Is India being marginalized?

by Ramtanu Maitra and Susan B. Maitra

The 14-party coalition headed by the Bharatiya Janata Party (BJP) has failed to speak in unison on any subject, particularly on how to deal with the recession-wracked economy at a time when the world financial system faces a blowout. Living in a world of their own, which is characterized by "business as usual" domestic political one-upmanship, the ruling politicos of India have made the second-most-populous nation in the world virtually a mute spectator, playing no role whatsoever in the midst of worldwide financial crisis.

The performance of the present government in the economic areas has turned out to be a complete flop. Its refusal to even recognize the two-year-old recession has further worsened the economic situation overall. The Finance Ministry is still telling all and sundry that the "economy is doing well," and that the economic fundamentals are "strong." As a result, the most recent budget, instead of fuelling a recovery, prompted a sharp rise in the prices of essential commodities. It is no surprise that fewer and fewer in India believe what their government has to say on most economic issues.

A positive infrastructure initiative

On Oct. 24, addressing the annual session of the Federation of Indian Chambers of Commerce and Industry in New Delhi, Prime Minister Atal Behari Vajpayee indicated for the first time since assuming office more than seven months ago that his government is planning to do something positive about the economy. He said that the government will begin spending on infrastructure to revitalize the economy. The first project will be a 7,000 kilometer highway creating a north-south corridor connecting Kashmir to Kanyakumari, and another connecting Gujarat in the west with Sikkim in the east. The $7 billion project—some estimates put the cost closer to $20 billion—will use concrete roads, to boost the flagging cement industry.

The Prime Minister also announced that a new telecommunications policy will be formulated within the next three months, to provide a state-of-the-art nationwide telecommunications network and speed up delivery of rural telephone services. He also announced on Nov. 1, the launching of the Iridium project for global telephone service.

In addition, Vajpayee said that within the next two months the government will invite bids in the oil exploration sector, offering deep acreages with high potential. Also, five cities will be identified for construction of world class international airports with a maximum of 100% foreign equity investment.

While such projects are of great importance, the question that is in everyone's mind is whether the government will follow through. For example, the budget allocation for highways for the year is a meager $120 million. One wonders how serious the government is, when the Prime Minister states coolly that work on the highway project "will start within this year and from 20 different places within the country."

Low credibility

It is an understatement to say that the credibility of the government on economic issues is low. Recent figures released by the government showed that the capital goods sector grew by 11% in the first quarter of this fiscal year, compared to last year. A healthy growth, no doubt, but the figure was immediately challenged by the Confederation of Indian Industry, which pointed out that the government included electronic hardware to make the figure look good. In reality, the entire capital goods sector, including the machine-tool industry, is suffering badly due to recession.

Finance Minister Yashwant Sinha's repeated assertion that the growth of the Indian economy will be more than 6% is contested even by government institutions. The National Council for Applied Economic Research, a leading institute for economic studies, projects growth to be not more than 4.5%, if nothing untoward happens to the global economy in the next six months. Commerce Minister Ramakrishna Hegde's statement that India's export growth in the coming year will be 15%, when worldwide trade has diminished by 50%, is rhetoric, and people know it.

When the Prime Minister spoke of setting up five world class airports, one wondered why, then, the government had failed to get one airport in Bangalore past the Civil Aviation Ministry, despite the staunch support of the Karnataka state government. Similarly, a lot can be said about the Vajpayee government endlessly messing up the telecom licensing policies, and creating a scare among the investors.

The credibility of the BJP-led government, and the Finance Ministry in particular, is now perhaps at its lowest ebb. In order to boost its image, Prime Minister Vajpayee and Finance Minister Sinha have both recently dolled out some lollies to the corporate sector, including allowing them to buy back their shares, removal of restrictions on inter-corporate investment, and dilution of provisions of the takeover code, hoping to revive the sagging capital market. Although the market responses have yet to come in, the fading credibility of the government has begun to do its damage. Beside asking the obvious questions—such as, "How relevant are these measures compared to the enormity of the crisis that the country faces?"—some observers have already come to the conclusion that the government will not be able to implement even these measures. This, in essence, expresses the paralysis, and the ostrich-like syndrome, that the government is suffering from.

