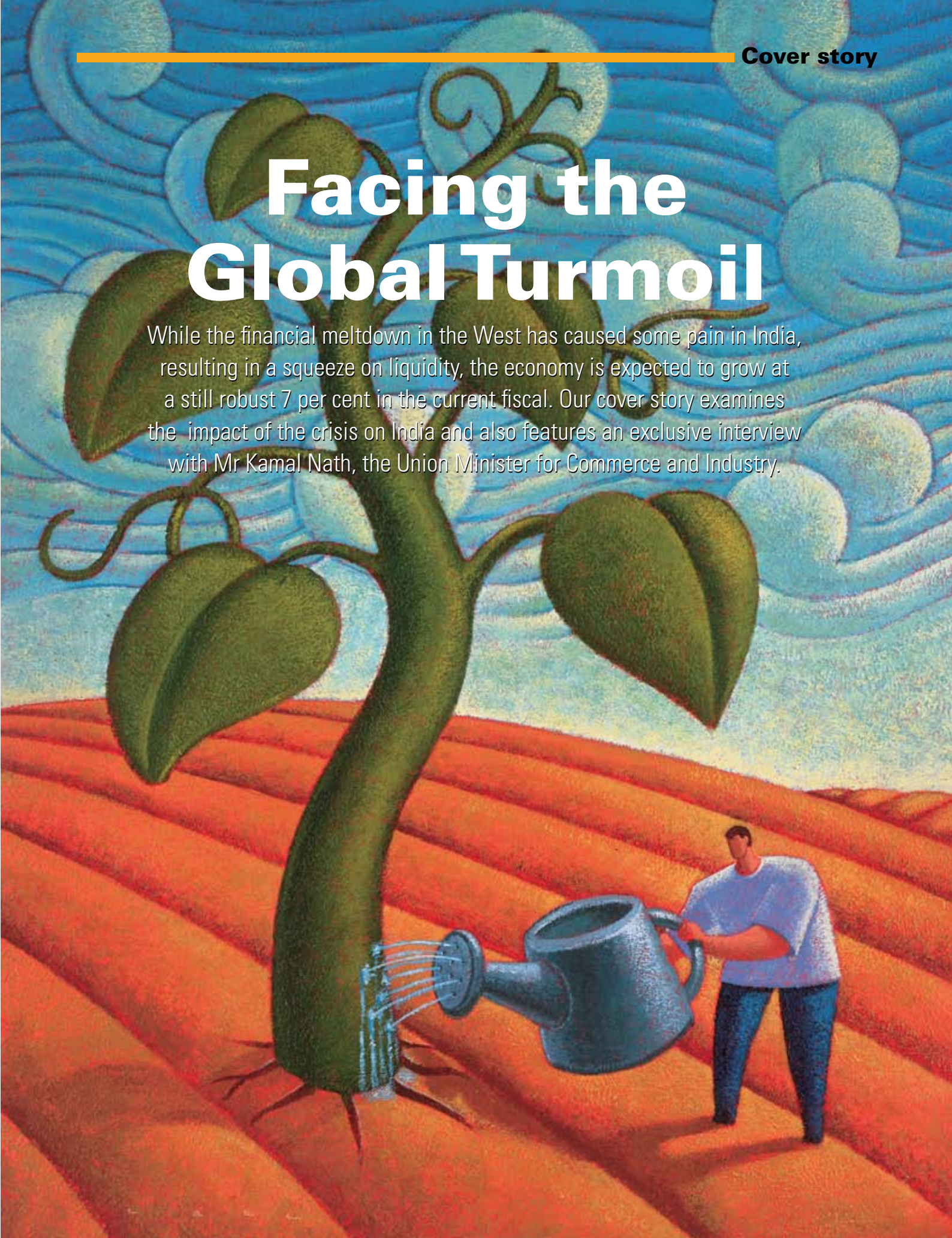


# Facing the Global Turmoil

While the financial meltdown in the West has caused some pain in India, resulting in a squeeze on liquidity, the economy is expected to grow at a still robust 7 per cent in the current fiscal. Our cover story examines the impact of the crisis on India and also features an exclusive interview with Mr Kamal Nath, the Union Minister for Commerce and Industry.



The global financial crisis, which started unravelling in the US in August 2007, following the sub-prime mortgage fiasco, has gradually entangled all the leading economies of the world.

