

India Inc having to pay the price of the government's inability to put its own house in order in terms of borrowing. Says Triveni Engineering chairman & managing director Dhruv Sawhney: "The target of getting inflation based on the WPI to below 5% is quite unrealistic. This will show up on industrial growth."

The credit squeeze is also expected to have long-term repercussions due to its impact on savings and investment. The record increase in savings by 24.4% in 1994-95 was due to a sharp increase in household sector savings, especially physical savings in the form of construction, machinery & equipment and stocks. Most of this was in the agriculture and small-scale sectors, both of which were aided by a surge in bank credit during 1994-95.

While growth in agricultural credit doubled from 6.2% in 1993-94 to 13.1% in 1994-95, that of small-scale industry increased from 13% to 22% during the same period. With the credit squeeze, agricultural credit growth in the first five months of 1995-96 has slowed to zero, while that of the small-scale sector shrank by 0.9%. The slowdown in bank credit to the small-scale sector, which accounts for 30% of industrial output, will be reflected in overall industrial growth.

Another result of the liquidity crunch is the sharp upswing in real interest rates. With effective commercial lending rates climbing to around 20% when inflation levels have slowed down to 5%, real interest rates have risen to above 10%. This is above the growth rate in the economy, and will be another limiting factor, at least in the medium term. "The key to sustaining the growth rate is the increase in private investment. If the government

is able to create an environment for increasing private investment, the growth rate can be sustained. The issue is whether the policies will induce a reduction in real interest rates," says Bhide.

The Economic Survey provides bad news in three other key economic indicators as well: food stocks, foreign exchange reserves, and the exchange rate of the rupee. Food stocks have fallen by 5.5 million tonnes, from 30.12 million tonnes in 1994-95 to 24.62 million tonnes in January 1996, though they are way above the buffer norms of 15.4 million tonnes. The drop in foreign exchange reserves by \$3.4 billion by December 1995, on the other hand, is causing concern. While total reserves — at \$17.46 billion — are still adequate to provide import cover for five-and-a-half months, the steep decline in recent months (\$1.6 billion in October alone) makes the situation disturbing.

According to the survey, the rupee depreciated by more than 11% against the dollar in the last six months, a fall attributed to the sharp increase in imports, inflation, and a slowdown in capital flows (capital inflows of \$1.5 billion in the first six months of 1995-96 were only a third of 1994-95's figure of \$4.8 billion). While the government believes the trend has been halted, nobody is willing to bet on the stability of the Indian currency. The annualised forward premium for the dollar touched an all-time high of 22% in the last week of February. And given the lower reserves, it could be difficult to halt a further run on the rupee.

Indeed, many economists express concern about India's long-term balance of payments and foreign exchange positions. Warns economist Bibek Debroy, till

recently a consultant at the finance ministry: "The crisis of 1991 took place mainly in the external sector. But that also is the biggest failure of the government. There is no reason why we cannot reach a similar situation again. If foreign institutional investor inflows taper off, there is no way the BoP deficit can be fi-

"The Situation is Fragile"

FOR nearly 18 months till December 1991, Jawaharlal Nehru University professor Deepak Nayyar was the government's chief economic advisor. In an interview to sister concern Television Bazar last fortnight, Nayyar trained his sights on official claims about the economy. Excerpts:

■ **The Economic Survey broadly concludes that the economy is going great guns, that it's in good shape. Do you subscribe to this?**

The real concern of the people of India is that prices are up.

■ **But the rate of inflation is down to below 5%**

It is my view that the government has failed to control inflation. Juggling statistics or obfuscating facts simply can't change this reality... The newspapers may report that prices have come down this week, this month or this year. For the ordinary man, what matters is that prices are higher this week, this month, this year as compared with last week, last month or last year.

■ **But there's an investment boom on, the GDP (gross domestic product) has grown by 6%, industry is growing by 10%. Surely, this is cause for optimism.**

These are CSO (Central Statistical Organisation) projections, estimates which often depart significantly from reality when the final figures emerge two years later. The economy has sustained itself on growth in the agricultural sector during this period of adjustment. This has had nothing to do with reforms, but with the weather gods.

■ **But surely the picture is not as bleak now?**

The macroeconomic situation is fragile. The inflationary potential in the

nanced. Foreign direct investments won't flow in immediately. Then the country will have to resort to commercial borrowings, which will in turn drive up the debt-service ratio. It could also lead to a downgrading of the country's credit worthiness." Debroy also says that while the economy is in better shape than it

was in 1991, it has not changed dramatically from its position in the eighties.

Clearly, while the Economic Survey provides some indication that the recovery has set in, it also highlights the fragile assumptions of growth. Indeed, in his speech to parliament while tabling the interim budget, the finance minister

himself called for further reforms of the policy framework to ensure high levels of public and private investment. Whether the next administration heeds that call is something only time will tell.

