A Decade of Economic Destruction

(A Compilation of 3-parts articles of
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Part I - Reckless imports put rupee on ventilator

After watching the relentless fall of the Indian rupee for 18 months with saintly restraint, Finance Minister P Chidambaram declared on August 12 that he would cut the Current Account Deficit (CAD) — the excess outgo over receipts of foreign exchange — and stabilise the rupee. In January 2012, Indians could buy one US dollar by paying Rs 45. But, by August 12, they needed to pay more, Rs 61 for a dollar, the dollar rising by over 35 percent since January 2012, mirroring an equal fall in the rupee value.

This is the direct outcome of the burgeoning CAD since 2004-2005. On August 12, Chidambaram announced "measures" to reduce the CAD and arrest the rupee slide. But, within 36 hours, on August 14, the rupee fell further, to Rs 61.50 per dollar.

This forced the Reserve Bank to restrict investments and remittances abroad to reduce the dollar's flow out of India. Even that did not work. It is Rs 62 to a dollar now. Even as the rupee was crashing, in January, The Economist magazine [2.1.2013] reported that the real value of the rupee, namely its purchasing power, equated a dollar to just Rs 19.75 - a third of the market value of the dollar today.

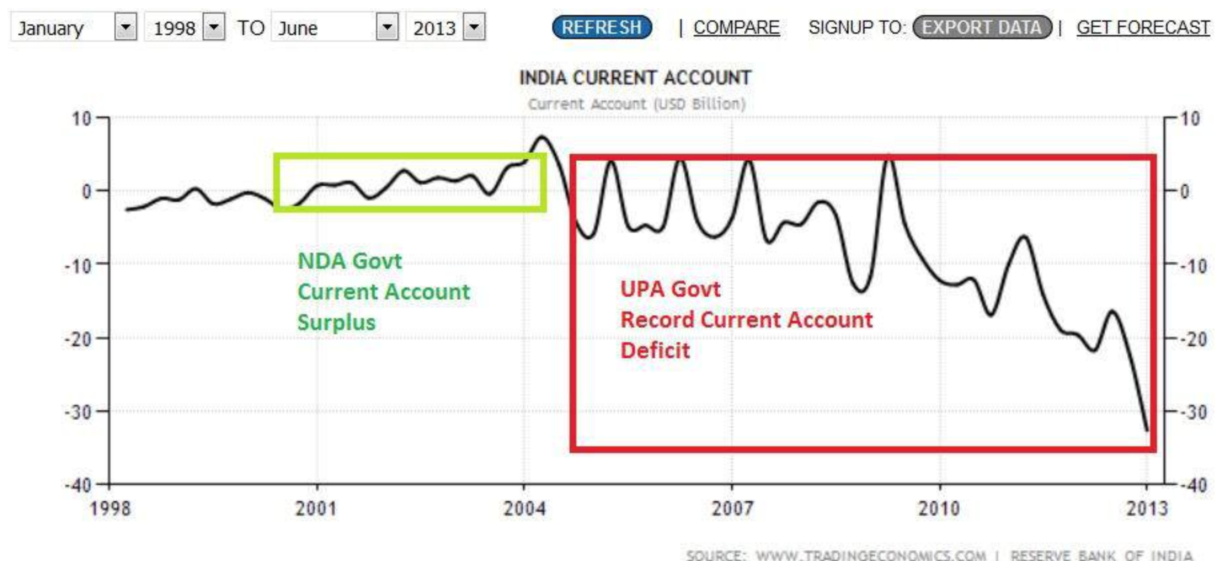
The Economist said the rupee is the most undervalued currency in the world market. Why does the already-undervalued, high real-value rupee keep losing value? Who is responsible for it? Chidambaram himself had acknowledged that the NDA had left behind a healthy economy.

In his budget speech (July 2004) Chidambaram said: "The economic fundamentals appear strong" and "the balance of payments robust". From "robust" balance of payments, the nation is today in a balance of payments crisis reminding the country of the dark days of 1991.

