Indian Government Struggles To Revive The Sagging Economy

by Ramtanu Maitra

After a year and a half of raised expectations of a higher growth rate, the Vajpayee government in India has finally landed on the hard ground. The Indian economy is in deep trouble, and now, New Delhi admits that the systemic maladies are getting worse.

Early in September, Prime Minister Atal Behari Vajpayee admitted openly that his government has failed in dealing with long-pending problems, such as entrenched poverty and disparity of growth. At a high-powered meeting attended by relevant ministries, Vajpayee proposed strategies to overcome the slow-growth syndrome and tackle the basic maladies that continue to haunt the Indian economy. He emphasized, among other proposals, mobilization of additional resources for investment in various development projects through budgetary and non-budgetary sources; utilization of surplus funds with banks and financial institutions to be channeled into productive public spending; modernization of railroads along with national highway development, and innovative use of surplus land to generate investment and house the poor.

Briefing press after the meeting, Finance Minister Yashwant Sinha said the focus of the meeting was to kick-start the economy with an envisaged spending of 750 billion rupees, targetting the rural economy and the infrastructure sectors.

Reality Is Worse

Despite the Prime Minister's suggestions and the Finance Minister's announcement, there is little reason for enthusiasm. Although the Indian economy's growth for the year ending this past March was announced at 5.2%, there is no end to negative news flowing in from all quarters. While the growth rates in industrial production and exports had both plummeted, New Delhi insisted on projecting 7%, and then 6.1% growth as late as in February. A growth of 5.2% of GDP—which translates to a 3.5% growth in per-capita terms—is an extremely disappointing performance and is a rapid deceleration from the 6.5% recorded in the preceding two years. More importantly, there is absolutely no reason why the slowdown was allowed.

If last fiscal year's performance was bad, this fiscal year's (April 2001-March 2002) performance is heading toward a disaster. Performance in crude oil, coal, and cement sectors dragged the infrastructure growth to 1.2% in July, compared to a poor 6.1% recorded in the corresponding period last year.

The combined growth of six infrastructure or closely related industries—petroleum refinery products, crude oil, coal, electricity, cement, and finished steel—fell to a dismal 1% in the first four months of the current fiscal year. According to the government's infrastructure data released in late August, electricity was the only sector which showed incremental growth in July, with generation of 42,016 million units as compared to 40,308 million units in the same month last year. Coal production, at 21.9 million tons, recorded a negative growth rate of 0.9%.

The Vajpayee government, when it assumed power in 1999, promised an acceleration of India's annual GDP growth rate in order to alleviate poverty and strengthen the country. During the almost two years that it has been in power, it has brought down the growth rate significantly and did little to alleviate the massive poverty that haunts India.

New Delhi's failure has two sources. First, the administration fully believes that free-market liberal economic reforms—privatization, globalization of trade, paring down of tariffs, meddling with labor laws, etc.—will bring in unprecedented prosperity and growth. Second, the administration's reasoning is paralyzed by the "magic" of foreign direct investment (FDI) and illusions about the growth of the software industry—which have been devastated by the collapse of the information technology economy worldwide.

Chasing Illusions About China

From the early '90s the mantra in India had been the magic of FDI. FDI worked wonders in China, the pundits said, and would be the salvation of the Indian poor. They said the foreign investors will come in with sacks full of hard currencies and help India to build capital-intensive infrastructure. As a result, the task of building power plants; renovation and modernization of railways and ports; building highways; and communications, were left to the "good Samaritans," who never came. New Delhi said that its role would be to facilitate their investments, which means changing the existing Indian laws, and bylaws, so that the investors' profit demands were met and their investments become fully safe.

But India has a basic industrial sector—some consider it small for the size of the country, but it is still much larger than most countries in the world have. This reality did not allow foreign investors to come in with the most absurd terms. Opposition came from both the people and the indigenous manufacturers.

