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P R O C E E D I N G S

MR. PRASAD: Good afternoon. Thank you for joining us this afternoon for this event on India. India, of course, remains an enigma for those of us who go there often and you talk to policymakers, you wonder how their economy grows. And then you talk to the entrepreneurs. You talk to many of the bright minds there and then you wonder why this economy isn't growing faster.

In fact, when I started teaching at Cornell about five years ago, I started teaching an undergraduate course and I wanted to talk about China and India. So, I called it China's and India's Growth Miracles. The last couple of years people have suggested that perhaps I should think about changing the title of that course but perhaps also in a couple of years from now the title will become relevant once again.

So, we are at an interesting point in India's economic development. After many years of relatively pallid growth the economy did seem to take off and then the economy survived the financial crisis reasonably well considering how difficult it was for much of the rest of the world to make it through that difficult phase. The last couple of years however have been very trying ones for India with a lot of foreign investors, in particular, seeming to lose confidence in India, the India growth story coming into question. But it looks like the economy may in some sense have bottomed out but that is a question we'll talk about today.

And it's a very opportune time to talk about India because the central government released its budget which is not just a fiscal statement but also a statement about the government's reform priorities. And we have a very distinguished panel here today to talk about it. Starting on my right with Dr. Ejaz Ghani who's an economic advisor in the South Asia region of the World Bank and has been doing very interesting research in India.

Anne Krueger, who's very well known. She's held many important positions as the Chief Economist of the World Bank, as the first Deputy Managing Director of the IMF and now she's back to the academic side of the fence where she's a Professor at SAIS at Johns Hopkins.

Diane Farrell who used to be at the Export-Import Bank and did a lot of work with China and is now the Executive Vice President of the US-India Business Council.

And finally, Laura Papi, who for a number of years was the IMF's Mission Chief for India. Just recently she's moved on to manage yet another challenging economy, South Africa. But once you get on to working in India it's really hard to let India go. And, in fact, Laura was the author of the most recent IMF report on India.

The IMF does these things that are called annual article for consultations with each of its member countries and produces a report that basically summarizes the IMF's views about the macroeconomics of that country, where the country is in terms of policies and what the country ought to be doing. And just a few weeks ago, the India report was released by the IMF so we're going to kick off the event by having Laura give us the highlights of that report and from there we'll segue into a discussion about where India stands now in the budget.

So, Laura?

MS. PAPI: Thank you Eswar. Good afternoon, everybody. I just want to make sure this is not just my report. It's the team's report. And the team is hiding in the audience somewhere.

So, I will try to just give you a few of the highlights and I hope you have a chance to actually take a look at the report. First, let me just say a few words about our reading of the economy. Of course, we know that the economy in India has slowed quite substantially in the last year and a half and it started with quite a weak investment. But this investment slowdown has now generalized and is affecting both consumption, exports, et cetera.

What struck us about the slowdown is that it cannot just be explained by the fact that the global economy has been in pretty poor shape in the last few years. And this chart on the left shows that external factors fall short of explaining India's slowdown. So, there must be something domestic going on and we did a little bit of digging, especially in terms of investment because that's where the slowdown started and continues to persist. And what we found is that looking at standard macro variables, interest rates, the level of activity, the level of global growth, the banks, et cetera, didn't allow us to predict invest well especially in the last year and a half.

We consistently over-predicted investment. There was something else which is dragging investment down. And this is the reason why we said that there is an important structural component to this slowdown. What is this structural component?

We know that there has been a significant slowdown in investment projects' implementation, in the approval procedures, such as environmental clearances, and some of the supply bottlenecks that have existed for a while have actually become much more prominent especially in power and mining. So, we think that these factors have played an important role.

Also what led us to this conclusion is the fact that inflation remains high and especially consumer prices, but even wholesale prices despite the fact that the economy was slowing down again suggesting that this is not a pure demand shock. Vulnerabilities of the Indian economy have also come to the fore.

If you look at corporates' and banks' balance sheets we've seen a significant deterioration. Indian corporates by now are quite leveraged compared to other emerging markets and we've seen some form of stress appearing in terms of the default rates, the downgrades, et cetera. And the reflection of that can be seen also on banks' balance sheets.

Non-performing loans have increased and what has increased even more are so-called restructured assets which are somewhat hybrid element. And the point we've made is that we think that because of the nature of these restructured assets which are more concentrated in large loans, they come on the back of sort of a second slowdown. They come after another restructuring which was just after the global financial crisis. We think that the percentage of these restructured assets that will turn into non-performing loans will actually be higher than what the RBI estimates at 15 percent as the historical average.

We've seen also pressure on the current account, the deficit has widened. Again, this is another factor that led us to the conclusion that was talking at the beginning that structural factors have played an important role in the slowdown. And some of these supply bottlenecks act on both sides of export and imports.

Take iron ore, now iron ore exports have come down a lot. On the other hand, the problems with coal have resulted in higher coal imports. This is not the entire story but just to give you a sense of how some of these supply bottlenecks turn into a widening current account. There's also been an important component that we think is linked to inflation and that's due to -- and that's the increase in gold imports which are probably at least partly used as an inflation hedge.

Capital flows on the other hand have been quite buoyant and hence we conclude that the financial channel in transmitting external shocks has not been prominent in this last couple of years.

All this makes us conclude that the recovery is also not going to be a quick one. After the global financial crisis the Indian economy bounced back very quickly but this time things are different and we expect that the recovery will be much more subdued. In the report we had a forecast of growth of five point four for ’12- ‘13 and six percent for ’13-‘14 but last week some new numbers came out which again disappointed on the downside. Growth was only four and a half percent and so, I'm sure that the team will be revising down forecasts going forward.

Other indicators that are in these couple of charts of why we think that the recovery will be subdued is, the hit was particularly taken on investment. There is a quite a lag between the investment cycle and the GDP cycle and the high frequency indicators that look at investment projects continue to show that the new announcements of investment projects are falling while the number of investments projects that are stalled or shelved continues to rise. So, we haven't yet seen a convincing turnaround in investment.

The risks we think are still balanced to the downside. There are plenty of global risks or course, especially protracted slow growth in Europe and a possible reversal of capital flows into emerging markets. At the moment, the second one we're not seeing. But it is a possibility once the major advanced economies monetary policy turns.

Oil prices have a lower probability and they're more linked to a sort of geopolitical type of event but all prices are quite important for India. So, if this were to happen this would also be a negative shock for the economy.

On the domestic front, reforms appear now on both sides of the equation. I mean we have seen the government taking important measures in the last few months, things such as addressing some of the fuel subsidies with some moves on diesel and LPG. We have seen the creation of the Cabinet commitment on investment. We have seen the plans to restructure the debts of the power distribution companies.

So, we have seen some movement on the reform front. The budget has also announced a few things. The question is whether this will be followed through and there will be sufficient progress on the ground especially in relieving these supply bottlenecks. And power is really at the core of many of the problems.