How did the UPA manage to mess up the prosperous economy it had inherited in 2004?

Galloping CAD

A quick look at some simple facts will bring out the drastic change for the worse after the UPA came to power in 2004, which turned disastrous for the country after the UPA was voted back in 2009. Take the recent history of the CAD. The country incurred a CAD of $35 billion in 10 years from 1991 to 2001. But, under the NDA regime, it posted a substantial current account surplus - yes, surplus - of $22 billion for the first time since 1978. After the current account surplus of the NDA days, nine of years of the UPA regime saw unprecedented CADs of $339 billion, when Chidambaram [5 1/2 years] and Pranab Mukherjee [3 1/2 years] stewarded the national economy. See the transition from surplus into deficits under their economic leadership. While the NDA handed to the UPA a current account surplus of $13.5 billion in 2003-2004, the UPA quickly turned it into a CAD of $2.7 billion (2004-5) and trebled it to $10 billion each in the second and third years and thereafter multiplied it to $16 billion (4th year) $28 billion [5th] $38 billion (6th) $48 billion (7th), $78 billion (8th) and $89 billion (9th). The government repeatedly said oil prices and high gold imports are the culprits for the relentless CAD. Is the story of oil and gold as culprits true? Or the complete truth?



Reckless imports destroy production

A closer look at the import data reveals a shockingly different picture. Unnoticed (or suppressed?) in popular discourse, capital goods import skyrocketed under the UPA rule. The capital goods import during the NDA period averaged about $10 billion a year. But in 2004-2005, the very first year of the UPA, it leaped to $25.5 billion and then relentlessly rose year after thus: to $38 billion in the second year, $47 billion (3rd), $70 billion (4 th), $72 billion (5th), $66 billion (6th), $79 billion (7th), $99 billion (8th) and $91.5 billion (9th), aggregating to $587 billion in nine years.

Import of capital goods is a sign of vibrant economy. And in theory it generates higher national production. But, see what happens. The Index of Industrial Production (IIP) annually averaged 11.5 percent during the first four years of UPA rule. But in the next five years the annual average IIP came down to less than 5 percent — finally to a peanut of 2.9 percent for 2012-2013. Far from rising with the import of capital goods, the IIP growth has fallen from 11.5 percent in the first four years to 5 percent in the latter five years, a fall

of over 56 percent. In contrast, it was in the latter five-year period the capital goods import was $407 billion (79 percent) out of the $587 billion for the UPA's entire nine years, the average in the first four years being $45 billion and the later five years was $80 billion.

A rise of 78 per cent

Is it not shocking that when the capital goods import rises by 79 percent, the national production falls by 56 percent. The 2008 meltdown cannot be cited as an alibi for the decline in the IIP. Because the GDP has risen from 6.7 percent in 2008-2009 to 8.6 percent in 2009-2010 and to 9.3 percent in 2010-2011. Also, an economic slowdown affects investment first and production later.

Production falls after investment contracts. But here investment (read capital goods import) has risen by two thirds but production has fallen by half. Why this conundrum? The reason for the fall in national production in the latter five years itself is the rise in imports. The domestic capital goods industry slowed down and later declined because of the import of capital goods. Even as the GDP rose to 8.6 percent in 2009-2010, the IIP rise of 5.3 percent did not keep pace with it. Later the index of domestic capital goods production fell — yes actually fell — by 4 percent in 2011-2012 and 5.7 percent in 2012-2013. More, in the last three years to 2012-2013, the production of intermediate goods hardly grew. If capital goods import under the UPA hit the capital goods industry like a tsunami, foreign-manufactured goods flooded the Indian market.