Since the Vajpayee government took over, much has been said about how India has virtually insulated itself from the world financial crisis. The reality, however, is different. As one economic commentator pointed out, India can also experience a meltdown like that of Thailand, Malaysia, or Indonesia. One of the strengths of India's economic fundamentals cited by Finance Ministry officials, is that India's short-term debt does not exceed $5-6 billion. However, what they leave unsaid is the fact that convertible non-resident India deposits, which are easily withdrawable, amount to $20 billion. In addition, India's foreign trade is about $85 billion; along with current account items, it is close to $150 billion. Leads and lags amounting to just 20% of this total would exceed India's $24 billion foreign exchange reserves, one commentator pointed out. Therefore, the payment crisis that occurred in 1991 can happen again, whether the Finance Ministry admits this fact or not. We have seen, in the case of the Southeast Asian nations, how quickly things can turn sour when foreign portfolio investors act like a stampeding herd, moving their money out in no time in a state of panic.

During his visit to the World Bank-International Monetary Fund (IMF) meeting in October, Finance Minister Sinha attacked the IMF for its failures, but placed his faith firmly in the free-market process. The failure of the Finance Minister to articulate why the current Bretton Woods system is not conducive to economic development of the economically weaker nations, loomed large in Washington. Instead, the Finance Minister's gloating about how India has managed to avoid the financial collapse that the Southeast Asian nations have encountered sounded hollow, if not downright irresponsible.

A poor leader

What Finance Minister Sinha must admit, and admit publicly, is that the market-based solutions are not the answer. The collapse of the Southeast Asian nations' financial system, the destruction of the Russian economy, and the impending threat that looms large over Japan's financial system, have left every economic establishment, including the IMF and the World Bank, clueless about what to do next. On the Western bourses, share prices are in retreat. Neither the earlier boom nor the present despondency can be fitted into the conventional market theory to provide a satisfactory explanation. It is evident that it is time to go beyond the conventional thinking in terms of market-based solutions.

In addition, it is not at all clear that the Finance Minister is keen to really buck the IMF. While the country is suffering from deep recession, and the basic industrial and social infrastructure are in a total mess, Sinha reiterated in an economic editors' conference recently, his long-term goal of bringing down the fiscal deficit to 3%. He assured the IMF bureaucrats, revealing that he had told a recent meeting of secretaries to the government that they would have to stick to their expenditure targets and would get nothing more. Needless to say, the announcements made by the Prime Minister on Oct. 24 are in direct conflict with the Finance Minister's goal.

The government has failed so far to put the emphasis where it is needed. Despite oodles of promises made to Indian citizens by the last three governments, and this one, the power situation has gotten worse. The power privatization scheme, a hoax which this government also chooses to promote, has resulted in the addition of less than 1,200 megawatts of power generation capacity by private investors in the last seven years. The government offered private investors a 16% return on equity, and about 130 memoranda of understanding for a total of 70,000 MW were signed by promoters. Unfortunately, nothing much has materialized. Meanwhile, one government after another, citing the "great success" they have achieved in luring private investment into the power sector, has plunged the country into prolonged hours of darkness and deepened the industrial recession. Add to that the government's disinterest in revitalizing the bankrupt state-owned state electricity boards, the main suppliers and distributors of electricity in India.

A similar lack of concern exists in New Delhi about ports. In 1997, India's 11 major ports handled 251 million tons of cargo. A working group for the ports has estimated potential traffic by 2001-2002 at 424 million tons. This calls for an increase in capacity of 173 million tons within three years. However, the Ministry of Surface Transport points out that only 37 million tons will be attained from the schemes now under implementation.

While the Finance Ministry remains oblivious to the country's immediate financial requirements to build up its infrastructure, India's central bank, the Reserve Bank of India (RBI), under its governor, Bimal Jalan, has kept the short-term interest rate high. The banks are sloshing with money while the credit offtake remains weak. The banks are afraid that with price rises all around, the RBI will increase the interest rate again later in the year and cause depreciation in their investments.

The major task that confronts the Vajpayee government at this crucial time, and which it has assiduously avoided so far, is to help direct the international community in its search for an appropriate architecture for the international financial system. Such a system would help nations to embark on the development of their physical economy and social sectors. India has the responsibility to spell out clearly a much better currency regulation and monitoring of the financial system for all countries; the kind of institution which will replace the IMF; a more equitable trade agreement between nations; and how to deal with foreign debt, and private foreign debt in particular.

In order to begin to do the above, the Vajpayee government must set its own house in order. India's physical economy is in tatters, and is crying out for investments and quick implementation of those projects.