Another risk is fiscal expansion. Perhaps after the budget this could be a bit less so. We'll talk later about this. And I mentioned already that on the other hand if the reforms were to be accelerated, especially if there were to be progress on the legislative front, which is not at all incorporated in our medium term scenario, one could see higher growth returning.

Just very briefly, what have been our policy recommendations because we thought that it was important to address these factors that are hindering investment, we put a lot of emphasis on structural reform especially in energy. I talked about the plan for restructuring the debts of the distribution companies. Still, there hasn't been a lot of take up so it will depend a lot on the implementation. The fuel linkages, especially coal, to the power plants, there are still a lot of uncertainties there. The budget again has announced some measures.

Land acquisition remains critical for roads and we've also continued to highlight some of the longer term perhaps structural reform such as changes in labor laws as well as improvements in education to resolve skills mismatches, et cetera, some of the priorities that are in the 12th plan.

Also, a necessary complement to these structural reforms is sustainable fiscal consolidation and I would underline the word sustainable here. And I'll say a few words about the fiscal side just because we're going to focus the rest of the discussion on the budget.

On monetary policy we said that the best thing that the RBI can do for the economy is really to get inflation down on a sustainable basis. We have seen some decline in wholesale prices but consumer prices have remained above 10 percent and we are not convinced that the decline in wholesale price inflation is actually going to persist.

And finally, we've talked a little bit about financial sector risks addressing these issues that have appeared on the balance sheet especially of public banks. And this will be important going forward once these bottlenecks are eased and there is a renewed demand for investment. It will be important to have taken measures so that the balance sheet situation is not going to be then a drag on the recovery.

I'll just say a few words on fiscal recommendations given that we're going to talk about the budget. Bringing down the budget deficit is not going to be easy. I mean on the left you have the deficit of the central and state governments. There was a substantial consolidation before the global financial crisis but that was in the context of very rapid growth. And the right hand side shows the challenge in reorienting spending. What do we mean by reorienting spending?

The major thing that we said is to go from some parts of current expenditure, i.e. especially fuel and fertilizer subsidies towards capital expenditure and some social spending as well. As you can see, there is very little capital spending and actually has been declining in the last few years at least in percent of GDP.

Now, in terms of this reorientation we have done a little bit of work on subsidies, on fuel subsidies only this year and that chart on the left shows who is benefitting now from these subsidies which are not targeted. And as you can see, they are not the poor who are benefitting from these subsidies. So, this seems to be really an area which is key to reform to get to a much better and more pro-growth and pro-poor allocation of spending.

And even if the government were to target and say we will keep the benefits for the 40 percent bottom of the population, that will mean spending only a tenth of what they spend now. And what they spend now between the budget and what is covered by the upstream oil companies is larger than all the spending on health of the Indian Government. So, this is significant.

And then we've done some exercises in looking at what type of expenditure and also fiscal consolidation in general, not just expenditure, would be more growth friendly and switching more towards capital spending would indeed achieve that objective as well as targeting the benefits better.

There is also a need for taxation reform. A while before the global financial crisis India had reached a level of revenue which was comparable to similar countries with similar level of per capita income. Now India is a little bit on the low side. There are big plans for tax reforms in the works. GST would be really a game-changer but as we know there have been significant delays. Thank you.

MR. PRASAD: Thank you, Laura. So, that was a very good way to get our discussion started and perhaps I'll turn to you first, Anne. You have a longstanding interest in India. You've been to India and know virtually all the key policy officials there.

Laura has given us a presentation that I think is sobering in many respects especially on the fiscal side. What is your own reading of the budget and did you expect more? Did you find things in there that you think are going to be good for India's growth? How would you evaluate the budget and what it means for the reform process?

MS. KRUEGER: Okay. Well, I guess where to start is first I'll thank you for inviting me and I thought Laura's presentation was very, very good. And I'm in substantial agreement with her, only slightly more pessimistic. And slightly more pessimistic because I think the structural part is considerably more important than the

IMF has projected it and for that reason I also wonder whether the growth projections are not somewhat on the optimistic side. Given that what those growth projections are basically built into things without any race push on the reform side more than we've already seen.

So, let me elaborate on that. First off, the budget itself projects for a central government, what four point seven, four point eight percent fiscal deficit. Combine that with the State's you end up with an overall fiscal deficit in something on the order of eight or eight and a half percent. It is not low. And that is, I think in any event, optimistic.

The idea that we're going to put a 10 percent surcharge on luxuries and people will keep buying them this year anyway, they won't just postpone for a year strikes me as a little bit of wishful thinking. If that's true then the revenue projections for that part are false and some of the other revenue projections look to be also somewhat biased upwards. So, even on the numbers in the budget itself I'm somewhat doubtful.

But if I bought into a good growth story and so on, I would not worry so much. So, let me go back to that. As you said and as everyone here knows until the 1990s all we ever heard about was the Hindu rate of growth of three point eight percent which seemed to be something God-given or something. But in any event, with the reforms in the 1990s things picked up and they picked up almost miraculously, at least from the viewpoint of those who had learned to live with the earlier numbers. And in that context, growth reached almost nine percent in the middle of the last decade.

A lot of people got very optimistic. A lot of people thought this was going to go forever and nothing more needed to be done. As a result of which, especially since the last election, almost nothing more has been done at least until the current changes this past summer and I'll come back to those in a minute.

The reform has led to years of good growth and that continued really right through the reforms of 2000-2001 which I think everybody underestimates the importance of when consumer goods were freed from the prohibitions on imports that had been there. And when simultaneously tariffs were quite a bit lower than they were so that the Indian tariff structure went down and of course, removal of import prohibitions was even more important.

But the growth accelerated dramatically after that but then stalled. It peaked in 2007, 2008 and I was not alone at that time. Many of my Indian colleagues agreed or thought before the downturn in the West that the Indian economy was, if anything, overheating at that time. That rate of growth was not sustainable without further reforms and I don't see anything that has happened since that has made me seriously question the judgment of what rate -- or the question of what rate of growth is sustainable in the absence of fairly far reaching further reforms. And I guess I come out hoping for much better but thinking that something on the order of five or six percent is probably the best that's in the cards and I'm not even optimistic about that.

I'd agree that risks are on the downside which then raises questions about fiscal sustainability because you can't be running deficits of that size with that kind of growth rate for too long a period of time. So, I think there's some inconsistency there and I'm want to focus for the moment on the growth part; where reform is needed and why?.

Well, you can place your emphasis where you want to. Everybody's heard about infrastructure so I'll pass on that one except to say that there are clearly bottlenecks; not only power, but ports, transport, railroads, et cetera. They are all over the place. They are clearly an inhibitor but not the only inhibitor of growth and quite clearly some attention has been paid to that. Some things have been done. More needs to be done but my read is that, that more is happening at least to some extent.

But then I turn to some other things and the situation isn't quite as pretty. Labor markets, Laura briefly mentioned labor market reform and she talked about labor laws. Well, labor laws include the Industrial Relations Act but they also include the empowerment of unions and unions are very strong. One of the striking statistics about India which you should have seen if you haven't, is that during the period of high growth from 1992, '93 let's say until 2006, '07, industrial production more than doubled. Employment, in industry, in the formal sector did not increase period.

