Finance Minister's Address

Financial Security and International Interdependence

The Pala, ITC Sonar Bangla, May 27, 2012

Admiral P.J. Jacob Chairman, Global India Foundation,
Prof Omprakash Mishra, Member Secretary Global India Foundation,
Ladies and Gentlemen,

I am happy to be here today at this event being organized by the Global India Foundation. I had delivered the keynote address on the occasion of the launch of this Foundation in January 2007 when I was Minister of External Affairs. Since then, I am told that the Foundation has grown as a policy and research forum in the pursuit of India's contemporary interests.

2. I have been asked to speak on the theme "Financial Security and International Interdependence." It is a topical theme in today's context. At the outset, let me make a distinction between the notion of 'financial security' and the notion of 'financial stability,' so as to put the theme in an proper perspective. Financial security as a concept relates to issues of individual livelihood, assets and indebtedness. Financial stability is a concept that is generally applied to functioning of institutions, systems and nations. I intend to address both these aspects in my remarks.

3. It could be argued that the growing economic interdependence across countries, particularly in the past few decades, was guided by the urge to improve economic and financial security of nations and their people. The anticipated benefits flowing from a larger scale of production and markets, global capital, access to information, technology and expertise inherent in the process of globalisation were expected to support security and stability of financial and economic systems and improve human well being.

4. Many countries, including India in the last two decades, have been able to ride this wave of prosperity. Several developing countries have succeeded in raising their growth rates of per capita income and consumption, reducing poverty, deprivation and economic insecurity, and mobilizing unprecedented resources to bridge development gaps. At the same time, developed nations have been able to sustain and lead an extended period of growth in world output and trade.

5. While the level of global economic integration has furthered the degree of interdependence, it has also contributed to uncertainties in the international economy. The growth of international trade in natural resources, goods and services, and financial flows have turned what are otherwise small countries, and their problems, into global systemic risks. Indeed, systemic importance is not just a matter of country size anymore. It depends on the depth of transactions and inter-linkages between a particular country, an institution, or group of institutions, and the global economy.

6. Consider the situation in Greece today. Its GDP is about USD 300 billion, accounting for approximately 0.5 per cent of world output and its public debt is USD 470 billion or less than 1 per cent of global debt. At least on paper, Greece should not be systemically important for the health of the global economy. Yet its sovereign debt position has already affected the financial markets and continues to threaten the Euro zone with substantial spillover effects, if the issue is not addressed adequately. There is serious possibility of contagion spreading to other distressed European economies, such as Portugal and Ireland, or even Spain and Italy and through them to the international financial system.

7. Following the global financial crisis, which precipitated one of the deepest economic downturns in 2008 that the world has witnessed in recent times, we were compelled to rethink some of our traditional principles of economic and financial policy making. We saw how unfettered growth of financial sector can have dangerous implications for the real sector, both in the developed and the developing world. The developments underscored the importance of understanding and regulating the financial markets and the innovative financial products in the interest of sustaining growth with stability and financial security.

8. In modern financial systems, an intricate web of claims and obligations links the balance sheets of an array of intermediaries, such as banks and hedge funds, into trans-border network structures. The advent of sophisticated financial products, such as credit default swaps and collateralized debt obligations, has heightened the complexity of such balance sheet connections even further. The failure of Lehman Brothers

and the rescue of American International Group (AIG) demonstrated how these interdependencies have created an environment for feedback elements to generate amplified responses to financial shocks.

9. In the past three years, we have seen how the financial security of individuals and the stability of the financial systems across countries were compromised by the global crisis and the resulting economic slowdown. No country has been immune to the contagion from the fallout of global financial crisis. There was recession in the developed world and significant fall in growth in the developing and emerging economies. It dislocated labour in many sectors of the economy, creating financial hardship and unemployment.

10. Though the economic downturn was moderated and growth resumed in the second half of 2009 in most economies, the pace of recovery has since remained uneven and uncertain. Developments in recent months have been less encouraging. The tepid global economic recovery that we have seen so far is already stalling. Growth in most advanced economies has declined since the second quarter of 2011 with the exception of the USA. The emerging economies like China and India that led the recovery, with Latin America and Africa following closely, are witnessing a combination of moderation in growth and rising inflation. This impacts financial security issues in both developed and developing economies.

