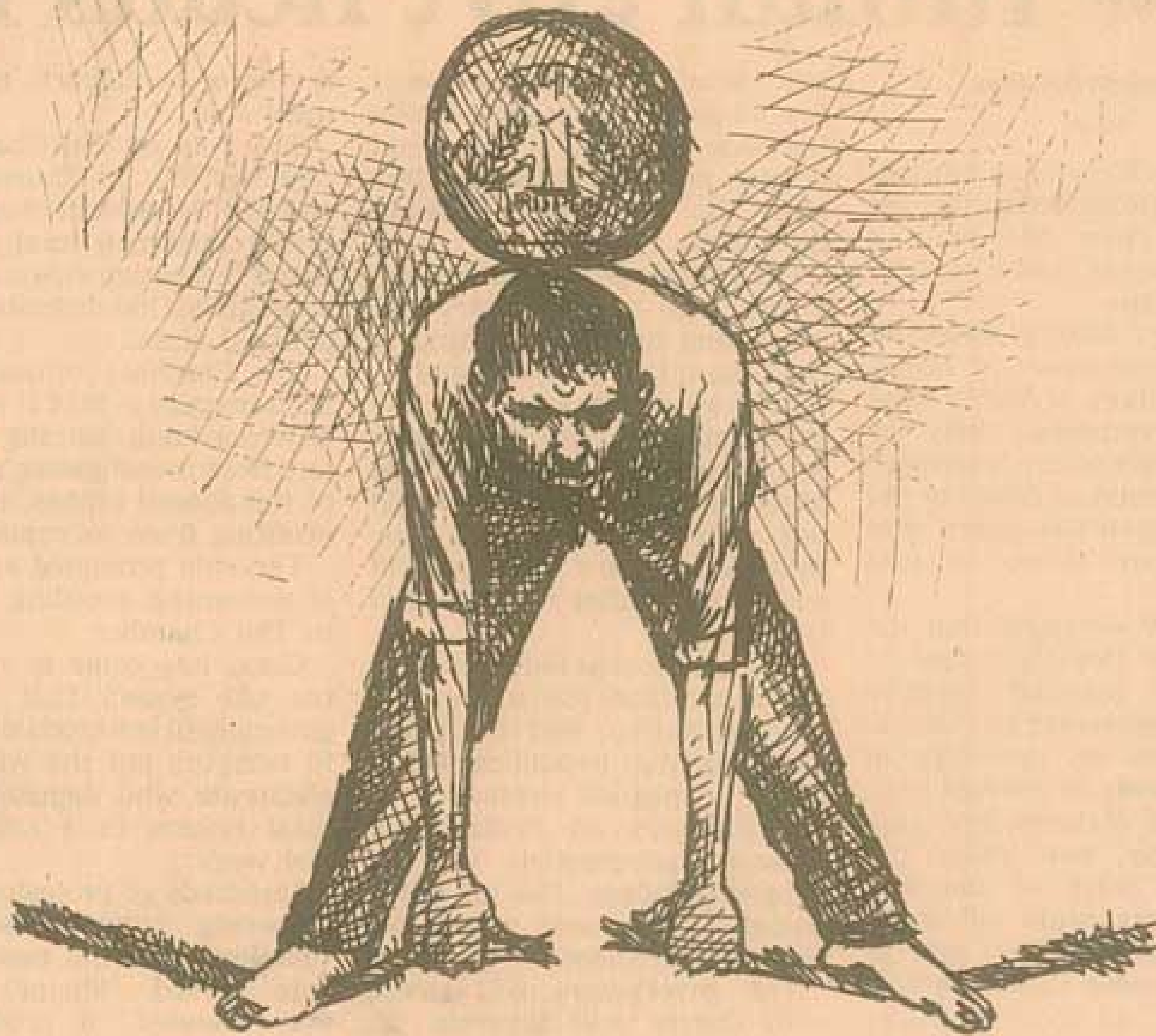
The Weekend Observer May 1, 1993



BoP still precarious

We cannot afford to ignore the trade deficit despite the rupee holding steady, says **Uttam Gupta**

NEARLY seven weeks have passed since the unified exchange system was introduced. Much to the pleasure of those who wanted to take an immediate plunge, the rupee has not only been steady but even looks distinctly better than it was for nearly two months preceding presentation of the 1993-94 budget.

The trends have generated an air of exuberance. But, this is not the time to jubilate, much less to consider it a grandiose success of the revolutionary decision. As it is, seven weeks is too small a period for reaching any meaningful conclusion. Still, we may have some thing to fall back on to guide us.

It may be recalled that from March 1, 1992, we had a dual exchange regime. Under this, the market-determined rate of exchange applicable to all transactions other than import of specified priority items remained more or less stable at about US$1 = Rs 31 almost throughout 1992-93. Should that not justify our optimism with regard to the likely outcome of the current regime, which is no dissimilar.

The stability of the rupee in the market sector can be directly ascribed to consistent improvement in the foreign exchange position. Foreign exchange reserves at the end of 1992-93 were about US$6.3 billion i.e. 700 million more than at the end of 1991-92. How did this come about? Partial convertibility of the rupee undoubtedly made things a shade better for the exporters than under the erstwhile official exchange regime. At US$1 = Rs 29 being the weighted average realisation at the prescribed 60:40 ratio, the exporter was definitely getting an advantage of about 12 per cent. Together with liberalised rules for gold and silver imports, this helped in beating down the *havala* market. The inevitable followed and there was largescale diversion of foreign exchange remittances to official channels. But, there are other fundamentals that impinge on the balance of payments and the resultant foreign exchange situation.

