

# Indian Economy

Rashmin Chandulal Sanghvi

Indian economy is having good growth for the last few years. How long can such growth continue! Can there be even larger growth! Is it necessary that the growth has to cause inflation! Can there be growth & price reduction! I am sharing my views in this article. I am also expressing some observations on the relevance of the Finance Minister's speech devoting considerable time on agriculture and rural economy.

## I. **Growth Potential:**

My opinion: There is still a huge potential for economic growth in India. With proper strategic planning, the growth can be continued for another ten years. Before the theory, let us see some illustrations of two different kinds.

### I.1 **Indian Investment Abroad:**

Indian Investment Abroad is, under FEMA, referred to as Joint Ventures abroad. Just for convenience, we use the same terminology - JV. During the bad old days of **FERA**, all JVs required prior permission under FERA. The approval was to be granted by the Commerce Ministry, followed by RBI. The scrutiny was tough. I sought two clarifications from an officer: (i) What would he, an officer of the Government know about the business abroad! How can he make a judgment! (ii) Why was the Government so strict about JVs!

His reply was: "So far, from independence, there are only 'xyz' JVs abroad. (I forget the exact number. But it was surely a small number.) Out of all these, only ten percent or less are successful. Why should we spend the country's precious foreign exchange for JVs!"

First question was not considered worth answering.

I wrote a paper: "**FERA should be scrapped**" and personally handed over to the Executive Director, RBI. The whole notion that the Government owned the foreign exchange (Fx) and should control its use, was unacceptable. The root cause of failure of Indian Investments abroad was excessive regulation by RBI & a huge fear of the Enforcement Directorate. Indian investors were not allowed to take risks.

Luckily for the nation, Dr. Man Mohan Singh became the finance minister. He was given full charge of economic liberalisation and was protected from the political ideologists; by the then Prime Minister Narsimha Rao. Rest is the history on "Struggle at the helm - for Economic Democracy in India."

Today we have Indian Industrialists who go abroad, take loans from foreign banks etc. and buy foreign companies worth billions of dollars. Much before the famous takeovers of the years 2006 & 2007, we have witnessed some smaller Indian companies buying over foreign companies.

These takeovers have proved that the **excessive control** of the economy **was the root cause of our failures on several fronts**. Removal of the controls is the prime mover for the growth of the economy. Apart from FERA, industrial licensing, import licensing, gold control; and a host of other unnecessary controls have been removed. Indian businessman is free to grow.

There is more to it. Most Indians are by their very nature intelligent; capable of meeting uncertainties & unexpected difficulties; and capable of taking risks. In short, we are entrepreneurs by nature. All the necessary ingredients of business success are in abundant measure available in India. Our potential was suppressed. Now it is free. It is only natural that Indian economy has to grow. When the potential suppressed for fifty years is released, the baseline is less relevant. Until we reach an optimum level of development for the Indian economy, the growth will continue. Thereafter we will be at par with the world.

## I.2 Let us see another illustration. **Agriculture.**

**Dharampur** taluka is the poorest taluka in Gujarat. It is situated in Valsad district. Most of the people are poor tribals. Average income per capita per year may be Rs. 10,000 or less. Vedchhi Pradesh Seva Samiti (VPSS) started in the year 1999-2000 water management - building small little check dams in the area. Shri Pradipbhai (A. J.) Shah donated Rs. 15,000 for one of the first dams. As a consequence of the dam, from the first year, the incomes of the tribal community in the area is estimated to have increased by Rs. 2,00,000 per year. Where can you get this rate of annual return!

There was no magic. Simply the area was totally undeveloped. All the potential that was lying there was never tapped. Since VPSS tapped it, the growth came out. What is the growth rate?!

One can argue that such individual incidents do not make up the country's economy. Let us consider one more illustration.

Limbdi Seva Mandal started in the year 1995, digging (desilting) of existing lakes. The project was a success. Gujarat Government took up the project. Government started desilting thousands of lakes every year all over the state. The state witnessed compounded growth rate in

agricultural production in the years 2005 & 2006 of 50%, each year. Imagine the multiplier impact of such growth.

There are several such sectors all over the country where we can attain growth rates of 50% for successive two to three years. **All these together can sustain 12% GDP growth at national level for next one decade.**

## II. Growth & Price Reduction:

My view: For India, growth and price reduction both can be achieved simultaneously. Our situation is different from others; & specially western developed countries. We need not follow the western system.

