Evolving International Governance, Emerging Markets and India's Economic Prospects

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- I'm honoured to be speaking today at this important event sponsored by EXIM Bank -- an institution that is playing a key role in promoting India's trading relationships with partners around the world -- and I would like to thank the management of EXIM for the opportunity to be here.
- Of course, EXIM Bank's kind invitation to be the 2015 Commencement Speaker led me to look back at the institution's history. I found it somewhat surprising that the institution commenced operations just 33 years ago. Perhaps the promotion of India's international commercial relations previously hadn't seemed so central to India's future progress and prosperity, as it does today. Of course, it is sobering, daunting, but also amazing and energizing to realize how much has changed in just that relatively brief span since EXIM's founding. For example, India's population has increased by roughly 500 million, or by 150% of the current US total. At the same time, India's external trade as a percentage

of GDP has increased more than four times and the country's GDP has nearly doubled every decade.

- I recall vividly my first visits to India – beginning nearly 25 years ago – as I sensed then the possibilities that were waiting to be realized. My understanding has deepened with repeated visits. No doubt, my views on India's potential most likely were influenced as well by my personal connection with Stanford University and its Silicon Valley surroundings – where so many Indian technical and business experts have contributed to the area's exceptional spirit of innovation and entrepreneurship.
- In fact, I recall a visit to Delhi a few years ago when I spotted a phalanx of new office towers that were sprouting up along a highway leading out toward Rajasthan. I thought they looked just like the IT company offices that sit alongside the Bayshore Freeway near Palo Alto. And they indeed proved to be just that -- IT company offices, no doubt being constructed with the same spirit of enthusiasm and optimism that characterizes the original Silicon Valley.
- Of course, much changed in India over the life of the EXIM Bank, but more broadly, the role of the large emerging market economies also has assumed very much greater importance at a global level than was the case 33 years ago. The chance to visit India at this moment is especially attractive, because as you all are acutely aware, among the group of large

emerging market economies, India currently is viewed with particular favour and optimism among international investors and businesses.

- Happily, this relative improvement in large part reflects positive developments, in that there is a sense around the world that India could be at the beginning – perhaps I should say commencement -- of an exciting period of accelerated progress that could encompass many important social, economic and financial aspects. However, some of this current relative favour is just that, reflecting a somewhat less positive outlook than previously toward other large emerging economies and markets, and in fact toward emerging market economies in general.
- In my remarks today, I will try to impart one principal message: Viewed from a global perspective, India appears poised to enter into a period of powerful progress that can carry widespread and profound benefits. But this highly encouraging outcome can't be taken for granted. It will be realized only if the opportunities are seized, including through a combination of reforms and new investment. Oh, and some good luck wouldn't hurt, either.
- In fact, I suspect that you are convinced of this message already. And I certainly haven't come here with the idea that you need to hear from me a specific recipe for success. After all, you understand your country far better than I ever could. But I hope to offer some perspectives that might

help to put current circumstances in context, and that I hope will be interesting and possibly useful.

- I propose to discuss four themes: First, I will summarize some recent history that provides some perspective on the changing role of emerging market economies. Next, I will summarize –very briefly, at least by my standards -- the prospects and risks facing the global economy, including a highly compressed progress report on recent efforts to improve global economic and financial governance in the wake of the Global Financial Crisis of 2007/2009. Third, I'll explore recent shifts in international investors' and businesses' views of the prospects of emerging economies, and finally, I will draw some implications of relevance for India stemming from these developments.

Building the Post-War International System

First of all, a brief survey of recent history might offer some insights. In particular, the seventy-year span since the end of World War II can be – at least for my purposes today –- divided into two broad periods. The first period encompassed the years running from the formation of the key global institutions of the post-War order in the mid- to late 1940s through to the 1990 collapse of the Soviet Union – and the entry of China and India into the global trading system in a major way. The second period may have run from about 1990 through to the onset of the recent Crisis in

2007. As I will discuss, it remains to be seen whether the post Global Financial Crisis period in fact represents a new, third period or not.

