Mint ND 29-Aug-13 P-15

# Five steps for economic stability

## MARKET ECON

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The Indian economy is expected to have grown at just around 4.5% in the first quarter (April-June) of the current fiscal. The actual data will be released later this week. At 4.5%, the growth in the gross domestic product (GDP) will be lower than the lows of 4.7% attained in the third quarter of the last fiscal. With no visible sign of a turnaround, even 5.0-5.5% growth target for the full year now looks difficult to achieve.

Sliding growth with a high current account deficit is unlikely to yield stability on the external front—the most worrying area for most people at the moment. Therefore, it is not entirely surprising that the Indian rupee breached the 68 mark against the dollar on 28 August with no sign of stability in the near term. The steps taken by the Reserve Bank of India and the government of India to protect the decline in the Indian rupee, as expected, failed to provide stability of any kind in the currency market. Therefore, as the US Federal Reserve begins to exit from its bond buying programme, things will only get complicated for the rupee and the Indian economy. However, as argued before in this column, the weakness in the rupee, apart from the changing expectations around interest rates in the US, is also a reflection of the weakness and loss of competitiveness in the Indian economy, which has brought down growth to the lowest level in a decade. Therefore, in the present circumstances, stability on the currency front can only return if the market is convinced about a meaningful recovery in economic activity. Here are five steps that can restore market confidence and help revive economic growth.

### Focus on the future

The government of India will first have to stop viewing the economy in the rear-view mirror and, instead of patting its own back for overseeing economic growth of seven point something in the last nine years, it would do well by focusing on a four point something that the growth has been reduced to. It is good that the Indian economy expanded at an accelerated pace in the past, but investment are not made solely on the basis of past performance. Investments, which lead to growth, create jobs and push income, are driven by the present conditions and expectations from the future.

### Focus on economy, not rupee

Instead of putting one false defence after another to save the rupee, policymakers should focus on saving the economy. It should be clear by now to both the central bank and the government that short-term fixes such as restricting capital movement, arbitrarily raising import duties on certain items or draining liquidity from the system does more harm than good and is unlikely to stabilize conditions. But we are yet to hear anything big that will meaningfully alter the growth trajectory. A lot has been written in this paper and elsewhere about the deteriorating business environment in the country. We are at a stage where even Indian entrepreneurs prefer investing overseas. This will have to change.

### Secure a strong credit line

Excess volatility in the currency market is a genuine concern as it can pose a risk to financial stability. However, this does not mean that the rupee should be defended at a particular level or should not be allowed to find its real value. But the government will also have to ensure that with over $170 billion worth of debt maturing in the next one year, India remains in a position to fulfil its dollar obligations. Therefore, all the talk doing the rounds on sovereign debt issue, quasi-sovereign bond issue and similar instruments should stop. Instead, the government should secure a strong credit line, maybe from the International Monetary Fund, which will release dollars if needed. This will take fear out of the currency market and allow the rupee to adjust to the extent that is fundamentally warranted. A bond issue will immediately bring in foreign exchange, which will be seen as a defence against depreciation and, apart from adding to the existing debt burden, will only have a short-term impact.

### Revisit the 1991 notes

Markets work on expectations. Therefore, to stabilize condition in the financial markets and to boost economic activity in a meaningful way, the very basis of policymaking needs to be revisited. India at this stage needs the 1991-style massive overhaul in economic policymaking. The time for incremental and arbitrary policy changes is gone. It is true that policy changes will not immediately result in higher growth, but the most important thing at the moment is that investors need to start believing that projects can be cleared, land can be acquired, labour can be hired and disputes can be settled in a reasonable time frame in this country.

### Hold early elections

The Indian economy and the financial markets have suffered quite a lot in the last few years and they need a fresh start. It will help if the general elections, which are scheduled for May 2014, are advanced to the extent possible. A new government will always be in a better position to make large-scale policy changes and give a new direction to the economy, which will also be acceptable to the market. It will also be in a stronger position to take what are perceived as tough decisions. There are limitations to what an incumbent government can do in the last leg of its tenor.

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**End Note**: India did not reach this state by accident, as we are expected to believe. The present condition is a consequence of a serious design fault in economic policymaking. It is clear that growth was not a priority for the government till it was too late. Even at this stage, the main concern is to create an "entitlement regime". If we had shown similar enthusiasm in pushing investment and clearing bottlenecks, perhaps, *Market Econ* today would have had a different story to tell.

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