Economic and Political Crisis Imperils 1.2 Billion Indians

by Ramtanu Maitra

Dec. 17—India's industrial output fell by 5.1% from a year earlier in October, pushing the national currency, the rupee, to a new low. This crisis emerged in the midst of year-long unabated inflation, and the growing public distrust of the Manmohan Singh-led United Progressive Alliance (UPA) government. "Things are looking bleak," Ved Prakash Chaturvedi, CEO of the capital markets and investment management group at L&T Finance Holdings, told Bloomberg UTV. "Globally, investors are in a panic and more needs to be done to reassure them of the opportunities in India." These developments have sent a clear message to the already paralyzed UPA government: Improve or perish.

The monetarist policies of the Manmohan Singh government have brought India to the precipice. Continuation of these policies could spell unmitigated disaster for the country's 1.2 billion people, of whom more than 50% live in poverty. Economic chaos would surely make India politically unstable, at a time when India's stability in that instability-infested region of the world is of prime importance. India already has its share of terrorists, secessionists, and religious conflicts. An economic collapse, such as the Eurozone is about to experience, could set the stage for violent conflicts. What happens in India is of both human and global strategic concern.

Since India's economic crisis has its roots in the overall collapse of the global financial system, Prime Minister Singh's conviction that his country will be saved by Foreign Direct Investment (FDI) is a delusion. In fact, his own misdirected developmental policies, centered on globalization, liberalization, and privatization, are part of the problem.

During its reign since 2004, the Singh government has failed miserably to improve India's vital infrastructural sectors and agricultural productivity, the cornerstones of any large nation's long-term economic well-being. As a result, more than 500 million people in India remain steeped in poverty. During this period, India's high GDP growth, of which the Singh government boasts, helped to create a thin layer of very wealthy people in a sea of poverty. This situation has not only sent the price of India's real estate soaring—an inflationary bubble of no benefit to the nation—but has imperiled the survival of hundreds of millions of people.

Added to these negative developments is the endless policy-making gridlock, as the government is distracted by corruption scandals and deterred approvals of projects needed to add capacity in an economy which is running on a borrowed time.

Rupee on a Downward Spiral

Since last July, the rupee has lost almost 20% of its value. This is merely a symptom of the wide-ranging economic weaknesses in India, and signals a "goodbye" to high economic growth. The weak rupee is confounding India's attempt to manage inflation, by pushing up the cost of imported items. Inflation has remained above 9% for the past 11 months, despite 13 rate hikes by the Reserve Bank of India (RBI) since March 2010.

Notwithstanding the sharp downturn in production, which is the third decline in four months, India's central bank has no intention of loosening the strings of the moneybags. On Dec. 16, the Reserve Bank held its policy repo rate at 8.5% after the November wholesale price index showed inflation holding above 9% for the 12th month in a row. (At 9.11%, it had fallen from 9.73% a month earlier.)

"While inflation remains on its projected trajectory, downside risks to growth have clearly increased," the RBI said in a statement, adding that inflation risks remained high, and the slump in the rupee was also exerting price pressures.

In an indication of cash shortages, lenders borrowed an average of 924.7 billion rupees per day in November, at high interest rates from the Reserve Bank, almost twice the amount sought in October, according to data compiled by Bloomberg. They borrowed 867.6 billion rupees per day this month. Overnight rates surged to 9.15% on Dec. 16, the highest level in three years.

The effects of the falling rupee are particularly devastating in the case of petroleum. India imports about 75% of its crude oil, which means it will have to pay more in rupee terms to bring the oil ashore. If the government succeeds in passing the higher oil cost to customers—which could be political suicide for the teetering coalition over which Manmohan Singh presides—it will add to the inflation. If it does not, the government will be facing higher fiscal deficits that will, in turn, drive down the value of the rupee further.

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Indian Prime Minister Dr. Manmohan Singh meets Russian President Dmitri Medvedev in Moscow, Dec. 16, 2011. Singh's monetarist delusions about a bailout for India from "foreign direct investment" are standing in the way of development of the economy, in partnership with Russia and other nations.

Crude oil is just one item, albeit the largest. But a falling rupee value will make all imported items more expensive—raw materials, intermediate goods, and finished products. The declining value of the rupee will prompt foreign institutional investors, fearing loss of value to their investments, to withdraw money from the Indian equity market.

Unlike most of its Asian peers, India has recently been running large current account and fiscal deficits. Its annual financing requirement of $119 billion is the highest in Asia, according to a Nomura report. The trade gap for the fiscal year ending March 2012 is expected to widen sharply to $155-160 billion from $104.4 billion a year ago. As of Dec. 9, 2011, India's foreign exchange reserves are close to $307 billion, according to the RBI.