Trade deficit during 1992-93 was higher by about US$3.0 billion than in 1991-92. Debt repayments were up by another US$1 billion. Gross disbursal of external assistance was down by more than US$1 billion. NRI deposits and foreign investment increased only marginally. Predictably, these negative factors have been offset by diversion of NRI remittances from the *havala* market on the one hand and borrowings from the IMF on the other. But, that offers no room for complacency.

On NRI remittances, two basic questions need to be addressed. First, those who remitted all their money through official channels did so because they saw the substantial monetary gain and reacted spontaneously. But, to ensure that they continue to do so, we have to make the banking system smooth, efficient and less time-consuming. Currently, it takes not less than two months for the NRI to put his foreign exchange earnings into the hands of his relative in India. Against this backdrop, the tardy pace of progress in financial sector reforms leaves a big question mark.

Second, remittances by itself is an area subject to great vulnerability. Over the years, these have gone down considerably.

Borrowings whether from the IMF or any other source is a dangerously unhealthy trend as it accentuates the debt repayment burden and only means more serious problems for future BoP management. Ironically, despite recognising this, we have no intentions of shedding our past habits.

Foreign direct/portfolio investment and investment in real estate have been in the limelight for some time now. Herein also, rules have been liberalised and concessions given to the foreign investors to the point of even discriminating against domestic investors. And yet, there are hardly any indications of foreign investment being undertaken in a big way. Indeed, the single most important reason for this is what Mr N Palkhiwala recently described as frequent violation of the principle of 'promissory estoppel' by the government and its agencies.

If we are really serious about effectively managing the BoP and want the rupee to behave the way it should, we can't afford to ignore the trade deficit. Unfortunately, it is on this front that the situation, far from improving, has only deteriorated. Exports increased by a meagre 2.2 per cent during 1992-93. In contrast, imports increased by about 15 per cent.

There is a belief that the market-determined rate of exchange will automatically put exports on a high pedestal. This is a totally misplaced notion. Even so, the only advantage an exporter now has is an extra eight per cent for every dollar worth of exports (Rs 31 to US$1 against Rs 29 under the dual exchange regime) But, what about a whole array of cost push factors that an exporter faces. The cost of export credit, continues to be twice as high compared to major competitors in the world market. Cost of infrastructure is still amongst the highest. Administered prices of basic inputs continue to rule high and are increased frequently. Custom and excise duties have, of course, been cut particularly on capital goods. But, the consequential gains are more than offset by unbriddled cost increases in other areas.

On the import front, the situation is no better. Production of crude oil and petroleum products, which constitute bulk of our import kitty, has gone haywire. The import bill on this account alone is expected to be US$1 billion more during 1993-94. Foodgrains imports on a significant scale is likely to encroach on our foreign exchange reserves sooner than later. For the fifth year in succession, we had good monsoons. Taking a cue from the past, the weather gods are unlikely to remain favourable in 1993-94. Besides, having already derailed our time-tested policies on agricultural inputs, particularly fertiliser, serious adverse effect on foodgrains production cannot be postponed any more. There are additional reasons why imports will grow faster.

In the name of globalisation, we are seeking to increase our dependence on imports even in areas where the items can be produced indigenously. Production of urea presents one such case where Indian companies are being enthused to set up joint ventures in the Middle East. Curiously, we do not make any sincere effort to tackle the high-cost syndrome in our own country and then, talk of importing. The recent signing of a MoU with Oman for purchase of gas from that country even as our own gas is being flared provides another example.

Needless to mention that in numerous areas, consequent to 'unfair' competition from MNCs taking advantage of our liberalisation spree, we are spending foreign exchange on items that are domestically available. That it has unleashed the horrendous phenomenon of de-industrialisation in India is an issue by itself to which our policy makers should wake up to lest the damage will be irreversible.

The upshot then is that stability of the rupee during the past 14 months or so, is fragile. Indeed, our BoP continues to remain as vulnerable as ever. NRI remittances or the IMF loan are no more than 'crutches'. And, the worst part is that having made the rupee fully convertible, we have tended to believe that all our problems will be automatically taken care off.

So much so, we even refuse to recognise the catastrophe we are in for in case the rupee slides say, to Rs 35 against one dollar, or even higher. For instance, what happens to the cost of food imports, crude oil or petroleum products and fertilisers. And, in turn, the all-round inflationary effect on the entire economy.

The case of power illustrates the dastardly consequences even better. To enthuse foreign companies to invest in the power sector, they have been allowed to adjust the power tariff to reflect the impact of exchange fluctuations. But, have we thought of the crippling burden such an arrangement will lead to as and when the rupee depreciates.

There is no alternative but to deal squarely with some of the basic maladies. First and foremost, is dealing with the high-cost syndrome. Some beginning was made in the respect of taxation by the Centre. However, the administered prices of basic inputs as also the interest rate need to be reduced to levels comparable internationally — i.e. in power, railway freight, telecommunications, gas etc..

Second, the procedural/bureaucratic hurdles remain intact. Only the form has changed. Prior to the reforms programme, these worked through licensing, now environmental and numerous state-level clearances are big bottlenecks. All this has to go.

Third, fiscal profligacy continues unabated. The colossal expenditure on governance is religiously left untouched in every budget. In this situation, control on fiscal deficit is only at the cost of development expenditure which amongst others, would have helped exports.

Finally, for a few years now we seem to have lost pride in calling ourselves an economically sovereign nation. This has resulted in abandonment of some of the policies, which produced excellent results in the past.

The need of the hour is to address these issues with sincerity of purpose and commitment to the nation. If we do not, the full float of the rupee could bring us even greater misery.