All of that growth happened with capital deepening, with more investment, investment did rise, with improvements in efficiency. Unless they had to, employers were very reluctant to take on workers and especially unskilled workers. Now, if you think about India to this day with 65 percent or more of its people bottled up in agriculture, in rural areas, low productivity, the tremendous potential for Indian economic growth is moving those people to more productive, better paying, because they're more productive, jobs.

If, in fact, there's no more employment in the industrial sector where are people going to go? They're going to stay in agriculture and we're going to see a very large drag on the economy until such time as something is done to enable the rate of growth of urban employment and especially urban employment of unskilled workers to increase and to start rising at a fairly dramatic rate. Right now, the bottlenecks to having that kind of an increase in employment are many. There's the organized sector by which you can read the formal sector, which is a word you know better, but to get into the organized sector you have to, of course, get all the permits and so on necessary and get government approval to be in the organized sector.

Well, many people find that too much. Some try and fail but most are sensible and don't try. I have one friend who formed an Indian consulting firm and he thought he ought to become part of the formal sector. He had 35 economists and about the same number of research assistants and support staff and so on. He started out one February very optimistic that he could do this and two years later he was still struggling with it. He hadn't succeeded yet. Meanwhile, what he did was he had his brother who was allegedly running one firm and he another and of course they were all the same firm and so on and so forth. But it nonetheless puts a constraint on activity and especially activity that is needed for higher productivity things.

I judge the labor laws and labor regulations and the resulting power of unions to be a major bottleneck to the expansion of Indian growth. And I think it's something that needs more attention and more focus than either the article four gave it or that Indian policymakers or anybody else gave it. And I would imagine the reason the IMF team didn't give it is because by and large the Indian policymakers have thrown up their hands and said we can't attack this. But I think that it has to be recognized that it needs to be attacked. And if some of that money that goes on the subsidies that anyway go to the better off the in community went to doing things that would enable the industrial sector to expand more rapidly, which means enabling them to get more employees more quickly, that would be something that could accelerate growth. Without it, you've got to depend on capital deepening. How far can that go? I don't know. But I don't think it's terribly far.

I could go into land reform the same way. Land bottlenecks are huge. It's very difficult to get clear title to the land. Even the government has not been able to prove it owns some of the government land. Titles simply are not clear and court battles take forever. I had one friend whose husband died. They owned some land in Mumbai and 12 years after his death I saw her for dinner the night before she left for Mumbai for yet another court appearance to try and get a hold of the land to which she was entitled, the land and the buildings to which she was entitled.

This is not an infrequent occurrence. Delays in the legal aspects of doing business are huge and are probably as big a barrier as some of the labor laws themselves. It's something that needs to be addressed. It's hard to quantify but these things do matter and especially when companies are thinking about well, should I locate somewhere where I can get these things done quickly or shall I get them done where I can get them done slowly. By the time you think of the delays in enforcement of law, the labor laws and all that go with it and then on top of that, land acquisition difficulties and so on and so forth. It has to be a drag on growth of major proportions.

Well, I already said that I think the budget is optimistic in revenue side. I also suspect it's optimistic in the sense that I suspect expenditures will grow more rapidly. In part, because of course, we're coming up into an election year and in part simply because that's the way budgets are. And people like to be optimistic and say okay this is the best I can do. I'll try and squeeze it there. I will give the Finance Minister credit. He did come in with what he promised he would this past year which was a surprise to me and I suspect to many others. So, maybe he will do it again. He's got some credibility from that and we can hope that's right.

Laura mentioned subsidies. They are hugely important. They do go to the wrong people, not the poor for whom they're intended and they are a major cost in terms of the budget. But tax reform is important anyway because the coverage of the taxes is not what it should be. And that's an issue.

Legal reforms especially in the sense of removing the backlog in the courts are hugely important and they, as far as I can tell, have not been addressed except for a few minor issues with income. Obviously, the conditions for foreign direct investment needs some attention. I do not believe that foreign direct investment is crucial for growth but it sure can help. And when you have a company coming in and then discovers it owes a back tax bill and things like this, this does not exactly encourage others to come when they can't know what their liabilities will be in the future.

And that is especially true in the year before an election. It's something that is, I think, definitely going to be a drag on the economy.

Laura mentioned education. There's a real problem there. India has done well in expanding the coverage of education but it has not, from everything we know, been able to improve quality. And in some cases certainly has not even maintained quality which is a problem and many Indian firms are complaining about the lack of the skilled human capital that they need. So, they complain simultaneously they don't want to hire unskilled labor. It is too unskilled and it's too expensive and they can't find the skilled labor or if they do they get it bid away fast. So, you have problems and imbalances that way as well, part of which comes out of the education system.

Finally, let me just mention that of course, foreign trade is an issue. A number of tariffs were raised in the budget bill which is not the way things should be going in India. Most of them are announced as temporary. They are all within WTO rules because India did not bind its tariffs as most industrial countries do. But on the other hand, that's discouraging but the foreign trade policy bill doesn't come up until next month. So, we haven't seen what's in that yet. And that's an important part of the whole thing.

So, let me stop there.

MR. PRASAD: Thank you, Anne. I guess the IMF India team is probably happy because you'e written the entire policy recommendation sections for next year's report. So, I'm sure they'll be asking for a transcript.

Diane, now that Anne has cheered us up --

MS. FARRELL: I was going to say, has completely depressed everyone here.

MR. PRASAD: -- from the perspective of where you are especially in terms of how foreign investors, foreign businesses see how India's growth prospects are and how the reforms are going, how would you see the budget and how it laid out things that are of particular to interest you and your constituents?

MS. FARRELL: Well, again, thank you so much for inviting me and I'm thrilled to be here with all of you and talking about our 350 members within the US-India Business Council, all of whom have made the long-term commitment to India. But have all shared in some of the frustrations that Anne and Laura have just articulated and yet are still there and feel that it's a successful endeavor and they're there for the long haul.

If you see Jeff Immelt's comments recently they were picked up by the "Wall Street Journal" where he talked about how this first quarter was better than the first quarter a year ago. I think that companies who are successful in India take the long-haul approach and recognize that change because it is such a vibrant democracy and such an enormously large bureaucracy that change comes somewhat slowly, somewhat plodding unless you have exogenous shocks as we experience in the '90s for example, where reform finally kicked in.

Our reaction to the budget was it's a heck of a lot better than what 2012 had in it since 2012 introduced the notion of the retrospective taxes as well as the general anti-avoidance rules which were fundamentally problematic for companies in terms of an immediate implementation and not necessarily consistent with the kind of fairness and transparency that companies look for wherever they are when they're looking to invest.

So, our initial reaction was at least there's no Vodafone legacy although we do note that there is still an outstanding issue regarding Vodafone. So, that it's not completely settled. We are pleased to see the findings of the shown report have been accepted, not yet fully adopted and so, I do want to be very careful that again we remain vigilant. We want to encourage the Indian officials to continue that trajectory but till it's done it's not done as we're fond of saying.