**II.1** As per the **World Bank** calculations, the value of Indian rupee at the Purchasing Power Parity (PPP) should be around Rs. 11 to one U. S. dollar. (Source: World Development Report published every year by the World Bank. The **market value of Indian rupee is roughly 25% of its PPP value.**)

A hypothesis: If the Indian rupee appreciates to its PPP rate, what will happen! For starters, imported crude oil cost will come down by 75%. Since imports constitute around 50% of total crude oil consumption, the average fall in costs may be say, 37.5%. This means, if full cost reduction is passed on to the consumer; petrol, diesel, kerosene, every thing will be cheaper. Hence transport cost & thermal electricity will be cheaper. Hence cost of all products including onions & vegetables will be cheaper. **A virtuous cycle will start.** If a part of the cost advantage is not passed on to the consumer & retained by the Government, to that extent, the deficit will be less. Hence the inflation can be less. The multiplier effect can be enormous.

Similarly, cost of several imported goods will be lower. The virtuous cycle will be further strengthened.

It is true that such a massive revaluation of rupee is neither practical nor possible. However, even **if rupee keeps appreciating by 5% per year** for the next ten years; several virtuous cycles will be unleashed and tremendous benefits all over the economy can be experienced.

**II.2** The hypothesis looks unbelievable. Let us consider the following facts:

(i) **Indian rupee** has started appreciating or at least stopped the depreciation for the last few years. Immediate result is that there is a

tremendous influx of foreign exchange (Fx). The trade deficit continues. In other words, our imports are significantly more than our exports. And yet, Fx reserves continue to grow significantly. This has given a positive mood to the economy and the share market has sky rocketed. There are several other advantages to "India Incorporation".

- (ii) **The U.S.** has been adopting this policy for almost fifty years. The U.S. dollar has been artificially kept above its real worth or PPP value. Simultaneously the countries exporting goods have been forced or persuaded to devalue their currencies. (\*) This conscious and aggressive policy has resulted in the position where: 'A U.S. resident works less and enjoys more. At the same time people in India, China, Malaysia etc. work far more and enjoy less'. In simple terms, the U.S. should experience inflation which should necessarily result from its massive deficit financing. However, this **inflation is exported to India, China** etc. Hence the prices do not rise in U.S.A. to the extent they should rise as per simple economic calculations.

\* **Note:** This policy of **currency manipulations** keeps changing according to the needs of U.S.A.; and the then competitive comparative position of U.S. economy Vs. the country exporting to U.S.

(Again all these concepts need far more elaboration than permitted by this small paper.)

A **conclusion** of the above brief analysis is that India is currently in a position to achieve growth and price reduction simultaneously. It has to only protect itself from the manipulations and exploitations that are normal in free, global markets.

### III. **Agriculture & the poor:**

- III.1 **Mr. Sharad Joshi** (a Harvard Graduate, now resident of Pune) has proved beyond any doubt that the Indian pricing system is such that the farmer always gets the least advantage of growth. Many times he incurs losses whereas all the other sections of the economy dependent upon the farmer make huge profits. Mr. Joshi has proved this by comparing prices of onions & vegetables sold at the farms; with the same products sold by the retailer in Pune & Mumbai.

My first hand information in **Dharampur**: Three poor individuals from U.P. came to Dharampur some fifteen years back. They would take peanuts, gram & kurmura in their gunny bags. They would walk the forest trails of Dharampur, reach small villages and make small money out of their sales. These people realised that the farmers in Dharampur taluka were ignorant and unable to travel to Dharampur city itself. Hence they

started buying the farm products from the tribal farmers; and selling to the provision stores in Dharampur. Over the years, now they have been established as big wholesalers. It is rumoured that they must have net worth of crores of rupees. The Dharampur farmer has remained as poor as ever.

The underlying truth is that in the Indian economy, all the subsidies and tax exemptions apparently given to the farmer – never reach the small farmer. The **farmer generally remains poor**. The traders and the industries consuming agricultural raw materials take all the benefits. It is high time that the benefit is transferred from the trade and industry to the farmer. Mr. P. Chidambaram has apparently tried this through his budget – 2007.

**III.2** It is **normal society behaviour** that the poor, downtrodden and exploited people remain silent. And the rich people who are enjoying all the benefits of the economy, scream maximum when their opulence is not further enhanced by the Government.

Does “India Incorporation” include the following people:

- (i) the farmers and the rural poor;
- (ii) more than 50% of the population of Mumbai which lives in chawls, huts and footpath. (In short, the urban poor & lower middle class.);
- (iii) the police under the home ministries; and the military jawans & their families under the defence ministry. The ministry spends on weapons & equipments as well as on the salaries. We are concerned here about the welfare of the Jawans & the Police.

These people who together constitute more than 70% of India’s population are not a part of India Incorporation. Are any complains that the budget did not have enough for India Incorporation justified!