India's competitiveness problem is showing up in its widening current account deficit, to more than 4% of GDP in the July-September quarter, according to Goldman Sachs. That gap is being filled by flows of capital from the rest of the world, and not necessarily to the benefit of India. As one analyst pointed out, a sharply declining portion of capital inflows (as competitiveness drops) is from foreign direct investment (FDI), and remittances from Indian workers abroad—which means that balancing this untenable position is more and more dependent on hot money.

In a recent detailed and insightful article, "For Whom the Rupee Falls?," Virendra Parikh, executive editor of Corporate India, pointed out that India's external debt profile has also worsened: "The overall quantum of the external debt stood at $295.8 billion at the end of September 2010, up from $262.3 billion at the end of March. Short-term debt, at $66 billion, now comprises 22.3% of the total, compared with 20% at the end of March.

The other important debt sustainability ratio, the ratio of concessional debt to total debt, also deteriorated. It fell to 15.6% from 16.7% over the review period. And after a gap of seven years, India's foreign exchange reserves have slipped below total external debt. The country's forex reserves worked out to be 99% of its debt at the end of September 2010, down from 138% in March 2009."

One of the most disturbing aspects of this situation is the Singh government's illusion that the ongoing financial collapse in the West is a temporary phenomenon, and that the economies of both Europe and the United States will bounce back in no time, allowing India once again to secure substantial sums of FDI annually. Such a recovery, Singh claims, will also enable the West to import more and more from India, and elsewhere. A pipedream, as long as this bankrupt monetarist system is not replaced by a new international credit system, based on Glass-Steagall.

The Dream of FDI

It is evident that Manmohan Singh and his majordomo, Montek Singh Ahluwalia, both former employees of the World Bank/IMF, still go by the briefings sent to them from Washington and Brussels. The duo even fails to comprehend that the Eurozone is in its last gasp. Eurozone growth flattened at 0.2% in the third quarter—perhaps an unjustifiably rosy picture, whereas the actual numbers could be negative, according to official EU data. The 17-nation bloc's economic expansion between July and September was pulled up by growth rates of 0.5% in Germany and 0.4% in France, according to the Eurostat data agency. Four countries experienced contractions in the third quarter: -0.8% in Cyprus, -0.4% in Portugal, -0.3% in the Netherlands, and -0.2% in Slovenia. Belgium and Spain saw zero growth. In other words, the Eurozone is a world of the living dead.

What that means is that FDI is not going to flow in like monsoon water, as Manmohan Singh once told his Indian audience. His earlier silly statements, like the one about how $1,000 billion in FDI will be used to build up India's infrastructure, now draw guffaws. As Virendra Parikh observes: "FDI continued to be a concern with inflows declining to $2.5 billion from $7.5 billion a year ago, owing to lower investment in construction, real estate, business and financial services."

The more significant threat to the Indian economy is that its helmsman, Manmohan Singh, is intellectually bankrupt and politically paralyzed. Recently he tried to push another gimmick, trying to get some FDI by introducing a bill that would provide a wider playing field for foreign retailers. The bill has been blocked in Parliament by the opposition, and even by some of the UPA's key coalition partners. UPA spokesmen tried to cajole the opposition by acknowledging that FDI in multi-brand retail may not be the pep pill the economy needs, but that it should be seen as a signal epitomizing a "now or never" moment to snap out of the slowdown of growth. This approach, however, has failed to change the mood of parliamentarians.

Prime Minister Singh, whose economic education does not go beyond three chapters—liberalization, globalization, and privatization—has never had any contact with real people (nor has he shown any intent to have such) or any understanding of the country as a whole, while he continues to implement monetarist economic policies taught at foreign universities and promoted by his former employers, the IMF and World Bank. Having no clue how to build a nation which is the home of 1.2 billion people, he does not realize that the future strength of India lies in building up its physical economy, which could provide a respectable living standard, not just to a handful of Indians, but, among others, to the 400 million-plus people who still live without electricity.

His latest failed attempt to usher in the foreign retailers Wal-Mart and Carrefour drew howls of protest from opposition parties and from allies within his Congress Party-led coalition. The Indian Parliament remained adjourned for six days, holding up other major bills, such as one on food subsidies for the poor.

"The increase in foreign direct investment will lead to the introduction of modern technology, remunerative prices for farmers, and the common man will get essential commodities at lower prices," Singh told a Congress Party meeting, as party head Sonia Gandhi looked on. "The decision on allowing FDI in retail was not taken in any hurry, but well considered," Singh said, adding that investment rules would protect small businesses.

