# Whither Indian Economy?*

**Sunanda Sen**

Growing concerns on the current state of the Indian economy, which have been met with responses filled with assurances and proposals from official circles for remedial actions on part make it urgent to delve into the issues which spell out the reality.

Apprehensions relating to the economy are at the moment centred on further escalations in the high prices, of fuel and other goods in the domestic market, affecting the daily lives of people. As is generally held, the major reasons behind this include the rising dollar price of crude oil in international market and the steady declines in the value of the rupee in terms of dollar, causing escalating transport costs as well as the rupee prices of all imports. Specific issues as above are compounded by a general fear psychosis of an impending collapse of the current state of the economy and polity, threatening to impact the levels of whatever well-being, if any, currently accessible for people in different income categories.

Responding to the above, the official position (of the government) has denied that the economy is facing any impending threat, especially with what are seen as the four green shoots parameters. The latter include the current GDP growth at 7.4% , the highest in the world, moderate inflation with wholesale prices rising by 3.4% last year, official foreign currency reserves at a comfortable level of nearly $400bn and finally, the moderate fiscal deficit at 3.3%. The highlights, incidentally, accord well with the IMF's recent country report on India which was released on August 7, 2018.

The defensive position advanced from the official quarters as well the effectiveness of the remedial measures as suggested, do not, however, stand scrutiny if one recognises the fact that none of those indicators of a robust economy, as we point out, will be sustainable in the face of slippages running through the economy.

Consider, first, the Central Statistics Office (CSO) data on the high GDP growth of the economy at 7.4% for 2017-18 and growth rate for the Gross Value Added (GVA), at 7.1%. Leaving aside the rather serious misgivings concerning the method as well as the estimates of the calculation of GDP, we draw attention to the structure of the GVA with services contributing one half or more over the last six years. With the brick and mortar division of the industrial sector providing for less than a third of the GVA and with agriculture, the mainstay of the rural economy, providing less than a fifth, it does not come as a surprise that gainful employment has been far less than adequate for the reduction of poverty in the economy. A major explanation lies in the fact that the high-tech service sector of India is incapable of generating the much needed employment, well-being and sustenance for the public in general, and in particular for the unorganised 93% of population in the countryside.

The government also considers it reassuring that the wholesale price index, based on 2011-12, as per CSO data, has moved up only by 2.96% during 2017-18. However, movements in the index have of late been more, touching 5.09% during July 2018. In addition it can no longer be expected that prices will remain stable, especially with crude prices per barrel soaring up to $70 or above and the plunging rupee touching Rs 72 and more to a dollar. In the meantime, the rise in the consumer price index, reflecting the retail margins, has been consistent. This is evident with prices in July

2017 rising by 2.36% in contrast to the 4.17% hike in July 2018. In general, prices all over the economy are bound to move up, not just for fuel but also for commodities and services in general, with higher transport costs and the depreciating rupee which pushes up the local prices for imported inputs, much in use in both agriculture and industry.

Would India be able to avoid a balance of payments crisis by making use of the large foreign currency reserves, currently at $375 billion? We encounter here, several issues. First, we doubt the sustainability of the currently held stock of foreign currency with the RBI in the face of adverse market expectations. The latter explains the net FII outflows from RBI sources, to the tune of $3.5 billlion on average between April and May 2018, and more recently $3.7 billion, on average over July and August. Outflows also have been with the RBI's Liberalised Remittance Scheme with net outward transfers of $1.1 billion on average between June and July 2018.

Given the continuing downslides in the value of the rupee in terms of US dollar, those interested in remitting funds to India (exporters, overseas working NRIs and even the potential investors for the NRI bonds) may wait to see the rupee depreciate further, thus delaying foreign currency receipts from abroad. Finally, the official reserves may deplete with direct interventions of the RBI as it sells foreign currency against rupees in the market. Data released by the RBI indicates an actual sale of $16.30 billion by the bank between March and July 2018, much to arrest further declines in the rupee rate! It thus does not come as a surprise that foreign exchange reserve held at the RBI is already declining, by more than $4oo billion, from $380 billion in July 10 to $376 billion on August 17, according to official sources.

