The Observer of Business and Politics August 8, 1994

A turbulent journey

Restrict further inflow of foreign exchange, says **Uttam Gupta**

NOTWITHSTANDING the serious apprehensions expressed by the World Bank that the unprecedented inflows of foreign exchange could trigger inflation, destabilise interest rates and stall the economic reforms process, the RBI governor has adumbrated the capacity of the economy to absorb the inflows of $15.66 billion as in June 1994 and probably even a higher amount ($16.3 billion being the latest figure now dished out). When some of the East Asian economies much smaller in size can successfully manage with much higher level of forex reserves, why not India, argues Dr Rangarajan. While there may be nothing wrong in this, the fact remains that we are nowhere near them in terms of GDP growth or industrial growth.

Dr Rangarajan's confidence seems to be emanating more from the possibility of real GDP growth picking up to at least 5 per cent as against 3.8 per cent achieved in 1993-94, with industrial growth rate slated to be about 6-7 per cent. Of course, another pre-condition is that the government should live within its means.

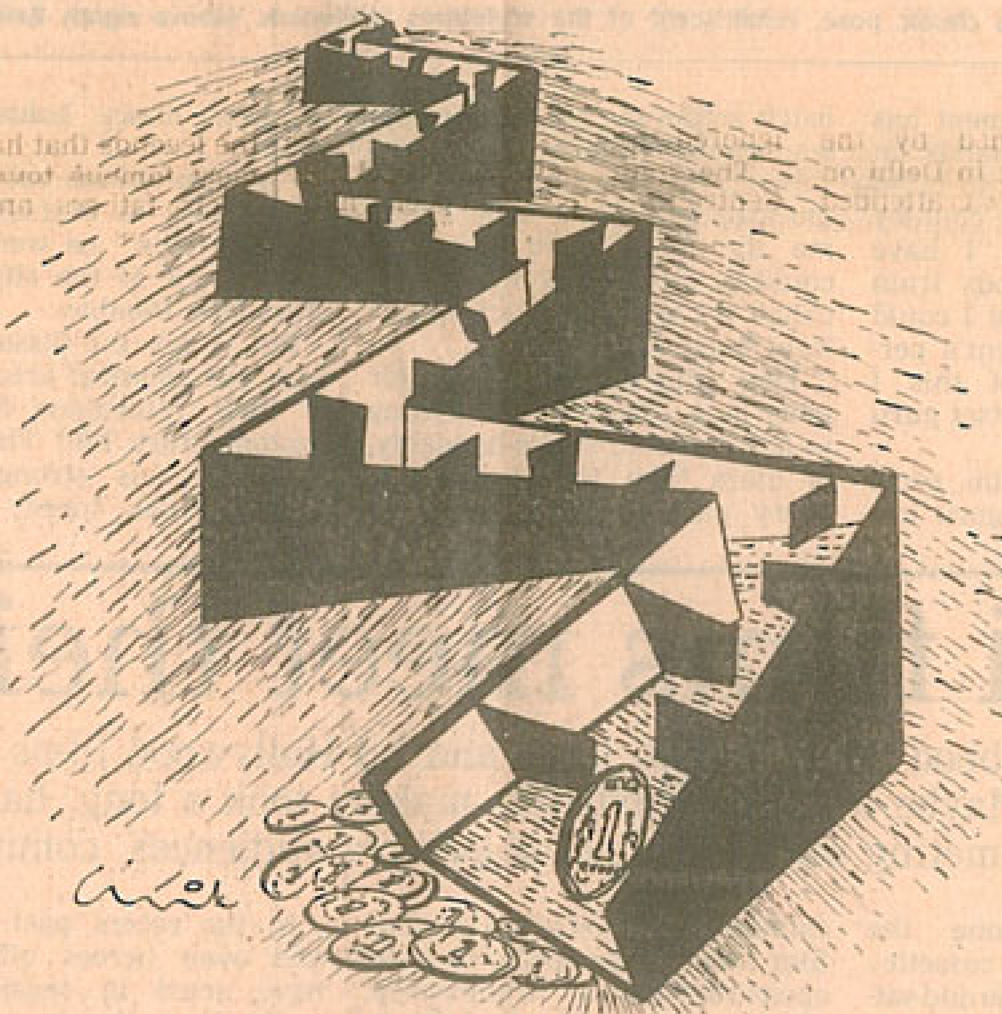
India should have by now consolidated at least on the initial gains of economic stabilisation in 1991-92 and to some extent in 1992-93. But, far from consolidation, on the fiscal front we do not even have stabilisation; indeed as the fiscal deficit for 1993-94 at 7.3 per cent would show, there is destabilisation. Clearly, the government has not lived within its means and it is difficult to believe that 1994-95 will be different.

