Expectations may devalue Rupee: Nayyar

THE UNIFICATION of the exchange rate has introduced a new element of uncertainty in that expectations about the value of the rupee will now be determined by the domestic level of inflation. People may start holding foreign exchange as part of their investment portfolios if they expect the rupee to devalue faster than the rise in prices.

In an interview with *The Pioneer*, Deepak Nayyar, former Chief Economic Adviser and Secretary, Ministry of Finance, said: "The qualitative change that has taken place is that actual outcomes (of the value of the rupee) would be determined by expectations of the inflation rate at home which, in turn, would become a self-fulfilling prophecy."

The Professor of Economics at JNU added that in foreign exchange markets, the capacity of Governments to control such expectations is limited. "Look at what happened in Britain," he said. "Mr Major and his men could not maintain the parity of the pound."

Prof Nayyar was also of the view that the Budget had overestimated revenue and underestimated expenditure by around Rs 5,000 crore. By the end of 1993-94, the fiscal deficit would not be around 4.8 per cent as claimed by the Government but closer to 5.5 per cent, he felt.

(See interview on Page 12)

Don't accept Budget arithmetic at face value

He's had a long love-hate relationship with the bureaucracy. After his studies at St Stephen's College, Delhi and Oxford University, he became an IAS officer for three years before returning to the world of academics at Oxford, Sussex and Calcutta. He then became Economic Adviser to the Commerce Ministry, then professor at Jawaharlal Nehru University. After a stint as Chief Economic Adviser and Secretary, Ministry of Finance, between July 1990 and December 1991, left-wing economist Deepak Nayyar, 46, is back at JNU. Having left the portals of North Block on account of "differences of opinion and perception," he has become a trenchant critic of the powers-that-be.

Excerpts from an interview with Paranjoy Guha Thakurta:

What impact do you think the recent incidents at Bombay will have on the inflow of foreign investment?

Even before Friday's bomb blasts and the communal riots in December and January, I held the view that there would not be a substantial inflow of foreign investment. Now I think it would be naive to expect too many foreign investors to come here. It is not just the economy which is unstable, the polity and the society is perceived to be unstable. Why foreign investors, even domestic investor confidence will be eroded.

Inflow of foreign investment should be a means of obtaining access to international markets and technology. But it can never become a means of financing the external current account deficit. Policy regimes are permissive not causal; a favourable policy regime is a necessary condition for attracting foreign investment but not a sufficient condition. There is scarcity of capital the world over. Every country is on a liberalisation binge. We have to first create an absorptive capacity for foreign investment in terms of a quality physical and human infrastructure, before we can expect a substantial inflow of capital.

You have been critical of the Budget and said that it has made unrealistic assumptions about revenue and expenditure. Could you elaborate?

The Finance Ministry has tried to achieve the impossible in the Budget. The Government has foregone huge tax revenues without any attempt to touch anyone's purse. In other words, the Budget appears to benefit many without harming any.

But I think the arithmetic of the Budget should not be accepted at face value. As always, there has been an underestimation of expenditure and an overestimation of revenue. This can be partly attributed to the devaluation of the rupee, the fact that no provision has been made for additional dearness allowance (DA) payments and the inadequate provision for food subsidy.

At the same time, the Government has assumed an extraordinary buoyancy in direct tax revenues. If one compares budget estimates between the current year and 1993-94, corporate tax collection is expected to go up by over 29 per cent and personal income tax by more than 20 per cent. It is difficult to put precise numbers, but my hunch is that expenditure has been underestimated by around Rs 4,000 crore and revenue overestimated in the region of Rs 1,000 crore. In other words, the fiscal deficit in 1993-94 would be higher by around Rs 5,000 crore or it would not be 4.8 per cent of the Gross Domestic Product as assumed but closer to 5.5 per cent.

Why do you say that the quality of fiscal adjustment embodied in this Budget is poor?

First, you can't provide a sustainable solution to the fiscal crisis through this Budget because it relies on a surplus on the capital account financing the deficit on the revenue account. The focus of adjustment is the fiscal deficit not the revenue deficit. I find it puzzling that there has been so much emphasis on expenditure cutting and so little on revenue raising.

Is it because the International Monetary Fund has made the fiscal deficit a holy cow?

The world over there are different concepts of Government deficits — primary, budget, revenue, monetised deficits etc. The IMF is obsessed with the gross fiscal deficit. What worries me is that while the fiscal deficit is being brought down, the revenue deficit as a proportion of GDP has been more or less constant. This was 2.7 per cent between 1985-86 and 1990-91 when the fiscal deficit was around 8.5 per cent. Now revenue deficit as a percentage of GDP is supposed to come down from 2.7 per cent in 1991-92 to around 2.4 per cent in 1993-94. But if one assumes additional DA payments of around Rs 3,000 crore, the figure would be back at 2.7 per cent.