The fact that it was an election year, I think it really was an honest endeavor on the part of the Finance Minister to recognize the pressures that any election year brings. But also recognizing the equal pressures coming from the rating agencies who, at one point, were talking about the possibility of India being the first BRIC to be downgraded to junk status. It appears that the Finance Minister has artfully crafted a budget that will hopefully avoid that fate and that's obviously very important. The fact that the Finance Minister talked about FDI up front in his remarks and he talked about it, Anne just talked about how it's not essential but it's a helpful thing.

I think at this point from the Indian Government's standpoint as they look especially to the near term and medium term. They see it as an essential. It's no longer an “either/or” it's an “and”. So, we were pleased to see the opening of multi-brand retail, for example, this fall. There are still issues as it relates to the parameters around that opening that are creating some problems for companies who are multinational companies who are interested in starting this program. As an example, the fact that states can opt in doesn't necessarily make this a contiguous supply chain. The fact that this is for communities of one million or greater makes it also difficult in terms of looking at a business model when you look at what the upfront investments are that are required.

So, there are some issues that will have to be worked out to make that a successfully attractive program. But we're confident that if Indian officials, Indian leadership, understand that as we all know, in fact FDI, though it was not required was put to a vote during the winter session and did, in fact, pass. So, we see that as good. We're hoping that reforms including insurance and pensions which has been longstanding but came fairly close in the winter session and we understand that it's likely to be reintroduced and we're hopeful that again, individuals on both sides understand the value to doing that in terms of what it can mean for long-term investment.

As has also been stated the bottlenecks, as they've been described, with regard to infrastructure have been very problematic. There is no question that they have had an impact on growth. There is also no question that there is at least an acknowledgement and an effort on the part of the Prime Minister and his colleagues through this Cabinet committee on investment, that they are looking to try to fast track projects especially when you start talking about the power sector. Because clearly that's an impediment to just about any form of investment.

So, we're again, hopeful that that's an earnest effort to move these things forward. But again, we'd love to see movement on the Land Acquisition Act so that there is some clarity there. And that there is a sense of fairness both for those who would be displaced but also for the investors who would like to participate more fully.

Eager to see the National Food Security Bill move forward, again, anything that we can do especially as we talk about at least a segment of inflation to begin to improve the supply chain. To create a real coal chain. The fact that we could impact favorably from a social perspective on food wastage just by doing that in addition to creating greater efficiencies that hopefully will also create greater skills and potentially move this amazing demographic dividend that we're fond of talking about in India, this incredible youth, 50 percent of the country under the age of 25. Moving them toward more skilled opportunities would be fantastic.

We would love to see the goods and services tax move. We were heartened to see it mentioned in the budget but not sure exactly how much traction that will gain. Only time will tell on that one.

We're personally working on a bilateral investment treaty as it relates to US-India trade relationship. We, of course, have our model bit now completed here in the United States. Indian Government is working on their BIPA. We're hopeful that they can complete that exercise perhaps within the year and we can begin to have some serious discussions. I know our government has offered to meet informally with the Indian Government just to help and to provide any information or background on that.

And then finally, ‘cause I know we're going to come to questions so I don't want to dominate the whole afternoon here, but we're also looking at the states. Because again, when we talk about what we're trying to do on behalf of our companies and where we're so grateful to these long-term economic forecasts and the kind of sage advice that we get from the IMF, from the World Bank, from SAIS and Brookings, I should say, as well. All that is extremely helpful for providing that sort of overarching background but at the end of the day this really is about project approval. It really is about investment.

And so, we look to the states as it relates to business friendly states, states who just don't really have that appreciation yet for bringing in global partners. And so, we've actually focused on eight States within the US-India Business Council. I'm going to do a pop quiz. What would be state number one? Oh somebody has to say Gujarat. Come on, guys. But in any event, because what we're trying to do also to mitigate frustration in some cases is to advise companies and to say there are states that will help with land clearances, that will help with environmental permitting, that will clear the way so to speak in order to enable the manufacturing to take place.

So, that's what we're looking at. The only last thing, I apologize but I would be remiss if I didn't say it. The other thing that has to happen and that we're constantly talking about when we get to financial issues is more long-term finance for infrastructure investment. And so, we're obviously pleased to see the infrastructure debt fund that was announced about a year and a half ago. But note that it really has not been taken advantage of to the extent that it could or can be with some revisions and some modifications.

And so, we're again, pleased to see acknowledgement when it comes to these infrastructure bottlenecks and hopeful that Ministry of Finance and others will also work through this long-term financing portion. So, that again, we can really get things up and running. Thank you.

MR. PRASAD: Thank you, Diane. You've moved us a little bit in the direction of hope which is a good thing. So, where will you take us, Ejaz? Now, Ejaz, I know you've been doing very interesting work on infrastructure distribution issues and so on. What are you perspectives on what the budget had or didn't have?

MR. GHANI: Thank you so much, Eswar. Thank you for inviting me.

So, these are my personal views and not the views of the World Bank because we are still thinking about it. So, I did try to catch up. You know, what is the popular perception on this budget? And the thing that really came out is, for example, Swaminathan Aiyer’s article that it's everything for everybody which actually pleased me because I thought that this is a very harmonious approach to managing the discipline of a budget with the harmony of good distribution and keeping it on the right track.

But then just before this meeting, Eswar also asked a very good question. Does it have the reforms? Does it have a framework to put ahead the agenda? Which really made me think because then, I mean, when we look at each individual reform ranging from trade, labor laws, subsidy, all of them, they somehow don't seem to fit in the budget. So, does it provide a framework?

And I thought in order to answer that question we need to go back to the five year plan that has just been released because that's where they put out their vision. And I decided to call my colleague at JP Morgan and said, look here. Tell me this capital expenditure has shot up. Where is it going? And he told me the three areas where it is going to skyrocket more than 40 percent. One is JnNURM which is urbanization with a focus on tier two cities. The second one is on the expansion of the manufacturing sector SEZs. And the third one is on the role of gender in development. These are the three things that really stand out.

Do these three things provide a framework to address the concerns and questions that have been raised by Anne Krueger, by everybody in terms of efficiency, job creation? The answer is yes. And I'm going to explain to you why. So, if you look at the massive increase in allocation to JnNURM which is the urbanization with the focus on tier two cities, just to give you a background. 600 million people in India will move into cities over the next two decades. And they can't be accommodated in Delhi, Mumbai and Calcutta and new cities will emerge.

The largest concentration of people who are seeking jobs or who are in poverty are in the tier two cities. So, how the tier two cities urbanize over the next two decades will shape the scope of efficiency gains, nonagricultural job creation; name it and its there. I'm not saying that the strategy is there but the large increase in JnNURM focused on tier two, not tier one cities signals to me that there is some hope there in terms of providing a framework.

What about manufacturing sector? There is a lot of talk about industrial, new industrial corridors coming up. Our own work on looking at the manufacturing sector shows that clearly manufacturing sector is not creating enough jobs. But most of the new manufacturing firms are establishing themselves not in cosmopolitan cities but in tier two cities where land is cheaper, labor is cheaper and in mature technology in the manufacturing sector, they want to move out. But in order to move out they need the infrastructure.