The average annual import of manufactured goods during 2001-2004 (the NDA period) was just $600 million. But from 2004-2005 to 2012-2013, the average soared to $5.5 billion, by 8 times. The nominal national GDP grew by 3.2 times in this period, by just a third of the growth of manufactured goods imports. The 9-year UPA regime saw manufactured goods imports of $50 billion against just $2.3 billion during the NDA regime. Obviously, the capital goods import did not add to, but actually destroyed, national production, ably aided by import of manufactured goods.

CAD kills GDP growth

It is basic economics that trade surplus adds to national wealth (GDP) and trade deficit cuts into it. So, the CAD, which is the trade deficit, brings down the nominal GDP by a like amount. Calculations show that the CADs have brought down the real GDP by 0.8 percent in 2007-2008, by 1.5 percent (2008-2009) by 2.1 percent (2009-2010) by 1.4 percent(2010-2011) by 2.6 percent (2011-12) and by 3.9 percent (2012-13). If the CADs were removed, theoretically, the real GDP of India would have been 10.8 percent (not 9.3 percent) in 2007-2008, 8.2 percent (not 6.7 percent) in 2008-2009, 10.7 percent (not 8.6 percent) in 2001-2011, 8.8 percent (not 6.2 percent) in 2011-2012, and 8.9 percent (not 5 percent) in 2012-2013. True, oil and gold too have eaten into the forex holdings. But there is a fundamental difference between them and capital goods. Indians buy a quarter to a third of the global supply of gold, which is not produced in India. Domestic oil production is just a quarter of national needs, necessitating the import of the balance three-fourths. But most imported capital goods, which are actually produced in India, has displaced domestic production of capital goods and brought down the GDP.

Oil and Gold as alibis

And see how the oil and gold story is not true or is true only partly. The gross value of gold, silver and precious stones import of $402 billion during the UPA's nine years looks huge. But if the export of jewellery and precious stones of $251 billion is set off, the net deficit is $161 billion in nine years. Likewise, the petroleum imports of $804 billion in nine years look gargantuan. But, if the export of petroleum products ($279 billion) is set off, the net import is down to $515 billion. It is less than the capital goods import of $587 billion. In the last five years, the net petroleum import is worth $360 billion, but the capital goods import is worth $407 billion. Does it need a seer to say that the real culprit is the reckless capital goods import and that it has killed the rupee through the CAD and hit domestic production and GDP? Just see one fallout of rupee depreciation. A calculation shows that for every additional rupee paid to buy dollars for oil imports, the additional oil bill for India is Rs 9,500 crore. In today's rupee value, the extra annual petrol bill will be Rs 1,60,000 crore. But the CAD is only part one of the story of destruction. Await further testimony on the decade-long destruction.

Part II - Economy on verge of internal, external bankruptcy

Undoubtedly the reckless current account deficit of $339 billion in the nine years of the UPA rule has directly hit the Rupee unconscious. The CAD is the proximate cause of the Rupee's disgrace, but not the only cause. Fiscal deficit is as much a culprit. Fiscal deficit is the excess outgo of government over its revenues. The deadly combination of huge current account deficits and high fiscal deficits have put the Rupee on the ventilator. See the fiscal deficits record of the UPA Government. In its nine-year rule, the UPA Government has incurred a fiscal deficit of over Rs 27 lakh crore -- of which it incurred Rs 22.66 lakh crore in the last five years at an average of Rs 4.5 lakh per year against the average of Rs 1.35 lakh a year in the earlier four years. The government's alibi for the huge deficit of almost Rs 23 lakh crore in the last five years is the stimulus it gave to the economy by cuts in excise and customs tariff because of the global meltdown in 2008.

Because of the tax cuts, the revenue deficit shot up to Rs 16 lakh crore in five years averaging over Rs 3 lakh a year against the average of Rs 0.75 lakh in the first four years. The stimulus given in 2008 is still on,

partially. See how this has robbed the nation, imposed high fiscal and huge current account deficits, eroded the Rupee's value and benefited only the corporates.