India, which along with China has been witnessing an inspiring growth rate (projections for India range from

7.5 per cent to 8 per cent in the current fiscal ending March 31, 2009), has gradually started feeling the pinch, especially in terms of liquidity. However, prompt action by the government and the Reserve Bank of India (RBI), the country's central bank, helped ease the problem.

The Indian capital markets also

reacted to the global meltdown, as overseas investors off-loaded a large part of their portfolio, to help them meet their commitments in their home countries. The stock indices tumbled in October, but towards the end of the month investors looking for bargains intervened, propping up the market.

The measured reaction of the

## EXCLUSIVE INTERVIEW:

### Mr Kamal Nath, the Union Minister for Commerce and Industry

#### "India has followed a calibered liberalisation and reforms process and this is being held forth"

India's articulate and affable Union Minister for Commerce and Industry, Kamal Nath, is a bundle of energy, who is equally at ease addressing constituents

at Chhindwara, his parliamentary constituency in Madhya Pradesh, attending a breakfast meeting with counterparts from around the globe in Geneva, or engaging in

tough trade talks involving mind-boggling minutiae and technical details in some distant international capital.

The minister's aides speak in awe of his ability to pack multiple tasks and assignments in a 24-hour span, his phenomenal grasp of complex issues, his negotiating skills and the capability to put in long hours of work daily. He can hold forth on India's positions in trade talks, reel out figures relating to exports and imports, foreign direct investment (FDI), special economic zones (SEZs), travel thousands of kilometres across continents (making-do with just a couple of hours of sleep) and then address a gathering full of dignitaries or an international news conference.

How does he manage all these tasks and yet appear refreshing at the end of a busy working day? "For me, the satisfaction lies in fulfillment of a goal, of achieving the given objective," the minister told *India Now*, in an exclusive interview at his Udyog Bhavan office in New Delhi. "When you pursue a goal and are keen to fulfill your commitments, you get the necessary energy to carry out the tasks," says the minister.

#### *Excerpts from the interview with Minister Kamal Nath:*

**Would you agree that one of the positive spin-offs of the current global financial turmoil is the realisation in the global community about the urgency to speed up the process for concluding the Doha round of trade talks?**

Economies are not necessarily inter-dependent, but they are inter-connected.



government also helped stabilise sentiments in the markets. Prime Minister Manmohan Singh held meetings with heads of banks and economic planners. An apex group has also been set up under his chairmanship to coordinate the government's response to industry's concerns about the crisis. The group includes Union Finance Minister,

P. Chidambaram; Union Commerce and Industry Minister, Kamal Nath; deputy chairman of the Planning Commission, Montek Singh Ahluwalia; and RBI governor, D. Subbarao. A committee chaired by the finance secretary is also meeting daily to tackle concerns.

Dr Singh made a suo motu statement in the Indian Parliament on the

impact of the global financial crisis. "The financial crisis and the economic slowdown in the developed countries are likely to have an indirect impact on the Indian economy," he declared. "Fortunately, the effect will be on an underlying strong performance."

He also assured the nation that the government was taking all steps to

With inter-connected economies and financial markets, it does lead to the necessity of reflecting on internal strategies. So this provides an opportunity for looking at new markets, greater efficiencies and for greater productivity, because trade becomes more competitive.

This drives greater global competitiveness also. In India, we will have to work on that, we will have to fall in line with the need for global competitiveness. And I see that happening in India and China, as well as in other emerging economies.

The United States, of course, has a problem of its own. Its financial system is in a different orbit to its economy. Much of its financial system is built on valuations. Valuations create paper and paper creates liquidity – where there is no valuation, there is no paper and no liquidity. There had to be a correction, whether by design or default. Unfortunately, this has happened by default.

The US will first have to resolve issues relating to its financial system. And in doing so, it will have to ensure that its financial system is more in line with its economy, rather than being in an orbit of its own.

### **Will this crisis have an impact on protectionism, especially in the agriculture sector?**

The US has always been protectionist so far as agriculture is concerned. If it is not in terms of duty, then it is in terms of non-tariff barriers and approvals. The US now has to transform itself from a consuming economy to a producing economy, from low-productivity to high-productivity and from a high-cost economy to a not-high-cost economy. Take the case of cars. You had cars only made in Detroit, which was the epicentre of automobile production. Now cars are made in other parts of the world. They will have

**Investment goes where there is merit. India's credibility as a country of investment merit is very high**

to strategise in all areas in a completely different way.