The government has said it will limit its borrowings from RBI to Rs 9,000 crore during 1994-95. In this context, the net RBI credit to the government since April, which stands at about Rs 4,000 crore, may look impressive compared to the Rs 13,000 crore in the same period last year. But, as past trends show, during the course of the year the quantum fluctuates violently. During 1993-94 for instance, the year started with about Rs 10,000 crore, increasing steeply to Rs 16,000 crore at the end of September 1993 and finally closing the year with Rs 9,000 crore. The reduction of the type that we have in the first quarter of 1994-95 is not due to any genuine lowering of government expenditure, but a reflection of rescheduling. A more realistic figure will be available some time near the elections. In regard to industrial growth rate, starting from a negative in 1991-92, and increase at a niggardly pace in 1992-93, 1993-94 achieved a modest growth of about 4 per cent. But, this was nowhere nearer the 8 per cent average in the 80s. The expected acceleration in industrial growth rate in 1994-95 does not seem to be borne out by the underlying economic fundamentals.

Domestic savings and investment ratio to the GDP has reached an all-time low. Investment by the government in financial terms is not increasing while in real terms, it is even declining. The government's resource position is poor to such an extent that VSNL, which operates in one of the most lucrative areas, had to go to the market even for a paltry sum of about Rs 200 crore for funding its expansion and modernisation programmes. During the past, investment in the private sector has been determined primarily by investment by government. This strong bondage has not broken despite liberalisation. Consequently, investment activity in the private sector continues to be sluggish.

In regard to foreign investment, the government itself is on record having stated in Parliament that FDI until the end of 1993-94 was about $1 billion, which is pittance compared to the overall level of investment and the increase necessary for accelerated industrial growth.

Unfortunately, the additional $5 billion, which has come in 1993-94 by way of portfolio investment and Euroissues, is not investment oriented. Ironically, having mobilised huge sums, Indian companies do not have the productive avenues to utilise them. And, this has a lot to do with the overall depressed demand conditions and the low purchasing power of the masses eroded progressively by rampant inflation.



Quite clearly, the economy simply does not have the capacity to absorb the heavy influx of dollars. It has been argued that control on fiscal deficit would give RBI some leverage in managing the consequential effect of dollar inflows on inflation. Unfortunately, the facts in regard to the former hardly offer any scope and on the contrary may, in fact, aggravate the problem of managing the increasing money supply and resultant inflationary repercussions.

During 1993-94, the RBI purchased as much as $7 billion to prevent the rupee from appreciating and hurting exports. And, Dr Rangarajan himself concedes, this pushed up money supply to over 18 per cent as against a target of just about 12 per cent fixed at the time of announcing the credit policy for 1993-94, subsequently revised to 14 per cent in September 1993. There is no reason to hope that money supply growth will be maintained at 14 per cent in 1994-95 and that too when RBI seems to be preparing the ground for increased forex inflows.

We need to take the advise of the World Bank in its right earnestness and take immediate steps to restrict the further inflow of foreign exchange. Portfolio investment is the biggest destabilising factor and is perhaps, the most difficult to deal with. This is all the more so when sops such as lower capital gains tax, tax on dividend income and unfettered repatriation facility, have made such flows attractive. Even without hitting the ceiling, the aggregate inflow may still be much higher than the levels desired to maintain money supply growth at the targeted level. There may be some merit in reducing the overall ceiling on such investment by FIIs and body corporates. However, supportive action on the other fronts would also be necessary.

More importantly, we need to give a fillip to FDI by categorical announcements of policies, speedy backup actions and quick responses. Such investments would raise the productive capacity of the economy and consequently, ease the supply pressure and provide an outlet for incoming forex through additional imports. Given the stock of investible funds from abroad, if only we could succeed in raising the FDI share we would be able to effectively manage the consequential forex inflows as well as contributing to the industrial and economic growth.

In the medium to long-term, domestic investment has to be raised substantially. There is no reason why we should not be aiming at say, 35 per cent achieved by China. For the government to invest more in projects, there is no escape from curtailing the non-development expenditure. And, herein lies an unprecedented scope. What is needed is just the political will to do things.

The need of the hour is not to get carried away with impressions that we could manage with $20 billion or even more, but to act fast in a carefully orchestrated manner to channelise whatever inflows into creation of production capacity and take urgent steps to substantially bring down the fiscal deficit.