Rs 30 Lakh crore revenue foregone

The Statements Revenue Foregone, annexed to each annual budget, details the tax waivers given by the government since 2006-7. In the nine-year UPA rule the tax waivers have accumulated to Rs 30 lakh crore! In the two years before the stimulus in 2008, the waiver averaged Rs 2.6 lakh crore a year.

But thanks to the stimulus, it almost doubled Rs 5 lakh crore each year for the last five years. Against the budget revenue deficit of some Rs 16lakh crore during the UPA's nine years, the tax foregone is Rs 25lakh crore! The rationale for the stimulus was that the economy, under recessionary stress, needed support. But surprisingly the corporate profits were more in the stimulus period than before. The corporate profits were 11pc of the GDP in 2005-6, before the 2008 meltdown, when the GDP growth was also one of the highest – 9.5pc. Against this base year numbers, the corporate profits to GDP ratio rose up year after year thus: 12.94pc [2006-7], 14.26pc [2007-8] 11.86pc [2008-9] and 12.71pc [2009-10] and 12.15pc [2010-11]. The excess over the base year's gains of the corporates during the five years was Rs 4.8 lakh crore. This meant that the corporates had swallowed the substantial stimulus meant for the economy. Significantly, before the stimulus [2008-9] the average GDP was 9pc, in 2008-9 it was 6.7, after the stimulus it averaged 9pc till 2010-11. Only later it declined. Obviously the stimulus was a kneejerk reaction, not entirely based on merits, given the good performance of the corporates and GDP during the six years from 2006-7 to 2010-11. The UPA's latest Economic Survey [2012-13] too laments about the huge tax foregone [p66-68] and counsels "there is merit in limiting" the tax waivers.

As far back as in 2005, both Manmohan Singh and Chidambaram swore that they would withdraw tax cuts but didn't. Not doing so then and not fully cutting the stimulus in 2009 amounted to a criminal mismanagement of the economy. The weak performance of the economy from 2011-12 itself was partly because of the huge fiscal deficit of Rs 12lakh crore occasioned by the stimulus tax cuts. On top of it now is the proposed expenditure for attempting an UPA victory in the 2014 elections at public cost like the Food Security Bill, which threatens to escalate the fiscal deficit by Rs 2 lakh crore more each year. This creates the market perception that the UPA is recklessly keen for power even at the cost of national bankruptcy. Why will the Rupee not collapse? Move on.

Tax cuts invite high CAD

The stimulus conceals a much greater evil than just loss of revenue. The stimulus cut in customs tariff in 2008 -- already down to one half in the last decade -- made imports cheap. Result, the capital goods import surged in the next five years [2008-9 to 2012-13] to $407 billion. In the previous four years it totalled only $180 billion. Obviously, the customs rate cut has to do with enlarging the flood gate of capital goods import. The customs collection, which was Rs 1 lakh crore in 2007-8, came down to 0.83 lakh in 2009-10 -- that is less by over 17pc - even as imports rose from Rs 8.4 lakh crore [2007-8] to Rs 13.74 lakh crore [2009-10] by over 56pc. Obviously, the surge in the import of the capital goods was stimulated by the customs and excise stimulus in 2008. As demonstrated yesterday (Monday), surging capital goods imports decimated the domestic capital goods industry and forced the GDP down. Thus the stimulus tax cuts have hit the economy

in every way – increased the fiscal deficits sky-high, imposed huge current account deficit and sent the Rupee to the ICU. But that is not the end of the mischief.