### **In hindsight, do you think India's conservative approach in financial matters helped it insulate itself from the crisis?**

India has followed a calibrated liberalisation and reforms process and this is being held forth. Whether we call it conservative or India-specific, because of the complexities in India and the infancy of its manufacturing sector, we had to obviously follow a very calibrated process.

In financial services, we followed a regulatory process, which was not conservative, but cautious. A cautious approach is not necessarily a conservative approach. And that has helped us. Our compliance with the Basel norms (on banking supervision) are much better than elsewhere.

We are not part of the global financial turmoil. For us, the problem just now is of liquidity; to some extent it happened because of inflation, which saw us cutting down money supply. But then we got double-barrelled; the other barrel came by virtue of the global crisis.

Our issue is a liquidity crisis, an internal

situation. Obviously in a global recession, we do see there has to be an impact in terms of purchasing power, in terms of availability for investment, foreign investment in India. FDI will be affected, as there is no liquidity. Until the liquidity issue is sorted out in Europe, the US and the Western world, we may run into a problem there.

Foreign institutional investor (FII) outflows have only established that the Indian stock market is safe, sound, healthy and profitable. That the easily encashable securities they had were in Indian stock markets. But this has happened at a cost to us, vis-à-vis the serious dollar outflow.

But I expect that in the end the European and American economies have to revive. So I do not see this as a long-term setback.

### **Do you see India continuing to attract foreign investment, especially in the infrastructure sector?**

Our reforms process and liberalisation are adequate to attract FDI. India will remain a very attractive investment destination because of its growing consumer market and because of our domestic driven growth. Investment ultimately goes where there is merit. India's credibility as a country of investment merit is very high.

### **How do you view the growth prospects for India in view of the global crisis?**

India is expected to register a GDP growth of between 7 per cent and 8 per cent this year. Economic growth over the next two years could be in the range of 8 to 9 per cent. India's economy is mainly driven by the high domestic savings rate (35 per cent, which is the highest in the world) and investment. *(continued...)*

## SECURING INDIA'S FUTURE GROWTH



While many developed countries are undergoing economic stagnation or are on the verge of getting into a recession mode India is one of the few large economies that is continuing to maintain pace.

Gross domestic product (GDP) is projected to grow by between 7.5 per cent and 8 per cent in the fiscal ending March 31, 2009. While many leading international financial institutions have had to book huge losses because of their exposure to the sub-prime mortgage crisis Indian banks and financial institutions have remained insulated from the crisis.

But the resilience of the Indian economy will continue to be tested by the looming global and domestic challenges. Over 600 government, business and civil society leaders from India and abroad are meeting in New Delhi between November 16 and 18 to discuss these emerging issues at the 24th edition of the India Economic Summit, organised jointly by the Confederation of Indian Industry (CII) and the World Economic Forum.

'Securing India's Future Growth' is the theme of the economic summit, which is being organised under four thematic pillars: global shifts, managing risks, inclusive growth and future competitiveness.

In addition, the growing middle-class income can sustain the market and achieve higher economic growth despite the global crisis. The regulatory framework in India is also much more effective, which has ensured far less impact of the crisis on the Indian economy.

**The principal theme of the India Economic Summit 2008 is 'Securing India's Future Growth'. Your views on how this can be done.**

India's economic growth will definitely be influenced by the global shifts being witnessed. The emergence of India and China has opened up new opportunities in the world. But sustained high economic growth that does not ensure benefits and opportunities to different regions of the country and sections of society cannot bring social stability. Inclusive growth is the key theme in the Eleventh Five Year Plan.

The global financial turmoil has brought out clearly the importance of risk management to ensure sustained economic

growth in the midst of global economic turmoil. Therefore, effective risk management is extremely important for securing India's future growth.

Economic growth must ensure better standards of living for the masses in the form of healthcare, sanitation, literacy and employment opportunities.

India must maintain its competitive edge in the global market to sustain future growth. This requires continuous development of entrepreneurship, innovation, induction of new technology, enhancing productivity, robust infrastructure and acquiring new skills.

**Will a slowdown in growth accelerate the pace of economic reforms, both in India and other parts of the world?**

Economic reforms are a continuous process. The global economic slowdown has thrown up new challenges both for India and other countries. Hence new economic reform measures would be required to address the emerging issues.

Economic growth must ensure better standards of living for the masses in the form of healthcare, sanitation, literacy and employment opportunities.