So, we find, for example, the golden quadrilateral. The connection of the road highways overcomes several problems by connecting megacities with non-megacities, smaller cities; you are immediately overcoming the problem of access to land. Land is very difficult to get in megacities. But in smaller cities which get connected, you can easily take over the land. So, we find that a lot of new firms are establishing in smaller towns.

So, that connectivity actually overcomes the problems of licensing raj, land raj, labor laws. So, there are some indirect routes that can work. So, the focus on the manufacturing sector is also a good one in this.

And the third one, of course, is the gender one and significant. And this, I don't have to say. I mean everyone has read the headlines in the newspapers, et cetera. But how do I tie these three things together? What does it mean? What does a new budget mean?

I can see embers of shared prosperity being defined. That in other words, this budget is trying to go beyond growth which is very important and primary but also starting to establish a framework for promoting shared prosperity by tapping into tier two cities, mature manufacturing sector which will create jobs, and taking into account the role of gender in development.

Now, will this be achieved? Unsure. Planned expenditures can be easily cut to achieve fiscal targets. So, a lot will depend on how it is implemented keeping in mind that one doesn't want to lose the targets of the fiscal discipline. Yet not lose on the hope of achieving shared prosperity.

MR. PRASAD: Thank you, Ejaz. You've given us a nice slogan in addition to some degree of optimism.

Let me turn back to you, Anne, in light of what Ejaz said and what the rest of the panelists have said. We've all talked about what India needs to, and we've talked about the same things for many years right now. What do you think are the big obstacles to reform? Is it the lack of well-articulated framework? Is it a set of political constraints? What is it that's keeping India from doing what needs to be done?

MS. KRUEGER: Well, quite clearly there is something of a political difficulty simply, and of course, you have a coalition government and everything that means. And with that the politicians are often scrambling for things other than shall we say the longer term advantage. And certainly what seems to have happened with reform is that there has not been enough consensus to carry it further. And that's clearly political in part.

Now, what's not clear to me and what many people in this room can say more than I, it is my impression that when growth accelerated or even now looking back on it, people do not give enough credit to the reforms that were undertaken in terms of understanding how India got where it is now. And I think that's a little bit of a problem. And I don't think it's been well articulated, at least as far as I've seen, in India. So, I would blame a lot of it on the political and if you like intellectual climate that has not embraced the past reformers and given them the credit that I think is quite clearly they're due in terms of delivering at least the growth that we've had to date.

MR. PRASAD: Laura, you laid out a very nice list of reforms so let me put you on the spot. Given the political constraints that Anne has talked about, if you had to pick one or two reforms that the government, let's say, really needed to stake its political capital on, what would you think those one or two reforms ought to be and again, not half a lesson but literally just one or two.

MS. PAPI: I don't have a mic so I suppose I --

MS. KRUEGER: Here we go.

MS. PAPI: On the fiscal side, as I mentioned I really think it's rotating from subsidies into capital expenditure. On the structural side, if I had to pick one thing it would be power. I think it just has such a huge reach and then of course, we want inclusive growth and not just growth. And hence, I think that the cash transfers program that has just started, that has really a lot of promise because it would mean reaching the right people with a much lower bill.

That's going to take time but I think that's really an important reform.

MR. PRASAD: Diane, let me get back to your comments. You spoke about the many areas in which there has been progress and you made this intriguing comment about how working with the states is in many ways a lot easier because that's where the action is. What is it again that you think that prevents what is being done at the states from being scaled up to the national level? And do you think that from the point of view of foreign or even domestic investors, creating the sense of competition among states might be one way to get around the political stasis at the national level?

MS. FARRELL: I think there's a certain inevitability to that, I really do. And states that have been written off previously, Bihar as an example, with this vibrant Chief Minister who's, you know, we're reading about positive stories. And while it may still be early days in terms of even greater infrastructure challenges in say, Gujarat or some of these other states, the potential is there.

Uttar Pradesh with a new Chief Minister, 38 years old, who was just elected last year who is feeling tremendous enthusiasm and energy toward wanting to bring investment to his state, understanding that this is the expectation that was part of his successful election. We actually have our Chairman, Ajay Banga, who is the President and CEO of MasterCard worldwide, along with our President Ron Somers, and a group of our board members who are travelling to Lucknow next week. And they're actually going to be holding an all-day seminar with high government officials from Uttar Pradesh culminating with a private meeting with the Chief Minister.

This will be the fourth or fifth time that Ron has met with the Chief Minister. Ajay met with him as well in October. So, that we're putting our hopes against some of these more progressive leaning leaders.

What's really interesting is we hosted Montek Singh Ahluwalia in New York last May. And as all of you know he's the Deputy Chairman of the Planning Commission. And he's been a person that many of us turn to for sage advice as we've moved through many aspects of the Indian economy over the last few years. And Montek shared with the group as we all -- we can always have reasons to complain about why things haven't gotten better more quickly or why they're backsliding. As Montek was fond of saying in the good times it's in spite of the government. And in the bad times it's because of the government.

So, either way they can't catch a break. But the other thing that even Montek talked about was looking at the states. And as we're fond of saying here in the US, the states are laboratories. And so, I do think that your question is excellent because whether it's from Chief Minister to Chief Minister feeling a sense of competition and wanting to see their growth rates rise or it does come from the bottom up in terms of the population's expectation for a better quality of life as they make those comparisons. I'm not sure how that will happen. But definitely there is a political component to this and one that we hope will result in as that expression goes, a rising tide lifts all boats.

So, that's the way we see it.

MR. PRASAD: Right. And in fact, to build on those comments, what we saw with the multi-brand retail FDA reform I thought was an interesting strategic approach because what the government didn't say was we're going to ram this down the throat of everybody. But said we're going to create this option and states can choose to allow investment and I presume that the idea was that you could have a positive demonstration effect in some states --

MS. FARRELL: Exactly.

MR. PRASAD: -- that encourages other states to take over. So, in that sense I do see a strategic sense or at least I saw a strategic sense in some of the measures that were taken last year.

Let me turn back to you, Ejaz. Now, you were somewhat more optimistic about where things are going with the manufacturing sector in particular. Now, Anne has pointed to this very damning statistic that even though the manufacturing sector has done very well over the last couple of decades, employment growth has been minimum.

In terms of your own research on the quadrilateral project and so on, are there specific things that you think could be done in order to deal with the manufacturing sector not only to make the sector itself robust but also make it robust in terms of generating employment growth?

MR. GHANI: Yeah. The stock of knowledge of that is immense which Anne Krueger has already highlighted. These are the reforms that need to be done in order to achieve.

But what we need to do now is to tie up those reforms from a forward looking agenda. So, for example, most of these factories and expansion of the manufacturing firms could do better by tying it up with the agenda on urbanization. We know that 600 million people are going to move into cities. So, a business environment and an infrastructure that promotes growth of cities will also enable the growth of the manufacturing firms which is going to create jobs.