- Of course, the lessons drawn from the horrendous period encompassing the Great Depression and World War II shaped subsequent developments in many critical ways. The leaders of the victorious Allies concluded – even before the end of the War – that the Great Depression had been a major cause of World War II, and that the Great Depression itself had been made "Great" by the simultaneous collapse of both the world trading system and the flanking international financial system. In particular, trade barriers of all kinds had been erected during the late 1920s and early 1930s in an inevitably futile effort to boost exports while compressing imports, including through various measures to subsidize domestic production. In the political sphere, the ineffectiveness of the League of Nations – which lacked the United States as a member, despite the institution's having been proposed originally by US President Woodrow Wilson -- meant that there was no political/security forum that could have served to help stave off hostilities. Disaster ensued.
- Even before this dark period ended, the key leaders of the victorious Allies naturally sought ways to make sure that these horrendous afflictions couldn't and wouldn't be repeated. Their analysis of the causes of the disaster guided the specific remedies that eventually were agreed.

At the heart of these efforts was the creation of a set of new global institutions to repair the systemic damage caused by the Depression and the War, and to prevent a recurrence by creating a durable new order. In many ways, these new institutions were unprecedented, and all of them treaty-based, giving them solidity under international law.

- The foundation of the Allies' grand design was a new system of rules of conduct, and a set of three new institutions to oversee them. The proposed new order encompassed the creation of the United Nations, an institution that was tasked with establishing the basic rights of both individuals and sovereign nations, as well as with creating a venue for multilateral engagement on political and security issues – and endowed with at least the potential power of enforcement. The second institutional element of this new order was the General Agreement on Tariffs and Trade (known as the GATT, now the World Trade Organization). The GATT's assigned role was to restore global trade flows by negotiating multilateral reductions of the then-impressive web of trade barriers that had grown up since the onset of the First World War. The third institutional foundation of the new order was the International Monetary Fund, tasked with establishing rules of the game for international finance that would prevent a new disruption of the financial flows that are needed to conduct international trade (of course, the Fund was accompanied by its Bretton

Woods sibling, the International Bank for Reconstruction and Development – now the World Bank).

- Please allow me to share a few observations on the IMF's role. At the heart of this novel institution – for which there was no exact historical precedent -- were two rather radical provisions: Contrary to conventional wisdom, I am not referring to the creation of the dollar-based fixed exchange rate system, in which the US dollar became an indirect stand-in for gold. Rather, I am referring to two other provisions of the IMF Articles of Agreement (that forms the Fund's de facto constitutional document).
- The first of these was the provision that Fund members were obligated to allow their citizens – as a matter of right -- to obtain foreign exchange in order to make permitted current payments (that is, for the purpose of making payments for imports of goods and services and for interest on external debt) free of official interference (that is, free of limits or controls implemented solely for balance of payments purposes). At the time that the Fund was founded, such interference -- in the form of foreign exchange controls -- virtually was universal. Today, following years of phased reductions, such restrictions have become a relic of the past in the vast majority of Fund members, although emerging market economies were relatively slow to dismantle them. To be clear, this undertaking under the Articles didn't in any way preclude the use of

import controls or tariffs for all standard reasons (revenue raising, safety, security, environmental concerns, etc.), but trade controls were to be governed by the multilaterally- agreed rules of the GATT (now the WTO), rather than imposed unilaterally – typically by central banks -- through the financial system.

- The second novel aspect of the Fund is its governance structure. According to the Articles, voting shares are to be apportioned according to “economic weight”, with reassessments mandated to take place on at least a minimum five-year cycle, if not more frequently. Thus, if we could posit for purposes of analysis that per-capita incomes eventually will became equalized among all Fund members (And why not think of this as one of the Fund’s fundamental long-term goals?), the Fund by design would then become perfectly democratic, in that voting shares would become aligned exactly with population shares. I believe that this construction of a governance system that is designed to evolve as a perfecting democracy is unique among global institutions.
- Jumping ahead of the story, at least for a moment, you most likely are aware that the last realignment of IMF voting shares was agreed at the November 2010 G20 Seoul Summit. In the Seoul arrangement -- endorsed unanimously by the G20 Leaders -- the top ten IMF voting shares would be held by the G7 countries -- minus Canada -- plus China, India, Russia and Brazil – and that the top ten members would then hold

52.1% of the voting power (while representing about 65% of global GDP). It is exceptionally frustrating that the adoption of this reform has been held up solely because of the lack of US Congressional approval, as it strikes me that this top ten line-up already is broadly representative of current economic realities. I will return to this theme later when I address global governance reforms in the wake of the Global Financial Crisis.

