2004 has been a year of great surprises for India. Several months after the victory of the Congress Party during the national elections in May, the uncertainties arising from the event appear to have dissipated. Market fears gradually reversed on the understanding that economic reforms remain on course. The stock market’s rise to a new high as the year concluded bears witness to this, along with the continued accretion in foreign exchange reserves.

Within the Morgan Stanley Capital International (MSCI) Asia Index, India’s performance (up 22.3 per cent) ranked third best in the region, trailing Indonesia (59.7 per cent) and the Philippines (35.7 per cent), indeed a remarkable achievement given the market’s volatility during the early part of the year. The market’s performance was matched by a resilient economy, which, despite a less favourable monsoon compared to fiscal year 2003/2004, remains on course to grow at a rate between six to seven per cent. By and large, this pace is still faster than in most major Asian countries and indeed, other emerging markets.

**India’s Growing Emergence and Challenges**

India is now rapidly gaining recognition on a global front. Arguably, India is on track to be one of the major growth centres in the world over the medium-term, with an average real growth rate of six per cent over the next 10-15 years a distinct possibility. Hence, India’s gaining prominence against many economies within the emerging markets universe offers opportunities to both domestic and international investors. Indisputably, the country’s population and demographics are one of its core growth drivers. With over one billion people whose average age is about 25, India is set to be a major source of labour supply to the world economy in the coming years.

However, economic growth is not just a function of population alone. The quality of human capital plays an equally important role in determining the sustainability of per capita income growth. This in turn implies an educated and skilled labour force in order to contribute efficiently in the economy’s productivity.

In this regard, India is still deficient in providing the basic education for its youth. However, two things are noteworthy in this respect. First, India is recognised for its high stock of trained labour with tertiary education, comparing favourably with China. In 2003, in a range of 0 to 10 with the latter representing the highest score, India scored with 7.2 in IMD’s category of ‘Skilled Labour’, putting it ahead of China with just 4.3.

Similarly, in the category of ‘Qualified Engineers’, India (8.9) ranked ahead of Singapore (7.9) and the US (7.3), while China trailed with a score of 3.9. As a consequence, India’s IT sector, which employs a large proportion of well-trained professionals and has thus been a boon to India’s growth in recent years, is expected to continue to contribute strongly to the country’s acceleration. This is just one sector among many that have yet to be fully tapped. India’s pharmaceutical, automobile and textile industries are gaining rapid international recognition for employing highly-skilled individuals. Undoubtedly, the enormous potential in these sectors will be instrumental...
to India’s transformation into an even more competitive global player.

In addition to enhancing its human capital, there are several other structural factors that need to be addressed in order to lift India to a sustainable growth path. One encompassing area is the country’s large fiscal deficit, which has hovered around 10 per cent of GDP for over a decade now and has arguably constrained growth. Development expenditure by the government has constantly fallen since the early 1990s to below 10 per cent of GDP, while non-development expenditure rose continuously, demonstrating the distortions in allocation of resources that poor public finances have created over the years. Thus, the development of the country’s infrastructure, such as its ports, airports, roads, railways, electricity, water supply and telecommunications, which are all critical inputs to servicing the country’s productive capacity, has mainly been neglected.

One desirable improvement is to increase the country’s savings rate. A relatively high savings rate is conducive to economic growth as it provides a natural resource from which investment for productive capacity can be drawn. While India’s savings rate has largely remained stable at roughly 25 per cent of GDP, the level pales in contrast against major Asian economies. Regulations against private and foreign participation in public sector utilities have impeded foreign capital which could augment India’s low savings rate to finance the needed domestic investments. For instance, FDI in some sectors is still fully (or partially) restricted, which limits the capacity to modernise infrastructure.

Recent policy directives toward attracting FDI investment in infrastructure development are encouraging. In addition, the construction of the golden quadrilateral highway, connecting the major cities of Chennai, Mumbai, New Delhi and Kolkata, represents concrete progress in this direction.

 Opportunities for India’s Capital Markets
Economic liberalisation as well as financial market restructuring will underpin the progress of India’s capital markets. In this regard, the future looks promising, given the perception that economic reforms are on an irreversible path. And, as the economy gradually undergoes its transformation, similar developments will be called for in India’s financial markets in order to meet the more enhanced savings and investment needs of the private sector, on the one hand, and the financing requirements of the corporate sector on the other.

Going forward, the availability of marketable securities and investments will be evolving in tandem with India’s financial liberalisation. This evolution will open a vast array of opportunities for domestic and foreign investors alike. In terms of policy, it remains instructive for India’s policymakers to create a macroeconomic environment that can effectively manage the anticipated amount of capital flows. This will entail, among other things, a gradual dismantling of the remaining capital controls in the country, supported by strong exchange rate management and monetary stability. While privatisation activity slowed this fiscal year in contrast to the previous period, it seems an inevitable event which shall resume as capital markets develop. Privatisation will not only bring in private or foreign expertise, leading to more efficiently run companies, but also increase corporate governance standards. Greater participation by the public should promote the concept of shareholder value, which has been gaining more ground among local investors.

India has come a long way from its near balance-of-payments crisis over a decade ago. Since then, policymakers have embarked upon various measures to reform the economy. But as the outlook for opportunities abound, so are the challenges that need to be addressed with increased resolve in order for India’s citizens to reap the benefits of a fully liberalised economy.