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(With reports from Bhupesh Bhandari)

country's economy is a cause for concern. The balance of payments (BoP) position is nowhere near as good as it is made out to be.

■ **Is there anything positive in the economy's balance-sheet for the past five years?**

The only positive thing is that the economy has coped with the period of adjustment, with a somewhat higher range of growth than one could have expected. However, this is because of the flippant weather gods.

■ **Are we worse off than we were in 1991?**

We are almost as badly off. The object of fiscal adjustment is to reduce the difference between the income and expenditure of the government. This is what the government has attempted to do over the past five years. The outcome cannot be described as a success. The central government's gross fiscal deficit has moved like a yo-yo. It dropped from over 8% of GDP in the second half

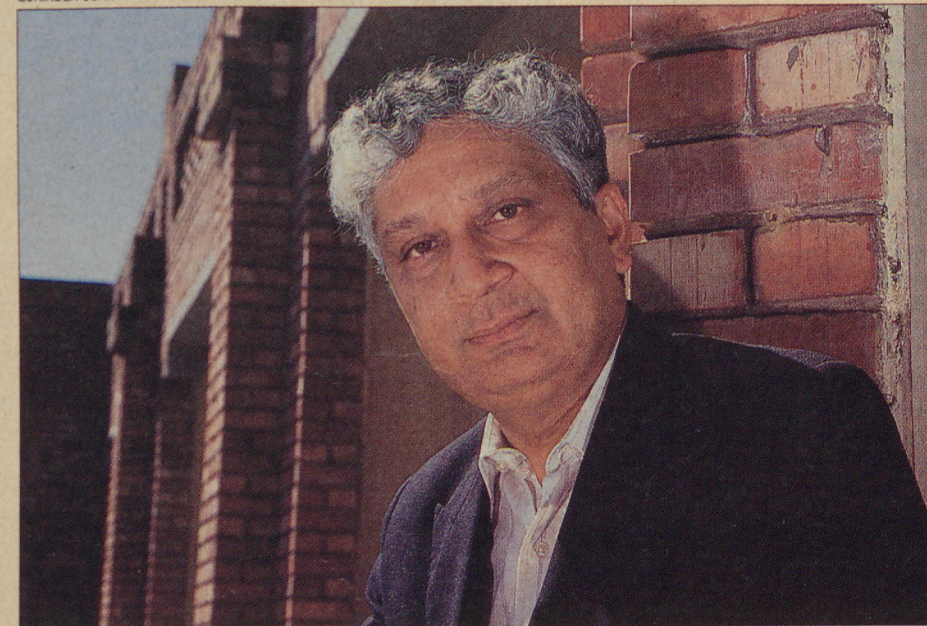
of the eighties to a little less than 6% in 1991-92 and 1992-93, but went back to 7.5% in 1993-94 and 6.1% in 1994-95. The problem is not the quantity but the quality of adjustment, because Narasimha Rao's government has used a surplus on the capital account, namely borrowing, to finance a deficit account, namely consumption.

The real cause of concern is the government's revenue deficit, the difference between its revenue receipts and its non-investment expenditures, which was 2.5% of GDP through the second half of the eighties, remained at that level in 1991-92 and 1992-93, but climbed to an unprecedented 4% of

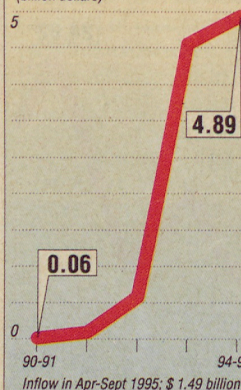
GDP in 1993-94 and 1994-95. So we are borrowing as much as 4% of national income to finance the consumption expenditure of the government. In an ideal world, you should have a revenue surplus which pays for expenditure on defence, on social sectors where there are no tangible returns. And you should borrow only to meet investment expenditure that will yield an income flow to the exchequer in future.

more than \$20 billion at the end of March 1995. But the comfort implicit in these reserves is illusory. These foreign currency assets are more than matched by foreign currency liabilities that have short-term maturities or can be withdrawn on demand. Consider the situation at the end of September 1995: \$23.5 billion. But short-term debt with a maturity of one year or less is \$4.5 billion; the value of outstanding

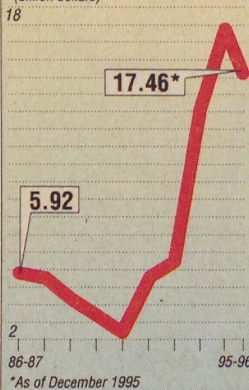
GURINDER OSAN



Foreign investments are flowing in
(billion dollars)



Forex reserves are comfortable
(billion dollars)



Inflation is under control
(Annual average increase in WPI)