- ***The First Post-War Period***
- Returning to my introductory narrative about the newly formed institutions, only the United Nations began operations in 1945 as a (more or less) universal institution, with 51 members, including all the victorious WWII Allies. In contrast, the GATT began operations in 1947 with only 23 "contracting parties" as they were called then (India was one). And the IMF began in 1945 with only 29 member countries (also including India).
- As I presume that you all know, the IMF was intended by design to have universal membership, but the Soviet Union – that had participated in the so-called Bretton Woods negotiations that drafted the Fund's Articles of Agreement – declined to join either the GATT or the IMF, opting instead to create the competing -- and ultimately ill-fated -- COMECON.
- Recounting this history hopefully provides two insights. First, the creation of the key institutions of the post-World War II order still left them incomplete, including relative to their founders' intentions. In

particular, if the goal was to create a global system that would foster expanding international trade in the context of sustainable balance of payments positions, the initial impact was rather uneven. Second, the effort to restore the global trading system and to create a resilient global financial system was – during the first post-War period – focused especially on the advanced economies. Thus, the benefit of the institutions' initial success in promoting trade and boosting growth was reaped disproportionately by the industrial countries. In fact, emerging market economies during this first post-War period constituted less than 15% of global GDP when measured at market exchange rates, or about 33% in PPP terms. Today, they comprise more than 25% at market rates, but more than 50% in PPP terms.

- ***The Second Post-War Period***
- The second post-World War II period was ushered in by the 1990/91 collapse of the Soviet Union, and the subsequent transition of the IMF into a universal institution -- today with 188 member countries – as its creators intended. The demise of central planning in the former Soviet Union was one important development, associated – among other things -- with the expansion of the European Union from 12 to 28 countries. Particularly notable as well was the entry of China – and to a somewhat lesser degree, India – into the global trading system. The growing role of emerging market economies was facilitated by the successful 1994

conclusion of the GATT's Uruguay Round trade liberalization, that encompassed major reductions in tariffs and agricultural subsidies, while allowing – among other things – full access for textiles and clothing from emerging and developing countries. The GATT was transformed into the current World Trade Organization in 1995, as GATT membership expanded from 95 in 1989 to 160 today in the WTO. China, as you will recall, joined in 2001, while Russia only joined in 2012.

- In systemic terms, these developments helped to re-establish a global trading system that effectively hadn't existed since before World War I. At the same time, the gradual elimination of foreign exchange controls under the IMF helped to create a global financial and capital system that effectively had never existed previously. As a result, I like to think of the period before 1990 as pre-globalization, or partial globalization, and the period after 1990 as "true globalization."
- I have subjected you to this potted history in order to establish some key points. First, according to my definition, "true globalization" remains a relatively recent phenomenon. It also coincides with a period of exceptional growth in global trade, in cross-border financial flows and in both GDP and living standards in many emerging market economies.
- This period of surging emerging economy growth was not uniform across all countries, and only some emerging market economies managed to sustain rapid growth for an extended period. The World Bank-sponsored

Commission on Growth and Development – headed by Nobel Laureate Michael Spence – looking back at this period concluded that several key factors were common to all of the emerging and developing economies that had achieved sustain strong growth. These factors included "strategic integration in the world economy, the mobility of resources, especially labour, high savings and investment rates and a capable government committed to growth." Thus, it is not surprising that the era of true globalization – including enhanced trade openness -- was associated with rapid economic progress among many emerging economies and notable increases in investment flows to them.

