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The unreformed fundamentals

The government has failed to break ground in key sectors of the economy, says **Uttam Gupta**

IN the first week of November, an IMF team led by Mr Bijan Aghevli, deputy director of the Central Asia department, visited New Delhi to apprise itself of the progress of economic reforms and the changes proposed for the next phase. Contrary to the impression that our foreign exchange position is quite comfortable and that there is no immediate necessity for India to go on another borrowing spree, the finance ministry seems to have already requested assistance under the extended fund facility (EFF). In fact, the government is reported to have initiated discussions on a $7-billion loan in November but was told by the IMF authorities to wait until the presentation of the 1994-95 budget.

The IMF's express dissatisfaction — manifest in the statements of Mr Hubert Neiss, director in charge of Asia division, and now by Mr Aghevli — is not without reason. By current indications, there cannot be any realistic expectation that the fiscal deficit would be contained within the five per cent target by the end of March 1994. Last year too, similar hopes were raised but, at the end of the year, the revised fiscal deficit worked out to 5.9 per cent of the GDP. Though inflation right now seems to be under control, the net RBI credit to the government sector continues to increase at a galloping pace which raises serious doubts about our capability to hold the inflation rate down. Already, the index has moved up by two percentage points over the bottom line of six per cent attained in September.

Some of the subsidy systems like the retention pricing and subsidy scheme on phosphatic fertilisers have been dismantled, but subsidy as such continues to exist under new incarnations whereby even the effectiveness of such subsidies is under doubt (for instance, ad hoc subsidy of Rs 756 crore during 1993-94 on decontrolled fertilisers).

Even with regard to foreign exchange reserves, which is quoted repeatedly in support of the success of the reforms programme, the position continues to be extremely vulnerable. Of the total reserves of about $8 billion as on October 1, about $5 billion is made up by the foreign currency non-resident deposits alone.

A deposit in India by a non-resident Indian is by nature highly volatile. Two years ago, we witnessed an unprecedented run on these deposits. It happened primarily because the fundamentals of our economy were weak at that time. The run was stopped only when we gave a clear indication that we were attacking the fundamentals through pragmatic policies. Now, with much of the momentum lost, the possibility of a similar run cannot be ruled out.

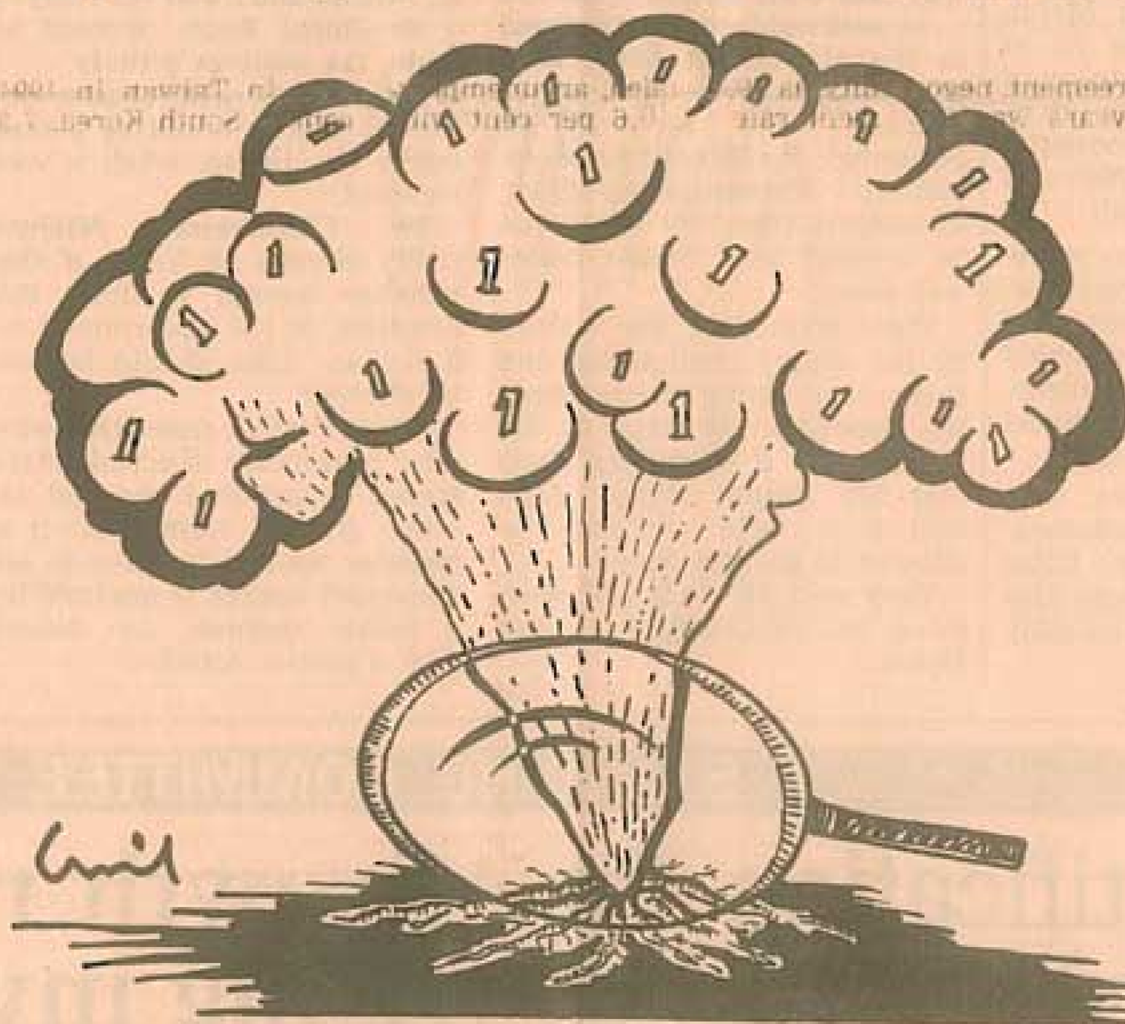
Look at it from another angle. During bilateral consultations, the IMF took note of our inability to meet the prescribed targets in several key areas. However, it has not spoken it's mind on the dilution of the reforms process or, for that matter, lack of progress in financial sector reforms, exit policy and total elimination of subsidies. But, the day IMF becomes vocal, there could again be a run on NRI reserves, lack of interest in lending by multilateral financial institutions and a dip in foreign investments.