CAD causes huge debts

Even as the post-2008 budget deficits added Rs.21.6 lakh crore to the public debt, the current account deficits necessitated huge external borrowing. This is despite the fact that during the UPA rule, the investment flow into India was unprecedented. FDI inflow into India during the nine years was $205 billion. Deducting the investment outflow of $102 billion from India, the net inflow of FDI was $103 billion. The net FII inflow into stock markets was $124 billion. The two added $227 billion to the forex kitty, but that was short of the current account hole of $339 billion. Huge external borrowing became inevitable. Including the risky short-term debts, which rose by 17 times from $4billion to over $70 billion, the external debts leaped by $288 billion during the UPA regime to $396 billion. The huge rise in investments and debts caused a four-fold rise in the net outgo of the income on investments and debts from $4 billion to $16.5 billion. With the current account deficit of $339 billion eating away most of the investment inflow [$227 billion] and additional debt [$288 billion], the forex reserves grew only by $180 billion to $292 billion. With the Himalayan current account and fiscal deficits continuing, escalating debts, increasing servicing spend on debts and investments and disproportionate short-term debts, the statistical forex reserve of $292 billion barely conceals the semi-external bankruptcy that has put the Ru pee in ICU.

Culture saves India

But what has ultimately saved India from internal and external bankruptcy is not fully evident in the public discourse. How were the fiscal deficits financed? Simply by the government issuing bonds to the commercial banks and the Reserve Bank and borrowing. The government could borrow within India because the traditional Indian families 'safely' bank their savings. They deposit close to Rs 10 lakh crore a year in the banks, which saves India from internal bankruptcy. But how is the bankrupting CAD really met? The truth, an untold story, may shock. It is the 'remittances from the Indian workers for family expenses' and 'local withdrawals' from the non-resident Indian accounts that has saved India from external insolvency. The forex contributed by Indian families totalled $335 billion during the nine-year UPA regime, almost equal to the CAD. Not a single dollar of this remittance is returnable. It bears no interest. This huge lifeline remittance is not the product of economics laws or the government policies. It is the traditional, cultural gift to the Indian economy. Had the traditional Indian families, struggling against modern individualism, not held together, would there have been such remittance?

Never. More. If the Indian workers did not remit for the maintenance of their kith and kin, besides the loss of the $335 billion lifeline for India, the state will have to fend for them. Has the Indian establishment discourse ever noticed this culturally devised protection to the economy? The relation-based nature of the Indian society makes this remittance culturally mandatory. This would not happen in contract- based societies like those in the West. Yet the government is making laws and the public discourse is striving hard to atomise the Indian family and society and turn it into a contract-based one. The establishment takes this lifeline for granted, perhaps not even conscious of it. But it tom-toms the investment inflows and debts.

The final part of the story will show how naive or criminally negligent the UPA Government has been in allowing a large part of the huge current account deficit to run contrary to India's strategic interests.

Part III - UPA policies weakening India and enriching China

The import of capital goods for $587 billions, most of which India could make in its own backyard, drained out a third of India's GDP under nose of the UPA regime. The UPA government also eased customs and excise tariff to facilitate their entry into India with the least fiscal resistance and consciously ran current account deficits of $339 billions. That means what? To that extent India has lost its wealth to the other nations. Who gained from India loss? Not America, nor England, Germany, France, Japan, or Russia – countries friendly to India. It is China. Year after year from 2006-7, it has been the single biggest beneficiary of India's import orders. India's imports from China was 13pc of the country's total imports in 2006-7. It rose to 17pc by 2011-12. Result, India's trade deficit with China topped $175 billions in the last six years to 2012-13. The UPA was the architect of the huge deficit syndrome with China. India ran a trade deficit of $1 billion with China in 2001-2. By the third year of the UPA rule, it rose to $9 billion. Later it galloped to $16 billion [in the 4 year] $23 billion [in the 5] $19 billion [in the 6] $28 billion [in the 7] $ 39 billion [in the 8] and $41 billion [in the 9] aggregating to $175 billion or 54pc of India's total current account deficit of $325 billion in the last seven years. The capital goods imported from China alone amounted to $150 billion plus. India imported from China three times more than it exported to it.