But I think it's important also to keep in mind that 80 percent of jobs in the manufacturing sector and in services are in the informal sector, unorganized sector. So, although a large proportion of output is accounted for by organized sector, proportion of firms and jobs are dominated by the informal sector. Now, we've been examining the relationship between formal and informal sector, looking firm level evidence big time. And it's not easy to draw any conclusions.

But one of the things that come out, first, one thing that stands out is that the relationship between formal, informal is a very strong one. They both move together. So looking at firm level data in the different districts we see that if the organized goes up, unorganized also goes up.

So, just to say that it is restrictive labor laws that are explaining this relationship is not good enough because we find that the organized and unorganized are moving in different directions. The organized manufacturing firm moves out from Delhi or large cities because land is too expensive and they go out to the suburbs or tier two cities. They don't mind poor infrastructure. They set up their own power plant and start producing.

The unorganized firms, on the other hand, are moving into cities looking for infrastructure because they don’t have the money to set up the power plant. So, the expansion of this manufacturing sector has to tie in with the broader agenda of urbanization and something which I've overlooked and I should mention. That this budget also has social insurance schemes for rickshaw pullers, for dhobi wallas. So, this kind of social protection for the informal sector which has started to germinate will also help achieve that.

So, really these are three goals to be achieved with a few instruments.

MR. PRASAD: So, Anne, let me get back to you. I didn't give you a chance to express your optimism about India. You spoke about how the growth projections that we saw might in fact be somewhat optimistic. You spoke about how progress on the fiscal side may in fact turn out to be somewhat optimistic. But do you see any promising signs on the reform front? I mean, we all know what needs to be done but in terms of what we've seen especially in the last few months in terms of the government's stated intentions, do you see signs of hope?

MS. KRUEGER: Sure. In the stated intentions there are, of course, a few signs of hope. And the government does seem probably since last August to have been moving a bit or at least moving in statements and intention a bit. Now how much will actually come to fruition especially with an election coming up I think is an open issue.

But, yes. Again, there is at least some intention to get somewhere. I think in the budget speech there is an intention to do something so that the Vodafone mess cannot happen again even if that doesn't straighten out the current one. There are some other good intentions along the way. Whether these things can bear fruit, I think, is still the real question.

MR. PRASAD: Let me turn back to vulnerabilities a little bit. We will have some time for Q and A at the end. Laura, you spoke about the current account position and you seemed to be of mixed views on that. On the one hand the current account is a source of vulnerability but you spoke about how foreign influences are still holding up reasonably strong.

Now, the Indian rupee has depreciated a good bit over the last couple of years but India doesn't seem to get the traditional sort of benefits. Because on the one hand the import bill goes up especially with the oil import bill rising and on the other hand the manufacturing sector doesn't seem to be able to use the competitiveness gain from the exchange rate depreciation to boost exports a lot. Do you see this as a major source of vulnerability especially if there is more global financial turmoil that leads to capital again flying away from all the emerging markets including India? And what could India do about it?

MS. PAPI: I mean you are right. At the current juncture there are plenty of capital flows. The question is what happens if there is a reversal. So, I think that this is a vulnerability and we actually have underestimated the current account deficit in the last couple of years. And the reason is because we have underestimated the role these structural factors have played.

In terms of the exchange rate, I mean, we have seen exports reacting and imports especially reacting when there has been a very significant in the exchange rate. So, I would agree with you that the elasticity is probably higher to income levels but it is also not negligible on the exchange rate front.

MR. PRASAD: Do you see that, Anne, as a major source of vulnerability? The current account and what do you think the right adjustment mechanisms are as well as India's concerned?

MS. KRUEGER: Well, the current account is there. Obviously it's a vulnerability but that's not independent of this fiscal deficit. In fact, I sort of see the fiscal deficit as a central piece which then generates some degree in the inflationary pressure. It generates part, at least, in the current account deficit and in addition, it pulls some resources away from more productive uses elsewhere.

Now, within that you also have a fact of subsidies, et cetera, et cetera. So, there's also an inefficiency, if you like, both on the tax side and the expenditure side. But I think all of them are part of the same phenomenon. They are not independent events and in a sense their correction has to be -- entail all of the above and not just any one thing.

MS. PAPI: Actually, if I may add, I agree a hundred percent. The current account is like the symptom of several problems rather than being the cause. And the other point that I would like to make is that if you look at the external vulnerability overall still the level of debt, external debt, is manageable. The level of reserves is more than adequate.

So, this was behind our assessment that the overall external vulnerability is still quite manageable.

MR. PRASAD: So, given where the current account deficit is and even though the position might be manageable, India clearly needs to remain friends with foreign investors. From the point of view of foreign investors, financial institutions and so on, do you see major barriers to your operating in that area? Are there specific things you would like to see are dealt with or removed? I know there are these things we've talked about in terms of what India needs to do for itself but to be especially attractive to foreign investors, do you see specific steps on capital account opening or issues of that sort that you'd like to highlight?

MS. FARRELL: I'm not sure that I can get as specific as what you might be looking for but if there is one word that would summarize where investors want to be, and this is true everywhere, is predictability. They need a level of transparency so that they're making an informed decision in an environment, in a predictable and a stable environment.

And so, part of what was so jarring last year was the whole notion of a six year reach back. In the same way that the original GAAR Proposal put more emphasis on the taxpayer having to prove they didn't owe more taxes as opposed to the state, the government having to prove that additional taxes were owed. That was one of the issues that the Shome committee actually took up.

So, there are lots of financial openings. I mean, the Companies Bill, the whole notion of bank licensing, of dealing with the issues of siterization right now which is a debate point between international banking institutions and Reserve Bank of India. So, there are a number of those issues. But at the end of the day, whether you are looking to cite a plant, or you are looking to put private equity into a project, or you are an institutional investor who are looking at this in the broader terms, the key is the notion of predictability.

And here in the United States, of course, you know the Foreign Practices Act guides investment in any category. And so, it's those standards that we know we have to hold to. And we also know that at the highest levels of government there is an interest in making sure that offerings to our companies have that degree of transparency. It's just where the rubber meets the road. It's when a project gets going it's dealing with that issue at every single level.

And again, it's been a stated purpose by whether its Chief Ministers in particular states or those in the central government who understand that it's an impediment to investment. And so, again, these are the things we look for and that we are hopeful for as the budget moves forward.

MR. PRASAD: Okay. So, the impediments, the policy uncertainties and the policy reversals of the sort we've seen all seem to be creating a fairly toxic mix.

Ejaz, let me turn back to you as the optimist relatively speaking on this panel. Anne has argued that the IMF growth forecast which is already pretty weak might be somewhat optimistic. Given what you've said about how there is some progress on the manufacturing side, do you see India as moving on the right path to get to a higher growth trajectory in the next five to seven years?

MR. GHANI: Yeah, if I may say next 10 years, yes. I think there are, I mean it's well known that India stands to gain a lot from demographic dividend. It stands to gain a lot from what we call the new faces of globalization where services sector take off. It will gain a great deal from the rise of the middle class. So, it's not just the export but the consumption within the country. So, there are several factors which actually in the long run, India will gain as opposed to some of the more developed economies which will not have that benefit.