Not much discussion has been there on the steady build up of the forex reserve at the RBI, which shot up from a paltry sum of $4.38 billion in April 1991 to respective stocks of $107.4 billion and $281.5 billion respectively by April 2004 and April 2014. Unlike the situation in China where reserves were contributed largely by the large trade surpluses the country has been earning, foreign exchange reserves in India have grown mostly with inflows of capital and that too of a short-term variety. Facing the continuing trade deficits which exceeded the sum received as net invisibles along with remittances, India has continued with a yawning current account deficit which has been financed by more than proportionate inflows of short-term capital from abroad. This has been especially true since about two decades now when short-term FII inflows were further liberalised. The outcome has been one where maintaining official reserves has no longer been at the discretion of the national monetary authority at the RBI. Instead it is subject to possibilities of flocking in or deserting as and when portfolio managers decide on the matter.

The official position on what they currently perceive as stable macroeconomic parameters in the economy also include their resolve to continue with the currently controlled fiscal deficit at 3.3% of the GDP. The decision indicates a continued policy stance towards what is viewed as financial stability for the economy. It may however be noticed that the goal as above, while considered a major tool to avoid inflation in mainstream economics, has a very different implication in terms of alternate approaches which rest on the Keynesian New Deal type of expansionary policies. Fiscal restraint, as can be held in terms of the latter, neither fulfils the goal of price stability nor can achieve growth via expansion of demand.

Let us, in the following, pay attention to the possible implications of the targeted fiscal deficit ratio of GDP in the current context of the Indian economy. There remains a major problem in maintaining the so-called "Fiscal Responsibility and Budget Management", an Act which is being followed by the Indian government since 2003. The statutory fiscal stringency amounts to a trade-off within the budget, between state expenditure on capital formation and social security on one hand and meeting interest liabilities on the other. Most often, the balance is tilted in favour of the latter, as the capitalist state follows its priorities to provide the rentiers their dues on financial assets sold by the government. Data from last year's budget indicates a picture of the interest bill at Rs 575 billion crore which considerably reduced the expenditure on public capital expenditure and social security. As recorded in the budget estimates of aggregate state and central expenditure for 2018-19, the interest bill as above has been 18% of above, far exceeding the 9% share on subsidies.

The government, however, seems to have taken the recent developments, especially relating to the external economic environment rather seriously. This has come about with the recently announced measures with liberalised norms for external commercial borrowings upto $50 billion with one year validity by manufacturing entities, the floating of NRI (or masala) bonds and the liberalised norms for portfolio investments. In addition, the government expects to initiate controls on what will be identified as non essential imports. The measures undoubtedly reflect a sense of urgency and admission on part of the government, that there is a threat to India's external payments front!

It may be too early to expect much from the official announcements. However, given the turbulent global scene in terms of trade and financial flows as well as in the domestic economy as discussed above, sentiments abroad on future prospects of investments in India are naturally at a low ebb at the moment. Grant of liberal norms to potential Indian borrowers in the international market is unlikely to change those sentiments of lenders overseas. In addition there remain multiple factors like the steady depletion of the official exchange reserves, the steady withdrawals of short-term FII investments, the declining external value of the rupee, the Trump-China trade war threatening the current global structure of trade and finally the US Fed's resolve to raise interest rates. Those are aspects which speak of the difficulties of an easy resolution of the problems in the external economic front of the country. The short-term measures may even add to the interest liabilities on new external borrowings in near future which would neither be easy to meet nor qualify in terms of related budgetary cuts on social sector spending and investments.

What, then, emerge as policy options for India in the current situation? While problems as have arisen by following the norms of trade and capital account opening under globalisation cannot be reversed instantly, the state needs to recognise its futility in terms of the grave social and economic consequences as at present. It is time now to look inward to the vast potentials of the domestic market in India which can be invigorated and sustained with a new set of policies. There is a need to reject the priorities as at present on the finance-led external sector and follow a strategy which can succeed over time with adequate expenditure to revive demand for domestic goods, employment and human development.

*** This article was originally published in The Wire: September 22, 2018.**