Not in India's strategic interest

China has never been a great friend of India. India's Cold war with China continues. China breaths hot on Arunachal Pradesh. Builds dams on Bramhmputra. Not just that. It is a friend of Pakistan, the depth of whose nationalism is measured by its hatred for India. Not just a friend. China is Pakistan's strategic partner giving economic military and technological support. It has built up, and is still building up, nuclear arsenal and missiles for Pakistan. Economic consideration apart, it is certainly not in India's strategic interest to benefit China so hugely, at India's cost. The trade deficit of $175 billion with China [Rs 10 lakh crores] equals India's defence spending for the last six years! Based on the US Department of Defence estimates of $63 billion as China's annual defence budget, the $175 billion Indian trade account bounty funds the defense budget of China for some three years! More. The trade deficit with China weakens the Indian Rupee and Indian economy and strengthens the Chinese economy – which again does not serve the geo-political interests of India. How and why did the UPA government commit this geo-political and economic blunder? No answer. Apart from failing to resist the Chinese dumping, by cutting India's import and excise taxes, the UPA has positively helped China, already a cheap producer, to penetrate and dominate the Indian market. More. Its huge liquidity enabled China to lure the Indian importers of China's capital goods with billions of dollars of suppliers' credit virtually at throwaway interest rates. Had the UPA government been more alert, could it have prevented or mitigated this disaster? Yes.

India not alert to China's dumping

China entered the Word Trade Organisation [WTO] in 2001. It was preceded by huge tariff cuts effected by India under the WTO regime. India's import-weighted tariff of 50pc in 1990 came down to 20pc by the end of

1990s. From the 1980s, China has been a huge dumper of goods world over. Dumping means selling goods at less than their cost. Anti-dumping provisions are integral to the WTO regime. The previous Indian governments have been extremely alert in dealing with Chinese dumping. India used to be so offensive on dumping into India that, between 1995 and 2001, India launched as many as 248 anti-dumping cases – which was next only to the US [255 cases]. A fifth of India's anti-dumping moves were against China. The accelerated dumping of goods by China under the UPA regime coincided with the declining import tariffs of India. The trade-weighted tariff rates of India declined from 50pc in 1990, to 20pc in 1998, 14pc, in 2006 12pc in 2007 and 8pc in 2008. Yet shockingly, the anti-dumping efforts by India – instead of intensifying – slackened from 2008. In about 2002 [when NDA was in power and the trade-weighted tariff was still high, 20pc] India accounted for a quarter of all global anti-dumping cases. The cases dipped later but grew in 2007 to 27pc, but slacked and halved to 15pc in 2009 when the Indian tariff had hit the bottom, 8pc – precisely when the anti-dumping efforts should have been more rigorous.

China grabs Indian market

Result, China's share of imports into India is now more than a quarter of the capital goods, half of textile yarn and made ups, three-fourths of cotton yarn/fabric, nine-tenths of silk yarn and raw silk, half of manmade filament yarn/fabric, one-third of readymade garments, two-thirds of synthetic fibres, one-third of chemicals, medical and pharma items, two-thirds fertilizer manufactures, one-sixth of machine tools, one-third of computer software, a quarter of steel, two-thirds electronic goods, one-tenth of cement, one-third of metal manufactures, two-thirds non-metallic manufactures. This list, just illustrative, shows the Chinese domination of the Indian market. The dumping of goods by China has been an open affair. The media had extensively highlighted it. The Statesman [18.5.2009] had warned that Chinese dumping was irreparably damaging “the Indian domestic market and producers.” and “if the current situation continued Indian industry would cease to exist.” But it is after such public warning that the trade deficit with China shot up by $127 billions – three fourths of the total trade deficit of $175 billions with China since 2006-7. Yet, India did not even use the market access it provided to China as leverage for geo-political gain to settle the border and other disputes with China and negotiate its support for India's entry into UN Security Council. This demonstrated the lack of strategic element in India's China policy – pointing to utter failure of diplomacy and national leadership.