Gandhi also spoke at the meeting, her first public appearance since undergoing surgery this past Summer, but she made no mention of the retail reform. She has been cautious about the bill's effect of hurting small retailers. And Gandhi was not alone. A senior minister who was present at the Cabinet meeting that discussed FDI told the Indian *Deccan Herald*: "This issue is no nuclear bill. It can hit people's livelihood. For all political parties, this was a major issue and they grabbed it. It is like walking into a trap. Economic reforms-wise, was it necessary when we were still doing seven per cent growth?"

The bill died a well-deserved death.

Political Bankruptcy

It is widely recognized in India that Manmohan Singh has no political base. He was never elected through the people's vote, not even once: He was a consensus candidate. It is his lack of political understanding, his lack of knowledge about what Indians need, and his inability to make decisions based upon what is good for the people, all in the context of a profound global crisis whose existence he does not recognize, that have brought the country to this economic peril.

Although personally honest, he is unable to control corruption, and Indians have come to realize that controlling corruption was never a major agenda item for him. Many believe that his government is the most corrupt government in post-Independence India, and the allegation does hold some water.

The corruption that stank up the building of the infrastructure for the 2010 Commonwealth Games, held in New Delhi, was the most publicized, but just one of

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More than 50% of Indians live in poverty, and 400 million people lack electricity. Yet virtually nothing has been done, during seven years of the Singh government, to change this situation. Shown: women wash clothes in a ditch, Mumbai.

many scams over which this government has presided over. After the Commonwealth Games scandal came a scam of billions of dollars organized by Cabinet ministers and senior bureaucrats, in cahoots with some high-flying Indian entrepreneurs. That sordid episode, known as the 2G scam, involved federal government officials illegally undercharging mobile telephone companies for frequency allocation licenses, which they would use to create 2G subscriptions for cell phones. The shortfall between the money collected and the money that the law mandated to be collected is estimated to be close to $39 billion.

The licenses were issued in 2008, but the scam came to public notice when the Income Tax Department was investigating a political lobbyist in 2010. The scam has already sent then-telecom Minister and a slew of senior bureaucrats to jail. Reports from New Delhi indicate that Interior Minister P. Chidambaram, a Harvard trained-economist, is also involved in the scandal, and is on his last legs, politically.

While these scams have provided the Indian people the fodder to attack the government, the prime minister's failure to focus on developing India's infrastructure is a much larger crime. One official, monitoring government infrastructure projects, said that of 558 government projects, 241 were delayed as of the end of July, resulting in a cost overrun of some 20%, or more than $31 billion. The projects, which include setting up airports, new railway lines, ports, roads, and power plants, have been delayed by more than two years on average, due to issues of land acquisition, environmental clearance, and rising costs.

Consider two sectors of India's physical economy, and it will become clear that during the seven years of his reign, Singh has done very little.

Electrical Power Deficit

These two sectors are power and agriculture. As of now, give or take a few thousand megawatts, India's installed capacity of electrical power generation remains abysmally low, at 154,000 MW.

This is not the forum to compare India's power-generation capacity with that of China, but it must be noted that China's installed capacity is now well over 950,000 MW, and China is planning to add 500 MW every week. India has announced that it will be installing 200,000 MW of power over the next ten years, which works out to approximately 400 MW a week. In the case of China, however, we have seen that it implements what it says it is going to do, and more; but not India. It does not happen because the necessary groundwork to achieve such objectives has not been laid.

Take, for instance, what the Centre for Monitoring the Indian Economy (CMIE) published in its report on India's power-generation capacity in fiscal year 2009: India's power generating capacity went up by about 3,500 MW, but this was barely 32% of the target of 11,061 MW for the period.

Despite projections, and the expenditure of oodles of rupees, fully 56% of rural households in India are

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India's Koodankulam nuclear plants, under construction by the Russian firm Institute Hydroproject. New Delhi has done little to promote nuclear power, despite the fact that Russia has promised to build at least 14 more desperately needed reactors.

without electricity[1]—almost 500 million people. In addition to the health problems that such a condition creates, New Delhi is cutting off its own feet by not providing the basic necessities that would allow the next generation of Indians, who will have to become the leaders of the nation, to receive the absolute necessity: an adequate education.

New Delhi says it has targeted an investment of $350-400 billion in the power sector during the five years ending March 2017. But here is the caveat: Half of this expenditure, between 2012 and 2017, is expected to come from the private sector. It is difficult to assume that India's major business houses and corporations, supposing they would have the capability to assemble the required investment, would spend it providing electricity to the poor and hapless, instead of using it to enhance their manufacturing or service capacity.

This brings us to the status of two Russian 1,000 MW nuclear power plants in Koodankulam, in the state of Tamil Nadu. One is almost ready for commercial power production, while the other could go mainstream in 2013. However, the local residents have held these two reactors hostage and have made known their intent to prevent their commissioning for alleged safety reasons. For a country that is power-starved, to get these reactors online is a must, but New Delhi has made little effort to resolve the matter with the locals.