11. Indeed there can be little disagreement on the fact that development and poverty reduction can be profoundly compromised by a financial crisis that evolves into a global economic slowdown. Since the global crisis, the

recovery has been slow and unemployment high in the developed economies. There are concerns about fiscal sustainability and inflationary pressures threatening financial security of the marginal and poor households in developing and emerging economies, with the exception of a handful of countries.

12. In the post-crisis period, financial stability has become an integral part of policy discussions and macroeconomic objectives globally. The term 'financial stability' refers to a persistent state of robust functioning of various financial system components – markets, institutions and market infrastructure. It involves strengthening of the system to face any financial shocks with minimal disruptive impact. There is a process aspect which requires a rigorous, comprehensive and continuous systemic assessment of risk buildup across the financial system. Also an outcome aspect focused on having the necessary institutional and instrumental arrangements to take effective regulatory, supervisory and other policy measures to address the identified risks. A sound and resilient banking sector, well-functioning financial markets, robust liquidity management and payment and settlement infrastructure are the pre-requisites for financial stability.

13. India has been more fortunate in surviving the crisis without major disruptions and has recovered its growth momentum much faster than most others. As one of the largest and among the most dynamic emerging economies, India has demonstrated its resilience and the capacity to overcome adversities in its development path. The fact that India has not gone through any financial turbulence, as a result of the earlier phase of

financial deregulation is a testimony to our consistent view that reforms in global standards have to be adapted to local conditions.

14. We cannot take this performance for granted. Indeed, in a globalised world where developments from one part of the world are being rapidly transmitted to the other, we cannot afford to do so. We are aware that we have to consciously work towards realizing our developmental goals and national aspirations. Even while pressing the accelerator for growth, our priority is to make growth inclusive and sustainable, focusing on a broad-based strategy that encompasses all three sectors – agriculture, manufacturing and services. We have to strengthen the strategy that provides ample opportunities for people to grow and climb the ladder of productivity and knowledge towards higher incomes and well-being.

15. The economic reforms initiated during the early 1990s have borne good results for the Indian economy. We have taken steps in recent months, to take this process forward. Legislations have been introduced in the Parliament to address some issues in the financial sector including insurance, banking, and pension sectors. We have set up Financial Sector Legislative Reforms Commission to review financial sector laws with the objective of bringing them in tune with current requirements and global best practices. An apex-level Financial Stability and Development Council has also been established to strengthen and institutionalize the mechanism for maintaining financial stability.

16. We are working to build a policy consensus on a number of pending issues such as introduction of Goods and Services Tax, further

liberalisation of FDI, including in retail, deepening and strengthening financial markets for long term investments. A new and facilitative National Manufacturing Policy has been just introduced, with the objective of taking the share of manufacturing in GDP to 25 per cent and creating 100 million new jobs over the next 10 years.

17. The global crisis has offered the opportunity to revisit the conventional wisdom in many areas and review the approach to financial sector reforms. At the same time, these shocks are markers of shifting balance in the global economy, presenting new opportunities for us. India's robust performance in difficult times shows that we could actually come out stronger from these crises. We have to be alert to shape real-time policy responses, reform systems, improve the regulatory framework of our institutions and make the most of the opportunities coming our way.

18. Asian economic integration is underway. There are developments in the trans-border transport networks and energy pipelines with our eastern neighbours and our "Look East" policy has become central to our strategic global engagement. The economic relations with resource-rich nations and the new markets in Africa and Asia help ease the anxieties of slowdown in the economies of traditional trading partners. The vibrancy of our economic and trade relations with BRIC countries further support our vision of engaging beyond the established G-7 nations. We have to build on these initiatives with the involvement of all stakeholders.

19. Let me conclude by suggesting that organizations such as yours and other Think Tanks should occupy an prominant component of our policy

space, like in most G7 countries. You should play an important role in our intellectual and economic discourse with other nations. I thank you for giving me this opportunity to share some of my thoughts with you all. I wish you the very best in the times to come.

Thank you

******