## FDI INFLOWS ARE LONG TERM IN NATURE

Foreign direct investment (FDI) inflows, unlike investments by foreign institutional investors (FIIs), are long term in nature. Firms that bring in FDI do not panic at the slightest whiff of an economic slowdown or on fears of the dreaded R-word (recession).

Consequently, the global financial turmoil triggered off by the sub-prime mortgage crisis in the US has not derailed FDI investments in India, which have been on an upswing: FDI rose from US\$4.32 billion in 2003-04 to US\$29.9 billion in financial year 2007-08.

In the current fiscal, which ends on March 31, 2009, FDI shot up by 137 per cent during the April-September period, amounting to US\$17.21 billion. September alone saw inflows of US\$2.56 billion, a massive 259 per cent increase over the same month in 2007.

The Indian government expects a record inflow of US\$35 billion of FDI in the current fiscal. Union Minister of Commerce and Industry, Kamal Nath says: "As per the Grant Thornton IBR emerging market index, UNCTAD's World Investment Report 2008 and other international agencies, India continues to be one of the most attractive

destinations for foreign investment and is expected to remain so in the next three years."

The manufacturing sector received increased FDI inflows in the last two years, but its share is less than that for services. The capital goods sector, with a growth of 16.9 per cent in 2007-08, is one of the sectors (in manufacturing) where FDI is likely to increase, says the minister.

"Software, telecommunications, automobile, autocomponents and textiles have emerged as the most dynamic and vibrant

industries in India, which are competing in the global market and are potential investment areas for foreign investment," he explains. "FDI inflows into the infrastructure sector are expected to grow, since this sector requires huge capital infusion in the next four to five years."

Subir Gokarn, Delhi-based chief economist, Asia-Pacific, Standard & Poor's, points out that the 259 per cent growth in FDI inflows in September indicates that global investors have confidence in India's medium-term prospects. The fact that investors who entered projects with a two to three year horizon still retain their expectations is a very positive sign, he adds.



minimise the impact of the crisis on the Indian economy. "Our effort will be to minimise the negative effect of the financial crisis and, once the global situation stabilises, to return to the growth trajectory of 9 per cent," he said.

The Prime Minister also assured depositors that "Our banks, both in the public and private sectors, are financially sound, well capitalised and well regulated. There should be no fear of a failure of any bank. In particular, I wish to assure depositors in our banks that their deposits are entirely safe."

Montek Singh Ahluwalia, the deputy chairman of the Planning Commission, noted that "The government has taken a series of steps to improve liquidity in the market." These include cuts in the repo and the cash reserve ratio (CRR).

The RBI reduced interest rates over the last two months to ensure adequate liquidity for industry and trade. The bank cut the CRR, reduced the repo

(the key short-term lending rate) and even liberalised the external commercial borrowing (ECB) norms, allowing corporates to borrow up to US\$500 million a year for rupee expenditure and/or foreign currency expenditure for permissible end-uses under the automatic route.

By November, the CRR was brought down to 5.5 per cent and the repo rate to 7.5 per cent, from peaks of 9 per cent in July. These moves, and the assurances of government leaders, had the desired effect as the liquidity crunch eased.

Fortunately for India, the regulatory framework has been strong and financial sector players have adhered to the norms laid down by authorities. Consequently, the government has not had to bail out any banks or other players, nor has there been the kind of crisis witnessed in the developed world.

The proactive stance of the government has won applause from inter-

## DOHA ROUND: 'The outcome has to be development oriented and balanced'

India's Union Minister for Commerce and Industry, Kamal Nath, has been one of the most prominent figures in the ministerial-level engagements that seek to conclude the Doha Round of trade talks. The minister's views on the impact of the financial crisis on the global trade talks:

The global financial crisis and the food shortages underline the need for transparent, multilateral trade rules more than ever before. The food crisis more forcefully drives home the point that developing countries need to build up their agricultural sectors.

But farmers in developing countries would have the incentive to invest more in agriculture only if developed countries stop flooding world markets with exports of their surplus agricultural production.

It is now a well-documented fact that the generous subsidies provided for more than half-a-century by developed countries in the West to their farmers have distorted global production and trade. These subsidies have encouraged over-production, which is then sold in international markets, thereby depressing global food prices.

This acts as a disincentive to poor farmers in developing countries, leading in the long run to shortages in agricultural production in these countries.

In recent years, the increasing diversion of food crops into ethanol production with the help of substantial subsidies has further exacerbated the problem. Huge subsidies are being handed out to encourage production of bio-fuels by converting food products into energy products. Here again, the Doha Round would play an important role by capping product-specific support.