In the state of Maharashtra, Enron Corp. from the United States came in in the early '90s with a plan to build, in two phases, a $5 billion power plant. It procured from the state government terms and conditions which were so absurd, they made people wonder. Those terms and conditions hastened the bankruptcy of the Maharashtra State Electricity Board and are endangering the financial health of the state of Maharashtra itself. It is evident that New Delhi will have to cough up the money from its revenue earnings to whet Enron's appetite and get this white elephant off its back. It is not yet clear who is going to purchase the high-priced electricity sold by Enron. It is nonetheless a tragedy that in a country short of electricity, the only electricity available is the kind that no one can afford.

As for the software illusion, the financial bubble around the world that boosted the information technology sector in the United States in the late 1990s and the year 2000, had to collapse. But as late as the latter part of 2000, Finance Minister Sinha, flanked by his analysts, was still forecasting burgeoning earnings from the export of Indian software to the rest of the world. The United States buys 60% of India's software exports. India's software and IT services exports in the first quarter of 2001-2002 was about Rs. 86 billion ($1.79 billion). New Delhi has been forecasting that software exports would grow at a rate of 40% in 2001-2002 to $8.3 billion annually. Now, New Delhi would do well to pare that number down by half and finally bid adieu to this fantasy.

More Trouble Ahead

One Indian economist recently pointed out that "it is difficult to recall when in the past decade there was a thicker pall of gloom enveloping the [Indian] economy than today." While rampant inflation and a scarcity of foreign exchange are not the worries of the powers-that-be, the real economy is steadily declining.

What must not be underestimated is the grip of "free market" economists over the Vajpayee government. Non-intervention by government, even when the economy is sliding into stagnation and the process of employment generation has virtually come to a halt, still remains their advice to the administration. According to some of these economists, a good monsoon, the kind that India experienced this year, will automatically lift its industrial demand. This will allegedly happen through increased agricultural production and enhanced rural demand.

Fortunately, this convoluted concept has been shot down recently by the country's premier economic research institution, the National Council for Applied Economic Research (NCAER). NCAER concedes that agricultural growth is important in raising incomes for the rural population, but it may not be sufficient to raise significantly the growth rate of overall demand for non-agricultural output. According to NCAER's line of reasoning, the share of agriculture and allied sectors is now 24%. Therefore, an increase in agricultural output by 1% raises the GDP by 0.24%. Even a 5% growth in the agricultural output—not an easy goal to achieve—is not going to alleviate the non-agricultural sectors' problems.

India's large, and yet weak, small-business sector has been badly hit by cheap imports and dumping from outside. Among some of the small-scale sector entrepreneurs, a state of panic reigns. If the problems that ail the small-scale sector are not addressed quickly and effectively, their impact on unemployment could be frightful. At this moment, there are approximately 45 million workers in the manufacturing sector (excluding handlooms and handicrafts), of which 37 million are in the unorganized sector. Approximately, 28% of them are in the textiles industry and another 11% are in engineering. In the worst-case scenario, one economist recently pointed out, there exists the possibility of losing up to 10 million jobs in these two sectors alone. But these are not the only industries that will be affected, including by the flood of cheap imports coming into India.

Producers in chemical products, rubber goods, and plastics are being hit as well. Many more jobs will be lost in these sectors too. The estimate of 10-11 million jobs given above relates only to direct employment. In addition, a number of indirect jobs generated by these sectors will be also lost. In the textiles industry, for instance, the total number of direct and indirect jobs is around 93 million. Some economists believe that as many as one-tenth of these jobs could be lost.

Finally, the poorest performance of the Vajpayee government has been in employment generation. It has been reported, "Against the growth rate of job seekers of 2.3% per annum, the rate of job creation has dropped from 2.1% in the 1980s to a mere 0.8% in the 1990s. So far as the private sector is concerned, while jobs grew at an unprecedented rate of 3.1% per annum in the brief period from 1994-1997, the rate of job growth has fallen to a miserable 0.11% in 2000-2001. Since the public sector is now effectively bankrupt, and is creating no more jobs, it is hardly surprising that the [total] rate of job creation in the last three years has been below 0.5% per annum."

The scene is indeed bleak, and New Delhi has let itself be drawn into the quagmire. This prevented it from intervening with any amount of vision and imagination into the economic arena. While the war drums are being beaten in the region in the midst of a worldwide economic crack, New Delhi must not delay in implementing what the Prime Minister suggested as a way to make the Indian economy healthy again.