- Perhaps it also is not so surprising that the period of true globalization initially was associated with notable instability that afflicted many emerging market economies, as the process of opening and modernizing many of these economies created new strains. In particular, the so-called Tequila Crisis of the mid-1990s roiled many Latin American economies and markets that only recently had recovered from their "Lost Decade" of the 1980s. The subsequent Asian Currency Crisis of 1997/98 was even more impactful, as it afflicted the area that had for some time enjoyed the fastest sustained economic advances, and whose size in terms of both population and in economic scale overshadowed that of Latin America.
- These 1990s challenges facing emerging economies in many cases could be traced back to weaknesses in domestic financial systems combined

with inappropriate macroeconomic policy pairings – especially in those cases where expansionary fiscal and other policies were maintained in countries with fixed exchange rates, despite widening current account deficits. Domestic rigidities – typically afflicting labour markets – often added to vulnerabilities. This is not to absolve the industrial economies of any responsibility for the problems facing many emerging market countries at that time. For example, instability in the yen/dollar exchange rate in the late 1990s helped to create underlying strains in many Asian markets, while the US-originated "dot.com" boom and bust added to global financial market instability, even if the underlying economic impact of the so-called dot.com "bubble" was not decisive.

- Of course, the next step of this history was the unexpectedly rapid recovery of South East Asian economies: By 1999, this region once again was the world's fastest growing, defying conventional-wisdom sceptics whom had warned of the risks of an Asian "lost decade". Next came the unexpectedly strong rebound in US growth beginning by early 2003 – again defying conventional wisdom – reflecting in part the combination of expansionary US monetary and fiscal policies, but also the ability of the US private sector to adjust relatively quickly to changing economic and financial incentives.

- ***The Pre-Crisis Period***
- What ensued during the four years running from 2003 through 2006 was the most rapid period of global GDP growth registered in more than three decade, as global GDP in real terms grew by more than 5% per annum. Moreover, this period also featured the lowest dispersion of national growth rates registered in the entire post-World War II era. However, unusually similar GDP growth trends in fact masked substantial divergence in the rates of growth in domestic demand among several of the largest economies. As a result, uniquely similar GDP growth trends paradoxically were associated with record levels of current account imbalances.
- Even though these imbalances were viewed by some as representing a principal threat to both sustained global growth and to economic and financial stability, while also being associated with record high commodity and energy prices, attempts to better manage and coordinate global demand trends – most notably the IMF's Multilateral Consultations on Global Imbalances -- failed to gain traction, helping to usher in the 2007/2009 Global Financial Crisis.
- At the time, however, this 2003-2006 pre-Crisis period was viewed more commonly by public officials, analysts and investors as confirming the premise that globalization was ushering in an era of the inevitable advance – in both absolute and relative terms -- of the large emerging

market economies. What began in 2003 as “Dreaming with the BRICS” became a more generalized spirit of infectious optimism regarding a wide range of emerging market economies. As described vividly by such authors as Ruchir Scharma in his 2012 book “Breakout Nations”, the combination of strong domestic demand growth – especially in the United States – together with exceptionally favourable international terms of trade that benefitted many commodity and energy exporting emerging market economies – was associated with the spread of increasingly over-simplified and exceptionally optimistic views about the sustainability of rapid growth among the key emerging market economies.

- ***The Global Crisis Arrives***
- It is in this context that the onset of the Global Financial Crisis represented a much deeper and more profound shock then even those whom had warned of potential problems ahead had anticipated. While I don’t intend – or think that I need to -- recount the details of the Crisis’ unfolding, it is worthwhile to recall that the financial system of the advanced economies proved to be much more vulnerable than had been recognized previously, but also that the depth of global trade relations that had grown up in the previous decades meant that the economic shock of the advanced economies’ sharp downturn was transmitted immediately even to key emerging market economies, many of whom may have

thought that their vulnerabilities to advanced economy business cycles no longer was so direct.

- **The Crisis Response and Current Prospects**

- I will now turn to my second theme: The response to the Global Financial Crisis and the near-term prospects and risks to the global economy. Although the onset of the Crisis remains vivid to me – as I had the benefit and burden of witnessing it from my position at the IMF – I recall how the scale of the economic and financial challenge represented by the unfolding Crisis – that began for me in August 2007 -- was not recognized generally until the dramatic events of September 2008. From that point forward, however, the response of officials and others was alacritous. One aspect that was clear to all in the wake of the Lehman bankruptcy was that the sharp increase in the relative economic weight of the key emerging market economies meant that success in resisting the Crisis would require these counties' full partnership.
- The institutional hallmark of the Crisis response was the formation of the G20 Leaders Summit process – an unprecedented gathering of the Heads of State and/or Heads of Government of countries, including 8 from emerging market economies -- representing more than 80% of global GDP, more than 75% of global trade flows and more than two-thirds of the world's population. Their first meeting was organized in a matter of

weeks, but with the intention of creating an implicitly permanent governance process.