The financial crisis and widespread economic insecurity has fuelled calls for greater protectionism from some quarters. This undeniably makes it harder to convince people of the need for greater trade liberalisation as the

Director General of the World Trade Organisation (WTO) acknowledged in his speeches at Stanford University and at the University of California, Berkeley, on October 27 and 29, 2008.

But it is precisely at such times that we need greater transparency and predictability of trade regimes, which is what the successive rounds of trade talks are trying to ensure. Moreover,



this round has development concerns at its core.

Once the modalities in agriculture and non-agricultural market access (NAMA) are concluded to our satisfaction and the concerns of developing countries are met in these and other areas of the 'single undertaking', we will have in place agreements that will substantially cut trade-distorting farm support and tariffs in developed countries.

Developing countries will benefit through increased market access for their exports to developed countries, while being able to shield their sensitive lines from full tariff cuts, as well as cut tariffs over longer implementation periods. In services negotiations, we hope to negotiate terms for easier movement of our people.

The sooner we can settle all these issues, the better. But the outcome has to be development oriented and balanced. This cannot be sacrificed, whatever may

be the imperative for a quick conclusion. While the ministerial-level engagement in July did not culminate in a finalisation of modalities for agriculture and NAMA as intended, substantial progress was made. Even after the talks were called off, several members spoke of the importance of resuming quickly, so as to build on the progress already made.

A multilateral trading regime based on fair and transparent rules serves the needs of developing countries best and that is why we support a quick resumption of discussions. However, it is difficult to set a date for the conclusion of the round.

Contrary to general impression, we did not reach a final decision on any issue in July 2008. We only had the makings of a broad consensus on some elements of the modalities concerning agriculture and NAMA. But these are not the only areas covered in the Doha Round.

Multilateral negotiations in this round also cover services, rules (including fisheries subsidies and anti-dumping), Trade Related Intellectual Property Rights (TRIPS) and its relationship with the Convention on Bio-Diversity, trade in environmental goods and services, and several other areas that are part of the 'single undertaking'.

The round can only be completed when WTO members agree on the modalities for agriculture and NAMA and complete negotiations in all the areas covered under the Doha Work Programme. Progress in the talks also requires a greater willingness on the part of developed country members to appreciate the concerns of the developing country members of the WTO. We have always said that artificial and unrealistic deadlines would be counter productive given the scope and complexity of the negotiations. Moreover, at the WTO, decisions on any issue are taken on the basis of consensus. With a membership of 153, this is bound to take time.



**TUMBLING INDICES:** The US financial system, built on valuations, is in an altogether different orbit

national ratings agencies. Standard & Poor's, for instance, reaffirmed the investment grade rating (BBB-) for India in October. India's growth prospects would remain strong because of the buoyancy in its investment climate and good government debt market, despite the global financial meltdown, the agency noted.

"Given the buoyant private and public investments with some progress in economic reforms, India's business environment is likely to improve in the years ahead, notwithstanding the current dislocations in global credit markets," said the international rating agency.

The investment grade rating for India reflected its "strong economic growth prospects and its deep government debt bond, which helps accommodate its weak fiscal position."

US-based investment bank Goldman Sachs notes that the monsoons, critical

for agriculture, rural incomes and consumption demand, have been good. Falling global commodity prices will also help improve the terms of trade for India.

Goldman Sachs has scaled down its growth forecast for India, from 7.8 per cent to 7.5 per cent for the current fiscal. "The global financial crisis and the reduction in growth estimates by our economists for most countries should have an impact on India's growth rates. Therefore, we are reducing our estimates of external demand growth and investment growth by a notch," said the investment bank.

Another factor that will help India withstand the global financial turmoil is the continuing investments in the infrastructure sector. International investors who have taken an exposure to major projects continue to reaffirm their commitment and have not backed out because of the crisis.

India's economy has done well for much of the current fiscal. An excellent monsoon has led to increased demand for a range of consumer products and services in rural areas. One of the major concerns for the government, however, was inflation.

But thanks to the sharp fall in the international price of oil, inflationary pressures have also eased in recent weeks.

While GDP growth will slow down in fiscal 2008-09 and 2009-10, the long-term prospects for the economy are bright. Domestic demand in most sectors is more than adequate and international investors are confident about ploughing funds into projects and industries that have a long-term perspective.

The global financial crisis may have set back the growth clock by a notch or two, but the medium- and long-term prospects for India remain positive. 