The point is that the Government continues to borrow 2.5-2.7 per cent of GDP for current consumption. Add to this the revenue expenditure on defence and the social sector which does not yield immediate tangible returns and you would be expecting the Government's remaining investments to yield unusually high returns. This kind of fiscal adjustment is just not sustainable because it relies too much on squeezing investments.

Nayyar: Fiscal adjustment will hurt the poor *Manish Swarup/Pioneer*

Capital expenditure as a percentage of total Government expenditure, which has come down in the second half of the 1980s to a level of about 33 per cent, continues to decline: from 26.1 per cent in 1991-92 to 22.5 per cent in the 1993-94 budget. Then, capital expenditure in the Central Plan and in Plan assistance for the states and Union territories, appears stable at Rs 16,000-17,000 crore over the last three years, but only in nominal terms. In real terms, this figure will decline because of inflation and devaluation of the rupee.

The story is repeated if one considers the Budgetary support to the Central Plan outlay for three areas of the infrastructure sector, that is, energy, transport and communications.

But the Finance Minister expects private investors to come forward to fill this gap. He hopes to unleash the animal spirits of entrepreneurs. He thinks the concessions given in the Budget would spur private investment, especially in power.

In our country, past evidence has shown that public investment "crowds in" rather than "crowds out" private investment. The level of public investment is an important determinant of the level of private investment because of demand and supply side complimentarities. I don't expect a large inflow of private investment in infrastructure unless it is accompanied by higher public investment. Without investments, where will the impetus for growth come from? There is no evidence yet of the new policies unleashing the animal spirits of entrepreneurs. Private industry is currently having to bear with high interest rates which squeezes not just working capital needs but also reduces the surplus available for investment.

You have been arguing that the burden of fiscal adjustment has been distributed unequally and has fallen on the poor. But this Budget has increased social sector outlays on agriculture, health and education. Is this not a positive aspect of the Budget?

Let us consider Plan expenditure on the social sector as a proportion of the total Central Plan outlay. In the social sector, I include the departments of rural development, education, health, family welfare, water supply, sanitation, housing, urban development, labour, social welfare etc.

This figure has come down from a level of a little over 16 per cent in 1990-91 to 14.3 per cent in 1993-94. True, there has been an increase in the allocation to the social sector in the 1993-94 Budget in absolute terms, but in real terms the increase will not be significant.

Dr Manmohan Singh has argued that there is nothing wrong in the World Bank and the IMF asking us to spend more on the social sector since, after all, it is also good for the country...

The World Bank has loaned the country somewhere between Rs 1,200 crore and Rs 1,600 crore for creating a social safety net. But I think we are making a virtue out of necessity. The main point is that borrowed external resources should not become a substitute for domestic resources; they should, at best, be an addition to domestic resources. Also funds borrowed from abroad should be used for investment not consumption. This is what the country did in the second half of the '80s which landed us in a debt crisis. As for me, I don't mind anyone preaching the virtues of motherhood so long as it is good for all of us.

My view is that the fiscal adjustment should have come from a more appropriate mix of expenditure cuts and revenue raising efforts instead of relying almost exclusively on external funds. The way we have been adjusting has implied that a substantially higher burden of the expenditure cuts has fallen on the poor.

The Finance Minister has justified not lowering personal income tax rates on the ground that the states would lose revenue. Do you agree?

There are only 5 million-odd income tax assessees in the country. Personal income tax as a proportion of GDP is not even 1.5 per cent. It is absolutely essential that we broaden the income tax base and deepen it as well by increasing average (not marginal) tax rates.

The average rate of income tax in India is much lower than in many developing countries. Whereas direct taxes (income and corporation taxes) are barely 15 per cent of total tax collections in India, the proportion varies between one-third and half in countries like Indonesia, Malaysia and Thailand.

What are your views on the unification of the exchange rate?

It is an euphemism for devaluation. For any country to make its currency convertible, two conditions must prevail. First, inflation must be lower at home than in the rest of the world. Secondly, the balance of payments position must be stable. Both conditions are not satisfied in India at present. Inflation may be down on a point-to-point basis but not very much on an average basis. The reality cannot be concealed from the housewife.

Then, the forex reserves have been stable despite sluggish exports. This is because imports have also been sluggish and reserves have been built by external borrowings. This is not a stable situation.

