India's reserves are growing, but at a cost

by Ramtanu Maitra and Susan Maitra

The economic liberalization in India began in full earnest in mid-1991 when the newly elected government of P.V. Narasimha Rao found that the foreign exchange coffers were empty, foreign debt was mounting, and fresh commercial debts had been almost choked off by foreign commercial banks. The Rao government, steered by Finance Minister Dr. Manmohan Singh, set about to build up India's foreign exchange reserves and reestablish India's creditworthiness among foreign lenders. The effort saw the introduction of austerity, mostly at the expense of development funds, reduction of tariffs, promotion of exports, and devaluation of the currency, the rupee, by about 50%.

Thirty-two months later, the Rao government, led by the Finance Ministry, is gloating about the fact that India's foreign exchange reserves have since grown more than sixfold and exports have risen substantially, while imports grew at a slower rate to bring the trade deficit down from $3.5 billion to roughly $1 billion. But what has pleased the money-men the most are the statements of foreign investors exalting the opening up of the Indian economy. Although the creditworthiness of India has remained poor and the foreign debt has increased, the big money-managers from the West have begun to move in. The stock markets, infused with foreign capital, are experiencing a boom, crowding out the more basic issues such as the growing shortages of electricity, the increasing lack of drinking water, and rising prices of the most basic commodities. The wailing of the Indian industrialists, who are increasingly squeezed by nonexistent industrial growth and cheaper imports of capital goods and the high tariff for raw materials imported from abroad, has become louder.

Wooing foreign investors

But the media and the Indian money-managers want to talk about the impending flood of foreign money. Maharashtra Chief Minister Sharad Pawar was invited to the World Economic Forum at Davos, Switzerland where he wooed foreign investors. He promised them a financial complex, an international finance and business center planned for Bombay, and other lucrative incentives. Prime Minister Rao, in his speech in Davos, was clearly trying to convey that India is a more fertile ground for foreign investors than China.

Some claim that the bias in favor of foreign investors is allowing them to make a quick buck, which is the real reason why the big money-men are lining up at India's money houses. They point out that the Foreign Institutional Investors, who have invested close to $700 million in the Indian stock markets, have been allowed to pay only 10% as capital gains tax if they hold onto shares for more than 12 months. For an Indian company, the capital tax is 46%, after adjustment for inflation.

The big names in the world money markets are here—Lazard Frères, Smith New Court, Rothschilds, Morgan Stanley, and Merrill Lynch. George Soros, the notorious looter of eastern Europe and Russia, through his Soros Fund Management, has reportedly decided to take a 33% stake in the Indian GIC Mutual Fund. Jardine Fleming, Baring Securities, Lehman Brothers, Kleinwort Benson, Crédit Lyonnais Securities, Citicorp, and Crosby Securities are all brokering stocks in India. Indian companies, emboldened by the new-found global partners, are getting on the Euro-issue bandwagon, and country funds are floated abroad. As one executive of a multinational told the press, "India is quite fashionable in New York now."

But behind the glitter is the age-old India with its decrepit infrastructure. The government is not oblivious to the increasing decay of the physical economy, but it is evident that money-managers are more interested to spin money off money than to invest in infrastructure. Already the government is bending backwards to allow the multinationals to build power plants at a much higher capital cost than if Indian companies, under strict vigilance, were allowed to build them. Despite such offers, the power sector looks gloomier by the day. It is evident that within the coming two to three years, the total new generating capacity will not exceed 20,000 MWe, when the demand is close to 48,000 MWe of new capacity.

The government, encumbered with poorly managed and politically controlled electricity boards and coal mining operations, has shown little ability to make them competitive with the foreign invaders. As a result, there is a lurking fear that the government will privatize them. This will surely create a massive confrontation with labor unions which are beginning to mobilize against such steps.

These are not the only danger signals. Too much money invested injudiciously will spark higher inflation, hurting especially the 35% of the population below the poverty line. The Indian financial and banking sectors are hardly capable of dealing with the various scams that the money-managers are expert in. The securities scam was an example. Now, with the advent of individuals such as Shaul Eisenberg, the international gun-runner, Lazard Frères, Morgan Stanley, Merrill Lynch, etc., Indian authorities will have to keep a close eye on their own pockets.

Already, Morgan Stanley has been accused of rigging prices in the "gray market" before the subscription list opened for its recent public issue. There is a demand that these allegations of market manipulation and insider trading be investigated by the Securities and Exchange Board of India. Some of the big money-managers are expert in laundering drug money through offshore operations.