But there is no guarantee that it's going to happen. But your question is not on the long-term. We all know in the long-term it's going to play up that your question is much more on the short-term horizon. So, I don't want to be too optimistic on the panel here. I share and respect everyone's concerns here but we do know that India with Indonesia and China are the three fastest growing economies still although the growth has come down.

And there are issues of the base affect and other things that's happening. And there are so many unknown variables in how the growth is going to happen. It's not just within the domestic. It's the global economy and how the impact of other forms of structural reforms such as urbanization will play up. Still an unknown variable but I share the concern that we can't take growth for granted.

MR. PRASAD: Anne, I was perhaps lowballing what you were saying about growth. I should give you a chance to clarify what exactly your prospects are.

MS. KRUEGER: Well, I think there's a difference between the potential which could be realized if things went well and what will happen if the reforms don't take as strong a form as they would. We hear about the demographic dividend. There is a potential dividend there but if everybody's bottled up in the rural areas or stuck sweeping floors in shops in the city because they cannot get into more productive work, that demographic dividend will become a demographic nightmare as people are striking in the streets and people are rioting and all the rest of that.

So, it's a double edged sword. If you take advantage of it, it's a huge benefit. But it could also be a huge cost and I don't think that should be overlooked given the path, the trajectory of employment today. Average product last I looked and this is two or three years old of workers in the organized sector in industry five times that of an informal sector. Keeping people in the informal sector therefore slows growth. Everybody could move to the formal sector under appropriate conditions, not just hiring them for nothing to do, can make a difference.

There are other things that can help India and India has all the potential for, I think, nine or 10 percent growth but it would take the reforms. And without it, I think the real question is how rapid can growth be especially if you cannot move all these people in? How you'd move 600 million people into the cities without jobs I don't know. And how you'd get the jobs for them without doing something to relax the labor laws I don't know. So, that in a sense all of those things go very much together.

I agree with you it could be done. But I don't think it's going to be automatic and I don't think it's going to easy. And I do think it will take a change of mindset with regard to some of the issues in terms of fact or supply and so on to get there.

MR. GHANI: If I may add to this, I mean, the story of informality is a lot more complex. Because when I heard that informality is rising in Latin America, we opened up the informal sector by gender and we saw that all the increase in the informal sector in Latin America is coming because many more women after feeding their children, sending them to school, want to spend four hours to do the textile. To do some informal sector and they are the ones who are entering which is actually increasing.

Their participation is not bad. I mean you are right that the productivity has to shoot up but the productivity of the informal sector to go up may call for more deeper packages and reforms to support such as access to credits, skills, better transport, clean water so they don't have to walk one mile to get the water. All of these things can really accelerate the pace of manufacturing sector and productivity growth.

So, what I'm saying is there are too many relationships happening with factors of gender participation, rise of cities which are interacting which is going beyond just pure labor laws.

MR. PRASAD: Before we turn to you, my patient audience, I'd just like to get back to my pet topic and perhaps I will ask you, Laura, about the financial system which I think is sort of crucial in all of this. And spend much time talking about this. You laid out some of the problems in the financial system. What do you think really needs to be fixed in order to get finance to work well in terms of achieving all these objectives we've been talking about?

MS. PAPI: I think there are sort of two sets of problems. One is the short-term that I was alluding earlier, this deterioration in balance sheets. Here they have to really get to recognize their losses as soon as possible and some of the recommendation of the Mahapatra Committee that the RBI has already started to endorse, those will help.

Then there are sort of the more longer term reforms. And also, for the shorter term you need some injection of capital in the public banks which already the budget partly allows for. In the longer term is actually connected back to the fiscal. And one thing that, of course, lots of things have to happen such as the development of the copra bone market that would help also infrastructure. All these things are linked back to the fiscal.

And the SLR, the statute of liquidity ratio, is still 23 percent for the banks and actually if you look at the insurance companies et cetera, it's much higher. Of course, we are not advocating getting rid of the SLR quickly but as the fiscal deficit comes down that would be something that needs to happen. And that would mean that then the financial institutions can actually devote more of their resources to other -- to fund small enterprises, et cetera. At the moment, SMEs do not get much in the way of funding.

MR. PRASAD: Okay. Well, it's time now for you to let us know what's on your mind. There are going to be mics coming around. Please keep your questions short and compact and make them questions rather than statements. And please identify yourself at the beginning.

Let's start with you, Teresita.

MS. SCHAFFER: Tezi Schaffer of Brookings. I have a very specific question. How important do you think is the spread of electronic payment systems, cell phone banking and the like in expanding the possibility for people in tier two or smaller cities to get into the modern economy, whether or not formal?

MR. PRASAD: Laura, would you like to take that? That was addressed to Laura.

MS. SCHAFFER: It was addressed to whoever wants to.

MS. PAPI: Probably Ejaz maybe.

MR. PRASAD: Would you like to take it, Ejaz?

MR. GHANI: I'm not an expert in this but I do know that in Africa, in Kenya it's exploding. So, the answer to your question is yes, yes, yes.

MR. SHAH: My name is Azmat Shah from Business Times. I have a question, two questions for Diane Farrell. As we all know US-India Enterprise, US-India Business Council has been a premier organization promoting bilateral relations. We have all heard about the India as an industry destination but my question is that US economy is in a different shape and we need investments to improve our own American infrastructure for which your President Obama says that we need five trillion dollars for it.

So, my one question is that how do Indian business people or entrepreneurs can help America's financial activity sector? So far, India, the investors have already invested more than $25 billion and created 200,000 jobs in America. The question is that you have been US business-Council taking many delegations to India. And you know, serving the India's market very well. Could you please enlighten on the subject India which states are more I would say conducive for investments, for example, certainly someone said that made a statement that Uttar Pradesh is now offering a lot of opportunities in industry. So, these two questions. Thank you.

MS. FARRELL: Thank you very much. Let me start with the states. So, we're not being exclusive. I mean, I want to be sure that no one thinks that because a state has been left out, in some cases it will be fairly self-evident, but as I mentioned Gujarat, Uttar Pradesh, Punjab, Maharashtra, Andhra Pradesh, Bihar, Karnataka, have I gotten to eight yet? Somebody should be counting for me, I think. So, those are -- so they're fairly obvious choices I think.

With regard to investment, in fact we're about to come out with a publication that talks about invested America. Because one of the under told stories here in the United States especially as we're looking toward job creation is to recognize those

Indian investors and entrepreneurs who are actually here in the States. So, the obvious are obviously TATA, Essar, Reliance. In fact, Reliance has a huge stake in shale gas as an example.

Those are just a few. Also, ONGC, the national oil and gas company, GAIL, also associated have now opened offices in Houston as an example. So, there is a two way street. Clearly, still the investment flow is greater between US in the direction of India but as more opportunities arise we see a greater probability.