Ostentation, and mismanagement

Undoubtedly, the UPA has messed up, grossly mismanaged a rising global economic powerhouse by internal and external ostentation. When the UPA leaders saw the GDP growth rates surpassing 9.5pc in 2005-6 and 2006-7, the fiscal deficit coming down and the forex flows heavy because of phoney credit monies wandering all over the world, they became euphoric and lost all sense of proportion and moderation. In the euphoria generated by hot-money flows, the UPA opened the floodgate of imports and foreign investments by Indians. A mature leadership would have used the opportunity for fiscal and external consolidation. That was the right time to withdraw the tax waivers and build more reliable forex reserves. In the days ahead of 2005 budget Manmohan Singh and Chidambaram did threaten to cut tax waivers but kept silent about it in the budget. With the result the extravagant tax giveaways of over Rs 2.5 lakh a year continued. UPA government behaved as if India had already become a global power, not just one in the making. And when the 2008 crisis

hit, the government went overboard and doubled the tax giveaways to Rs 5 lakhs crore which hit the revenues, also made it possible for China and others to invade the Indian market with cheap equipments and products. The economic destruction of India took place between 2005-6 to 2010-11 when things could have been reviewed and controlled. Things tended to become uncontrollable by 2011-12.

The way out

Now, what is the way out? Not begging for inflow of hot money or external borrowing like the UPA government is doing. It is like applying ointment on cancer. How about these two big things? First, an announcement that the food security bill, that adds additional Rs 2 lakh crore fiscal deficit a year, will be deferred till after the looming crisis is over. This will instantly shock the market to think that the government is serious, to begin regaining confidence. Next, announce complete tax immunity, bring out the un-ornamented hidden gold, estimated at 3000-6000 tons, into interest-bearing government gold bonds, securitise gold, which has the potential to turn $200 billion investment into the economy and add equal amount of stable forex reserves. This can transform the internal and external economy dramatically. [To see the detailed scheme, read the materials in the links given below*******] Pranab Mukherjee was keen to do it in the 2012 budget, but he was scared of being bracketed with black-money holders by the anti-corruption road show heroes fashionable then. Will the government have the political will to do it? If not, later, it will do something like this or more drastic, helplessly. It is time that the government worked with the opposition to build consensus, like they did in 1991, to tackle this serious situation which has the potential to develop into a financial emergency.

******Also read:***

Note on policy for Gold

*(**http://media.newindianexpress.com/NoteOnGoldForFM_31_12_2011.pdf/2013/08/20/article1743784.ece/binary/original/NoteOnGoldForFM_31_12_2011.pdf**)*

India and Gold

*(**http://media.newindianexpress.com/PaperOnGold_31_1_2011.pdf/2013/08/20/article1743782.ece/binary/original/PaperOnGold_31_1_2011.pdf**)*

Gold Consumption in India

Gold, which was dominantly used for jewelry but not so insignificantly kept as investment in India, has, of late, emerged as preferred investment asset held in the form of bars and biscuits. This is not only due to economic variables like the instability in financial and stock markets, but also due to cultural pull of gold specific to India and generally to Asia.

During the reform period from 1997 to [Q3] 2011 India has imported 10600 tons of gold. Gradually, in recent times the share of gold as investment has risen, and the trend continues. In 2008, share of gold as investment in the total demand was estimated at 28%, 210 tons. It went up investment up by 25 per cent to 34% of the total demand to 220 tonnes approximately during 2009. It soared by 83 per cent in 2010 from the year earlier to 349 tonnes in 2010, accounting for 34% of the total demand.

In 2011, overall jewelry demand during the first nine months of this year fell to 464.4 metric tons from 471.9 tons a year earlier, but, investment demand grew nearly 26% year on year to 296 tons, according to the World Gold Council.

In recent times, there has been fall in demand for gold for jewelry but it is compensated a huge rise in investment in gold. The message is clear. Gold buying has not reduced; but there has been a shift from ornamental gold to gold as investment. The aggregate gold added to gold in investment for the years 2008 to Q3 2011 – 45 months period – amounted to 1073 tons.