All the expert discussions in the press and on television focus on the share market and India Incorporation. Why don’t we see the common man’s point of view in expert discussions! Remember that the famous Chief Minister of Andhra Pradesh – Mr. Chandra Babu Naidu committed similar mistake. He was booted out of power by the common man. Can we expect the present Government not to learn the lesson!

**For the next growth phase, we need to transfer more & more funds to the rural and agricultural economy. The trade & industry have been given enough.**

#### IV. Some food for thought:

**IV.1** Incidentally, my on article Economics: "India has abundant political democracy, but no economic democracy" was also published in the Chamber of Income-tax Consultants' journal - much before the liberalisation process started. **I thank CTC** for giving me this opportunity to again share my views on economics.

**IV.2.** Even thirty years after independence, there were some people, who had active careers during the **British Raj**. They would still say: "British days were better than the current days of political corruption & inefficiency".

Fifteen years after the commencement of our Economic independence, there are still bureaucrats who say: "**Left to the people, they will abuse every thing. We must control & regulate them.**"

Fortunately, no one listens to them. Except in RBI. During the FERA regime, the senior officers in Fx department did listen to logic. Today, under the liberalised regime, the Fx department believes, they should not meet the applicants & professionals. If they meet the public, some thing seriously wrong will happen!

**Isn't it an irony that under Dr. Man Mohan Singh's Prime Ministership, the Fx department of RBI has become less democratic!**

**IV.3 (i)** Criticising someone is the easiest way of having a satisfaction that "I am better than the person criticised". That is why a lot of people enjoy criticising others. It is said that everyone likes "**Ninda Ras**". Truth is, only people having an inferiority complex enjoy "Ninda Ras". A man who has quiet confidence in himself; who is at peace with himself; will not normally criticise others.

Criticising the Government is the easiest thing. No one answers back. And the whole group present will join you. It will be a collective enjoyment of the favourite "Ras."

**IV.3 (ii)** And yet, when the situation calls for criticism, professional must rise & criticise.

The difference between the two situations is perceived by **discretion or "Vivek"**.

#### **IV.4 Chinese Economy:**

There was a time when it was said that: "When the U.S. President sneezes, the world economy catches cold." Events on 27<sup>th</sup> & 28<sup>th</sup> February have proved that when China Sneezes, U.S. gets cold.

China has \$ 1 trillion Fx reserves & U.S. has got \$ 10 trillion foreign Fx debt.

People criticised China for shoddy quality of goods. They forget that from making outsourced components for IBM computers, China (**Lenovo**) went ahead & bought over IBM laptop computer business. It is not toys & shoe uppers. It is computers.

It is noteworthy that when the Chinese people go in the world to buy property, the property prices go up. China needs oil. It does not go out & make thirty years contracts for buying oil. It goes & buys out foreign oil wells & refineries.

Chinese economic reforms started earlier than the perestroika in the Soviet Union. Perestroika has been widely judged to be a failure while Chinese economic reform has been widely considered to be a success. This is largely because the Soviets went the western way; while In China the emphasis was on agriculture and light industry.

How is it that China has acquired such a clout! How is it that China can sell every thing at a price lower than world manufacturers' raw material costs!

This is a subject that deserves full discussion and cannot be covered in a part within a paper on Indian economy. Suffice it to say that:

- (i) The world needs to understand the **Chinese way of economic growth** & has to stay away from the American way of growth. One cannot go on saying that "We don't understand China". That would be our own loss. Some companies have suffered disaster by ignoring Chinese methods. We have to learn China & unlearn U.S.A.
- (ii) **Current global melt down** shows that the western style financial economy (merchant bankers, hedge funds, western mutual funds & all) is heavily dependent upon **leveraging**. In their greed for exponential profits, they leverage disproportionately. As a consequence, when even a small adversity occurs, they are shaken up. Several institutions have gone bankrupt- Barings Bank, Long Term Capital Market, and many more. Still, the survivors do not change their ways.

#### IV.5 More than a **thousand farmers commit suicide in India every year.**

In any other country; the urban, sympathetic people would raise such an alarm & outcry that Governments would collapse. Why is it not happening in India!?

**Conclusion:**

India can achieve a good growth in the economy, without inflation for the next decade. While the poor and middle class will benefit; the rich will benefit even more. That is the way the economy works. And no one may have guilty feeling. It is the work of the Government & the NGOs to help the poor.

Government needs to transfer more resources to the agriculture, rural economy, and to the poor. And the rich have to stop criticising the Government – when it does what it should do.

Hope, this paper will make us sit up & think.

Pranam.

Rashmin