- The first meeting in November 2008 produced an Action Plan with four critical elements. Institutional assignments – some innovative -- were developed in the following months to accomplish each of the four key goals. The four original agenda items were: 1) To restore global growth; 2) To repair and reform the international financial system; 3) To prevent new trade protectionism and to promote new trade liberalization; and 4) To reform the international financial institutions (IFIs), especially the IMF. To accomplish the first, and most critical goal of restoring global growth, the G20 created the Framework for Strong, Sustainable and Balanced Growth – charged with creating a novel cooperative, coherent and consistent approach to setting key fiscal, monetary and structural policies. A Framework Working Group was organized at the Deputy Minister/Deputy Governor level to operate a Mutual Assessment Process (or MAP) to implement this new approach.
- To accomplish the goal of financial sector reform, the G20 orchestrated the transformation of the pre-existing Financial Stability Forum into the Financial Stability Board by mandating the participation of all G20 countries (including India) into the formal process of financial standard setting. The third item – protecting and promoting international trade –

remained a responsibility of the WTO, while IFI reform focused on the IMF.

- I don’t intend to enter into more details about the G20 process beyond making a few points that I consider to be important in the context of today’s themes: First, that the principal institutional response to the Global Financial Crisis was not the formation of a new international institution (or institutions), but rather focused more on ad hoc initiatives. Second, that some 7-1/2 years after the onset of the Crisis (setting August 2007 as the start) -- and some 6-1/2 years after the formation of the G20 Leaders process -- none of the four original key agenda items can be considered to have been accomplished.
- Most importantly, global growth has not regained its pre-Crisis pace, nor have any of the advanced economies yet returned to full employment. As is well known, the United States appears to be growing more rapidly than are other large advanced economies, but all are continuing to utilize unprecedented measures, especially overwhelmingly accommodative monetary policies. At the same time, it is difficult to demonstrate that the policy cooperation effort represented by the Framework Working Group in fact is having any material impact on the economic policy choices of G20 members. To the contrary, it appears that the challenges facing the key advanced economies are rather distinct, and that their policy setting is

– just as would have occurred without the G20 -- much more attuned to their individual circumstances.

- If there is a global policy focus today, it is that investors and policymakers are today fixated on the issue of how soon the United States Federal Reserve will begin the inevitable process of normalizing its policy interest rate, even while the European Central Bank embarks on new expansionary measures, and expectations rise of new expansionary initiatives by the Bank of Japan. With regard to fiscal policies and structural reforms, not much notable is expected at all, such that significant new progress would constitute a positive surprise, even at an individual country level.
- Unless the G20 Leaders exhibit more dedication and political commitment to the Summit process than has been apparent in the past few years, it is difficult to view the Post-Crisis period as constituting a new period in post-War governance. Undoubtedly the Leaders meetings will continue, but the Summits no longer appear to be a venue for galvanizing action, as they were at the outset.
- I don’t want to sound too gloomy about the fundamental outlook, however. Last year’s decline in energy and commodity prices likely will provide a positive boost to the advanced economies this year. Moreover, a quick reversal in these prices isn’t particularly likely: In other words, it is easier to explain crude oil prices in the range of $50-$60/bbl, rather

than of $110-$120/bbl. At the same time, the recent combination of solid US domestic demand expansion plus a stronger dollar is helping to share US demand strength among its key trading partners. The IMF, for example, is forecasting advanced economy growth of 2.4% this year, up from only 1.8% last year. Hopefully the earlier worries expressed by IMF Managing Director Christine Lagarde that the world could get stuck with only a “mediocre” rate of growth will not be realized.