Of the balance $3 billion, a substantial element is by way of loan from the IMF while only about $500 million is from portfolio investments.

The repayment schedule for the IMF loan starts from the summer of 1994 and India Development Bonds, which contributed to the massive surge in foreign exchange in the first year of the reforms, are due to mature in 1995.

In its recent report on the 'Trends in Developing Economies,' the World Bank estimated that on a total external debt of $76 billion as in March 1993, India's total repayment liability during the next four years will be $23 billion or about $6 billion per annum. Together with the current account deficit, the World Bank estimates, the total burden will be $8 billion in 1994 and $10 billion per annum over the next three years.

Some time ago, Dr Montek Singh Ahluwalia mentioned that the only way our balance of payments position can improve is by converting the present deficit on the trade account into a strong trade surplus as that alone can help in servicing the huge borrowings in the past. To realise this goal, he advocated growth in exports at the rate of at least 30 per cent per annum.



And, that is where we seem to be lacking. During 1992-93, the actual growth in exports was only 3.5 per cent in dollar terms. During the first half of this year, it was around 24 per cent. But, that is hardly encouraging, particularly when we consider that much of this growth is in traditional sectors such as primary agricultural commodities, diamonds and jewelry and textiles etc. Besides, a large part of the exports is on account of delayed realisation of transactions carried out prior to the current year in anticipation of full convertibility of the rupee.

The narrowing of the trade deficit during the first half conceals the not-so-healthy export pattern. Growth in imports has slowed as a result of industrial recession and once industry tides over the crisis, it would be difficult to contain the trade deficit.

We have also to consider the effect of an increase in oil and fertiliser imports that is inevitable due to a substantial fall in domestic production of the former and failure to increase indigenous production capacity in respect of the latter.

The crux of the matter is that we are yet to take a major initiative in terms of tackling the fundamental ills of the economy that render our products and services uncompetitive. Our interest rates continue to be double than that of most international players.

Although customs duty rates have been generally lowered, there are serious distortions in many cases with raw materials, components and intermediates attracting higher duty than the duty on finished products.

Infrastructure continues to be an extremely weak area and is a major element in the high cost of Indian industry. An obnoxious sales tax regime is in place with the government showing little sign of using its moral authority to persuade state governments to eliminate or reduce such levies.

Then, we have the state monopoly in the oil and gas sector. Surplus manpower continues to be a major burden both in the government and the private sector, with political compulsions not letting even the most sincere managements take action on this front. All this gravely impairs the ability of the Indian producers to compete both at home and in the international market.

We have no magic wand that will pull us out of the morass. We have to work hard for it and put national economic considerations above everything else. The Indian industry, led by the Bombay Club, has already set at rest speculation about its supposed lack of commitment to economic reforms. However, the real issues that they have highlighted must be attended to in all seriousness to give them a level playing field.