The third point is that many countries have followed a particular sequence in making their currencies convertible. First there is trade account convertibility, followed by non-trade current account convertibility and finally, full capital account convertibility. We haven't followed this kind of sequence. Most countries in West Europe took over 25 years to complete this process and in East Asian countries, the process took over 15 years.

The cost of imported oil, fertiliser and defence equipment will now go up by around 25 per cent in rupee terms and the cost of all other imports by around 10 per cent. This will have a direct cost-push impact on inflation with indirect cascading effects. I think domestic petroleum prices will not be stable for much longer than six months because the IMF will insist on passing through the higher rupee costs of petroleum imports.

But the Government is claiming that the Reserve Bank of India (RBI) will intervene to boost the value of the rupee if it depreciates excessively...

The RBI has the ability to manage the float, but this capacity is not unlimited. Beyond a certain limit, the question would arise as to how much more the country should borrow to beef up reserves and maintain the value of the rupee.

For the first time, we have created a situation in the country where expectations about the value of the rupee will depend on the domestic level of prices. People here might start looking at foreign exchange as one more asset on their individual portfolios which is what happened in Latin America.

This would indeed be unfortunate. The qualitative change that has taken place is that actual outcomes (of the value of the rupee) would be determined by expectations of the inflation rate at home which, in turn, would become a self-fulfilling prophecy.

In forex markets, it can go beyond the capacity of Governments to control such expectations. Look at what happened in Britain. All of Mr Major and his men could not maintain the parity of the pound.

BUSINESS SCAN

Darshan Oils

Darshan Oils Limited will be entering the capital market with a public issue of 25,50,000 equity shares of Rs 10 each for cash at par aggregating Rs 2.55 crore. The issue is scheduled to open on 6th April 1993.

For the year 1991-92, the company made a net profit of Rs 21 lakh. The book value of each share as on 31.3.92 was Rs 31.52 while the earning per share was Rs 6.80.

The company was promoted by Daljit Singh in 1982 and started commercial production in 1985. It was converted into a public limited company on 1st May 1992 with the main object to carry on the business of manufacturing edible oils (mainly mustard, soyabean and cotton).

The promoters and directors are bringing in a sum of Rs 1.70 crore in the form of share capital of Rs 1.38 crore and interest free unsecured loans of Rs 32.27 lakh. This represents 40 per cent of the total cost of project.

Singhal Cement

Singhal Cement Limited, a company coming up for the manufacture of portland cement has tied up with the well-known Pittie Cement & Industries Limited for the supply oil machinery and technology and marketing its products.

This tie-up would give Singhal Cement an edge over other companies for production and marketing its products, according to a company release.

The company is implementing a Rs 4.04 crore project for the manufacture of portland cement with an installed capacity of 100 tonnes per day at Jodhpur (Rajasthan). The trial runs are expected to commence by April, 1993 while the commercial produciton soon thereafter.

Galaxy Indo-Fab

Galaxy Indo-Fab Ltd whose processing unit has already commenced commercial production for processing of polyester dress material, polyester sarees, blended shirting, blended suiting and cotton poplin fabric is entering the capital market on 19th April, 1993 with a public issue of 40,00,000 equity shares of Rs 10 each for cash at par aggregating to Rs 4.00 crore.

The issue is to part-finance the company's Rs 6.39 crore export-oriented quilted bedspreads unit located on U P — a notified category 'A' backward area, eligible for sales-tax exemption, state subsidy etc.

The company has already appointed M/s Intercan Trade Co., Canada as its marketing agent for sale of 50,000 pieces of quilted bedspreads. The company has also entered an memorandum of understanding for sale of further 50,000 pieces with Ms Simex of Ilede La Re Union for the European Market. The company has at hand orders worth Rs 10 Crores which is 67 per cent of the first year of production capacity.

Amrapali Industries

Amrapali Industries Limited, an Ahmedabad-based company proposes to set up a plant to manufacture all kinds of laminated sheets with an installed capacity of 9,21,600 sheets per annum. The plant is to be located in Sanand Taluka of Ahmedabad district.

To prt-finance the project the company is entering the capital market on March 15, 1993 with a public issue of 36,80,000 equity shares of Rs 10 each for cash at par aggregating Rs 3.68 crore.

The total cost of the project is Rs 6.05 crore. The amount is proposed to be raised through promoter's equity of Rs 1.22 crore, public issue of Rs 3.68 crore, lease finance of Rs 1 crore and a subsidy of Rs 15 lakh.

BPL refrigerators

BPL has launched four models of the latest generation refrigerators based on the state-of-art technology from Sanyo Electric Company, Japan.

The product incorporates frost free technology, integrated polyutherene foam (IPUF) cabinet and has compressors of a high energy efficiency ratio, according to a company release.