- Nonetheless, the near-term outlook contains important uncertainties. These include the financial market and economic impact of inevitable Fed rate hikes and the continuing strains within the Eurozone from – among other things – the yet-unresolved Greek situation, and the fate of promised French and Italian reform efforts. Moreover, the outlook for Japan – and the additional reforms measures that may be enacted by the Abe government – remains far from clear. Nonetheless, the most likely outcome for the advanced economies in 2015 is for a moderate improvement in growth prospects, but still subdued inflation pressures in the context of residual unused capacity.
- There are three more items on the G20 Agenda: Financial sector reform, trade promotion and IFI reform. Financial reform has moved a long way under the Financial Stability Board, but there is still much to do. There was little doubt that the system had been undercapitalized prior to the crisis; that risk controls had been weaker than they needed to be; that

resolution mechanisms were inadequate, and that many systemically important institutions remained outside the perimeter of effective regulation. There is little doubt that the financial system is safer and more resilient today than prior to the Crisis. But I wish that current reforms were driven a bit less by a desire to make sure that what happened before can't be allowed to happen again, and bit more by a clearer view of what the future financial system should look like along with a plan of how to create it.

- For example, honourable intentions to prevent money laundering are leading to a sharp contraction of correspondent banking networks, with little thought as to the broader systemic implications. And proposed new capital and with other charges and limits on banks are piling up without a completely satisfactory degree of clarity as to their overall systemic effects, for example on the balance between traditional banking and the world of so-called "shadow banks". Moreover, the original intent to make the reform process internationally consistent may not have been quite as successful as it might have been hoped. The result has been a tendency by many financial institutions to shrink from international commitments in a response to authorities' understandable emphasis on financial stability concerns. But at the end of the day, a proper balance between safety and efficiency – and among alternative institutional formats will be needed. After all, ships are safe at harbour, but that's not what ships are for.

- There is more to financial sector reform than just regulation, of course. I suspect that one advantage that has favoured the US recovery has been the tendency of a financial market dominated by the trade in marketable securities – as opposed to a bank-based system – to force early loss recognition in cases of credit impairment. Thus, US firm's balance sheets don't tend to get weighed down and immobilized by unrecognized losses. At the same time, borrowers get much more immediate feedback from investors regarding their current circumstances. The point isn't so much the superiority of one system over the other, but that there are allocational and efficiency benefits that derive from keeping financial valuations realistic.
- With regard to the G20 efforts promoting trade liberalization, of course the crucial November 2014 US/India agreement has paved the way for the WTO's " Bali Package" to move forward. Still pending are the US-sponsored Trans–Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP), as well as the China-sponsored proposal for a Free Trade Area of Asia Pacific (FTAAP). The stakes in this area likely are higher than is perceived generally. As Gary Hufbauer of the Peterson Institute has pointed out, there has been no major multilateral trade liberalization agreement for 20 years – not since the Uruguay Round and the North American Free Trade Agreement (NAFTA) were completed in 1994. Thus, it may not be so surprizing that

in contrast to most of the post-War period, world trade growth has not exceeded world GDP growth since the onset of the Crisis in 2007. At the same time, Foreign Direct Investment (FDI) flows peaked at $2.1 trillion in 2007; in 2014, FDI flows were only $1.3 trillion. In other words, lack of progress in these two areas undoubtedly has limited both actual and potential global growth. Hopefully, there will be new progress on both trade and financial reform in the coming year, but it can't be taken for granted.

- Finally, with regard to IFI reform, and specifically the failure so far of the Seoul IMF reforms to become effective. The impact of this failure undoubtedly has been corrosive for the coherence of global governance. It has undermined confidence in the reliability of the governance process of the existing multilateral institutions. It has raised questions regarding the solidity and traditionally bipartisan nature of the United States' support for the Fund. At the same time, lack of governance reform has encouraged the creation of such institutions as the BRICS Bank, whose substantive role is somewhat uncertain. The bottom line is straightforward: US Congressional approval of the Seoul IMF Reform proposals as soon as possible would be a overdue contribution to more effective global governance. But in any case, it is hard today to view the G20 Leaders Summit process as representing a new period of global economic and financial relations.