Manmohan Singh was in Russia recently, and the Russians made clear to him that this situation is unacceptable, since Russia has promised India at least 14 more large reactors. Facing the Russian criticism, Singh said he would attend to the matter.

Is Singh Anti-Agriculture?

India's agricultural sector, where almost 60% of Indians are rooted, has been subject to gross neglect for decades. Even if one acknowledges that the terrific food price rises have had more to do with the mismanagement and inadequate distribution system that has become the hallmark of this administration, the fact remains that India's agricultural productivity is well below what it should be. It was expected that the UPA, under Manmohan Singh, with the financial solvency it enjoyed (by contrast with previous administrations), would focus on improving India's agricultural sector, by improving water storage, water management, supply of power, fertilizer, etc. But during these seven years of the Manmohan Singh Raj, nothing has been done to alleviate the threat that India's agricultural sector faces.

In an analytical piece, "India's Farming Failure—Analysis," Sarosh Bana, a research scholar with the Hawaii-based East-West Center, pointed out last June that India's failure in agriculture is coming under increased scrutiny, as soaring food-price inflation ravages the common man and cripples household incomes.

Terming India's food situation "real bad," Dr. Lux Lakshmanan, director of the Agriculture Consulting Service of Davis, Calif., told Bana that he regrets that it is unlikely to improve in the foreseeable future. A consultant in crop production to California farmers, Lakshmanan has set up a center in Chennai in south India, where educated youth are trained to become agriculture entrepreneurs who will use modern crop production technologies and tools.

1. Source: the Ministry of Power's brochure on Rajiv Gandhi Grameen Vidyutkaran Yojana (rural electrification).

India's agriculture will need to evolve in a manner that meets the requirements of the officially projected population boom, to 1.33 billion by 2020, and to 1.4 billion by 2026. But there is no silver bullet, no single solution. At the same time, it is clear that the country cannot continue to be beset with low agricultural productivity and growth.

The problem is as much a matter of a shortfall as it is supply and distribution bottlenecks, Bana noted. Simple arithmetic demonstrates that if two decades ago, an output of 176.39 million tons fed, or nearly did, a population of 849.75 million, then the present numbers of 1.2 billion would need yields of at least 250 million tons. In 2010-11, foodgrain production rose to 232.07 million tons—almost 18 tons short of what is needed.

The 1.42% compound annual growth rate (CAGR) in foodgrains has trailed behind the 1.66% CAGR of the population. Oilseeds have trundled along at 1.14%, while production of pulses (legumes), the staple for a large cross-section of the population, actually dipped by 0.23%.

Indian farmers are vulnerable because of two primary factors. One relates to their small holdings, which tie them into a low-income trap, restraining any credible investment of their income or surplus in land productivity. Secondly, 60% of agriculture is still dependent on the rains; if the rains fail, or there are unfavorable variations in rain or other climatic factors, then crops suffer.

Bana paints a stark picture. India has no shortage of arable land, or of water. Almost half—159 million hectares (mha), or 397 million acres—of India's territorial area ofmha (820 million acres) is arable, the largest for any country after the United States' 167 mha (417.5 million acres). But while 48.5% of India's land is cultivable, in the U.S., it is only 18.2%; in China, 16.13%; and in Brazil, 7.82%. Yet the yield of paddy in India is just 3,303 kg per hectare (2.5 acres), compared to China's 6,422 kg, Brazil's 3,826 kg, and the world average of 4,233 kg. India's wheat yields are better, at 2,704 kg compared with Canada's 2,322 kg, the United States' 2,705 kg, and the world's 2,829 kg. In sugarcane, Indian yields are 72,555 kg per hectare, while those in Egypt are 119,557 kg; Guatemala, 88,630 kg; and globally, 69,998 kg.

One does not have to seek far to understand why Indian agriculture is lagging so far behind.

Although India's economy boasts of a 7.5 to 9.6% growth rate over the last few years (though it is now in decline), agricultural growth has foundered at 3%, sometimes a little above that, often below, but largely short of the targeted 4%. In 2006, pointing to a "crisis of stagnation in agriculture," the Planning Commission had postulated putting agriculture on a growth path of 4% for the ongoing 11th Five Year Plan (2007-12). Urging a "new deal" that would kindle "hope" for farming, the Commission prescribed that such growth was to be attained through spurring demand for farm produce, matched with the supply-side response based on productivity improvements. But the directionless Manmohan Singh has no clue what to do to improve this sector of the physical economy.

These two physical economic sectors are not the only ones that have been neglected by the UPA, keeping the country weak and devoid of a stable future. India's railways, unlike China's, have remained archaic. No modernization has been accomplished. According to Manmohan Singh, all this will be accomplished when the foreigners send hundreds of billions of FDI.