THE PROBLEMS OF PLENTY?

Bharat Jhunjhunwala writes:

Indian Economy is suffering with the problems of plenty. The economy is burning due to excessive capital inflows. Global investors are buying shares in the Indian stock markets. They are converting dollars into rupees for this purpose. This is leading to heavy supply of dollars and decline in the value of dollar visavis the rupee.

The Reserve Bank of India (RBI) is buying dollars in huge amounts to prevent such a rise in the value of the rupee. These dollars are being deposited by RBI in American Banks or in Bonds issued by US Federal Reserve Board. But this cannot help in the long run. RBI has to print notes to buy these dollars and that leads to increase in inflation in the country, huge loss due to devaluation of US Bonds.

The inflow of foreign currency by foreign investors is supplemented by external borrowings by domestic companies. Indian companies stand to gain twice from such borrowing. One, they pay low rates of interest compared to those prevailing in India. Two, they have to repay lesser amounts towards principal due to appreciation of the rupee.

RBI has recently allowed Indian companies to prepay their external loans in order to increase demand for dollars in the Indian forex markets and relieve the pressure of inward inflows. But this policy is unlikely to deliver because Indian companies stand to gain by delaying the payment of external borrowings rather than by early repayments.

A large part of Indian forex reserves can be invested in infrastructure. Deputy Chairman of the Planning Commission, Montek Singh Ahluwalia, had floated the idea of using \$5 billion of Indian forex reserves for this purpose soon after the Congress had assumed power. But this has not been implemented four years down the road. Not \$5 billion but \$100 billion should be used for this purpose. This amount can be used to import cement and steel to make ports and highways. The main problem is that forex reserves are held by the RBI while investment is to be made by GO1. Borrowing from RBI for making these investments increases the fiscal deficit of GOI. Belief is that increase in fiscal deficit is frowned upon by foreign investors. This argument had some credibility when India needed to attract foreign investment to increase forex inflows. But in the present situation, when Indian economy is suffering from excessive inflows, *lesser foreign investment is better*.

The Government can make a massive plan to use forex reserves to help other developing countries. The United States had given huge amounts under Marshall Plan to Europe to help rebuild that country from the devastation of the Second World War. Europe is ever indebted to the US for that assistance.

RBI is free to invest the foreign exchange purchased by it in any currency it considers appropriate such as in the Bangladeshi Taka or the Indonesian rupiah.

One should not be much influenced by the experience of Southeast Asian countries that faced currency crisis in the late-nineties because they did not hold large forex reserves. There is a qualitative difference. Those countries used forex

inflows to increase consumption of imported goods and to provide huge salaries to government servants. As a result they had no additional income to fall back upon when the inflows reversed into outflows. $\Box\Box\Box$