- **Evolving Investor Views of Emerging Market Economies**

- Now on to my third theme, which is the latest evolution of investors' views toward emerging market economies. It is certainly no news to this audience that in most cases, emerging market growth is flat to slowing. This follows the brief post-crisis "boomlet" denoted by strong energy and commodity prices. That earlier euphoria was associated with the hugely expansionary policies put in place after 2008 by the G20 countries, and especially by the stimulus-fuelled surge in Chinese demand. However, financial markets' so-called "taper tantrum" in May 2012 helped to focus investors on the reality that virtually each of the key emerging economies is confronting structural challenges.
- Moreover, investors have recognized that these challenges each have differing characteristics, but in broad terms represent barriers to fulfilling the paradigm for sustained strong growth described by the Commission on Growth and Development. One obvious conclusion was that investors' earlier recourse to analytical groupings such as BRICS and MIST countries – despite their diverse challenges -- made these acronyms uncomfortably similar to what the late American author Kurt Vonnegut humorously labelled a "granfalloon", defined as "associations based on a shared but ultimately fabricated premise." Instead, investor talk turned to

new and less flattering labels, like “the Fragile Five”. And this has been associated with market weakness and currency declines.

- Once again, I don’t want to be interpreted as being too gloomy: after all, many of the large emerging economies share characteristics that could create substantial and sustained opportunity for significant progress: These include favourable demographics, low productivity (such that paths to improvement are relatively easy to perceive); institutional weaknesses (thus, improvement is readily conceivable); and underdeveloped financial systems (ditto). And I don’t mean this facetiously: the key challenges aren’t those of invention so much as of adaptation and implementation. Of course, that doesn’t make them simple, easy or inevitable. But they seem possible, and hopefully practical.
- For right now, however, it is clear that investors harbour significant uncertainties regarding the near-term ability of India’s BRICS partners – as well as some other large emerging market economies, like Turkey -- to respond effectively to their immediate challenges, even if the longer-term outlook could become substantially improved. Other emerging market countries, like Venezuela and Argentina, are at present stymied by dysfunctional policy and political stalemates, with no clear resolution in sight.

- Implications for India

So now to my final theme: The implications of current developments for India. First of all, I am a bit reluctant to offer overly specific views on this subject to this audience, as your detailed knowledge eclipses anything I can muster. It is clear that the external environment is mixed but broadly favourable, in just the ways that I suggested at the outset of my remarks. While global growth could be stronger, the drop in energy and commodity prices already has been very helpful, and there are good reasons to expect only modest forces for reversal any time soon.

I certainly don't have to explain any of these factors to this audience, as you will have understood the implied savings for the budget, and the striking interest rate reductions it has allowed. The key challenge for India, however, will be to boost productivity significantly, and on a sustained basis. I don't need to offer a roadmap or a recipe. The recent budget points to increased public investment, tax reforms, and measures to improve the business environment, including an improved Bankruptcy Code, improved targeting of subsidies, and more decentralized – and therefore more responsive -- governmental decision-making.

Moreover, the financial sector development and reforms that have been proposed by the RBI all seem to work in the right direction, and are

exceptionally positive – as the recent Crisis has tended to obscure recognition of the critical positive contribution a well-functioning financial system can make to both growth and stability. All these factors seem very constructive to optimistic and hopeful outsiders. The principal challenge isn't so much in conceiving what to do, but in gathering popular support for change, and in effective implementation. And, that is always the most difficult part of any reform.

In the end, my message is simple: India's circumstances today are not exactly ideal, but they are unusually positive. The favourable combination of low advanced economy inflation and low interest rates – and improving advanced economy growth prospects -- will not last forever, but it should not disappear quickly. Lower energy prices and commodity prices are expected to add to the positive mix for some time to come. Investor expectations are favourable, both because of promises of reform and because of problems evident in other emerging markets.

I am quite aware that I have glossed over many challenges, especially those of a geopolitical nature. But the strengths of this country are so evident, and the opportunities for progress are so palpable at this time. I hope that the next time that I head out of Delhi toward Rajasthan, new improvements will be evident, not just in private construction – although that will be positive – but also in improved infrastructure. And I am

confident that if strong growth can be sustained, and the efficiency and effectiveness of the social support programs and be enhanced by the effective targeting of subsidy payments, the reduction in poverty and other social strains will be impressive. I will never expect to confuse the highway to Neemrana with the Bayshore Freeway, but I am hoping that the prospects for reform and progress – reasonably tempered, and not naïve -- also will not be disappointed. I am looking forward to many future returns to this beautiful and diverse country, and I am a bit confident that my optimism will prove to be justified.