The other thing to remember is as we look toward immigration reform and you talk about the STEM initiative right now, and you talk about the recognition that we have all these incredibly talented students, graduate level students who are coming from other countries and are wanting to facilitate the opportunity for them to stay should they choose to and begin their careers here is something that I think is also very forward leaning as you look at US interests when it comes to our need to grow our own economy and come out of this recession.

MR. PRASAD: We do actually have an audience member who's going to answer the first question. So, let's give her the mic.

MS. LIHKI: Sukriti Likhi from the embassy of India. To answer your question regarding electronic payments of subsidies, direct cash transfers, India is presently trying to implement a very, very ambitious program for financial inclusion. Direct transfer of subsidies is part of that program. We have 600,000 villages of which we have, at the present moment we have over 100,000 brick and mortar bank branches. The aspiration is to reach each person in the country and to provide each person with financial facilities.

So, there is this micro ATM which is manned through telephones, mobile telephones. And there is a technological revolution happening in India in terms of payments. And we are hoping that we will reach every family across India and we will be able to provide payments directly through them. Last mile connectivity is being provided through people. So, we have business correspondents employed by banks who go to the home of the person and deliver the payment because we cannot create bank branches in every village.

So, this is a fabulous program and it is going to make vast changes in terms of the savings coming into the system. And you're going to have banks being able to bank with people, micro insurance, micro credit and the banking rules will change in order to ensure that you can have a zero balance account. You can have an overdraft on that account. The changes to the "know your customer" norms for banking people who know banking; they have been facilitated in order to ensure all of this.

So, all the sectors across the economy are working together for this to happen. So, we're hoping this happens soon. And it will be a revolution.

MR. PRASAD: And we just need to figure how to channel those savings rightly but thank you for that very authoritative and official answer. Yes, sir. Yes, sir.

MR. GUPTA: Anil Gupta, Business Professor at University of Maryland, College Park. A question to Laura and Anne because your talks particularly focused on central government policies. Now, you probably all accept that both central and state level policies matter and while the center has gone to sleep by and large over the last several years, the states, not every state, but across the board have actually moved in the direction of reform.

So, the question is how critical for the Indian economy, state level policies versus central policies? And if you were to do a regression, kind of how large would be the beta for the states?

MS. KRUEGER: Well, they're both important. And I think of it as sort of a multiplicative kind of thing. Every reform at the central level helps business but it also makes reforms that come at the state level more productive. Every reform at the state level when it makes the reforms at the federal level become more productive. It isn't a matter of one or the other. It's a matter of both.

Some things matter more at the states. You know some legislation has even been cast at the central level as saying if a state wants it, it can do this. There are amendments that can be made to various for the individual states if they so choose which has been one way to get around the political bottlenecks you were talking about.

But there are some things that only the center can do, foreign trade policy for example. There has to be some degree of uniformity and a lot of aspects of financial policy. And there are some other things which can't be done any other way. And of course, when the center is doing a fiscal deficit of five or six percent of GDP the states really are compressed in what they can do. So, on all those grounds I would say both are important and each one that does better strengthens both itself and the other one.

QUESTION: In light of these kind of structural issues, I'm curious about your outlook on equity market performance and how you think the equity market will react with the upcoming elections and the reform agenda.

MS. PAPI: I mean, I think the equity market is very much influenced by foreign flows. So, it will depend on two sets of things. One is how conducive the environment for flows into emerging markets is going to be. At the moment it's very favorable and there is a secular trend towards more investment into emerging markets.

But then how the elections are going to go and has a domestic component, I mean this is anyone's guess I think.

QUESTION: My name is Jane; I have a question regarding the manufacturing industry. What do you think will be the promising industries in terms of manufacturing and why? Who will be their promising customers? Thanks.

MS. KRUEGER: Well, I mean the first thing that we know in economics is that you don't talk in industries, you talk in terms of activities and firms and even in very successful firms within a not very successful industry and vice versa so that it isn't a question of one or the other. And secondly it depends very much on how things change if labor laws and labor regulations and labor institutions were changed in a way that enabled a much more flexible market for unskilled labor.

In my judgment, then you'd see a big boom and some of the industries that have been, to a certain degree, pulled back because they are intensive in the use of unskilled labor and the restrictions make that a very difficult thing to do. If on the hand, the labor laws remain as they are, then I think some of the activities will go the other way. But you don't know and one of things you can't ever do is forecast which industry will do what. That's one of things that people who try and do it get in big trouble on.

You find an entrepreneur who's got a good idea and he carries out successfully, then others try it. Imitate, some succeed, some fail, it just depends.

MR. BOGART: Peter Bogart, I worked with the World Bank at the time of the reforms, the early reforms in the '80s. Now I'm back in the state just evaluating some of them. The issue is again the absorption of labor in these new cities, the second tier cities. There obviously has one --

MS. KRUEGER: Hold the microphone closer. We can hardly hear.

MR. BOGART: -- very important condition and that is to what extent small or medium industries where it's not only formal, informal sector but the famous small and medium industry in India had been heavily protected at the time of the late '80s early '90s. Has thay changed? Is that changing? Because that will be, obviously, one of the important issues, to what extent they will link into this overall employment growth.

MS. KRUEGER: You're referring to small scale reservation which was a very big thing. There were 890, I think, industries something around that number, anyway, which were delineated by legislation as saying that firms had to stay under such and such a size in order to be eligible for certain kinds of privileges which were pretty profitable. The result of which was, of course, that you -- and they were mostly identified as industries that used a lot of unskilled labor.

And so, they were exactly the ones that didn't want to get bigger because they'd lose their privileges. And yet, they were exactly what you should have wanted to expand. Most of these small scale reservation, if not all of it, legislation has been removed. There is still a legacy and India still has a very abnormal distribution of firms relative to most other countries even when you standardize per size per capita income and so on. In that they have lots of very small firms and some very big firms, and their middle is much less than you might expect if you looked at the distribution in other countries.

MR. GHANI: This budget has a very innovative idea which is that even if you go beyond, you’re no more small medium and you're becoming large, you are still entitled to some of the tax rebates for the next three years. So, it doesn't deter you from growing which was an interesting way of liberalizing some of these privileges and getting rid of it.

MR. PRASAD: Okay. Let's take one last question from back there.

MR. CHARLES: My name is Charles and I'm a financial student at Johns Hopkins University. I have a question about the informal sector. Does India have any sort of program to pull out people and companies out of the informal sector?

MS. KRUEGER: Does India have a program to pull companies out of the informal sector. Well, there are a lot of programs that might have some of that effect. There are some other programs that might have the effect of keeping them there and it's not clear that there's an overall, sort of this is the thrust and we're going to have a lot of programs toward it. There's nothing that's directly aimed exactly at it. Removal of a small scale reservation was one of the things that was done with the hope that that would do something. And I suppose it did. I just haven't seen the recent numbers.

MR. PRASAD: Okay, well it would be very nice if many of the voices that we heard today and all the tremendous expertise we heard on this panel could somehow make its way to Delhi and into the policymaking in India. But perhaps there is hope after all because many of the people on this panel are in fact talking to some of the key policymakers and we thank them all very much for their views on India and what needs to be done and what is happening. And thank you all very much for coming.

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