BANKRUPT!

How India got into the mess. And is there a way out?

It does not take very much to sum up the reality that is India today. The treasury is scraping the bottom, money is being spent faster than it comes in. Our government is living on borrowed funds—and borrowed time. There are shortages, prices are high, and people's incomes can barely keep up with them. And the government is taking with it India's citizens for a nightmarish tight-rope walk.

"I think that we have two basic problems in India," Prime Minister Chandra Shekhar told SUNDAY barely days after he was sworn in last November. "Scarcity of resources and great poverty...that was our problem in 1950. That is our problem in 1990." Shekhar's finance minister Yashwant Sinha is as understated. The economy's problems are "difficult but manageable", he says, and "if we make determined efforts we can improve the situation".

These assessments, however, do not reflect the true picture of the mess the country is in. Shekhar talks about problems being similar even after four decades. The thing is, the *nature* of the problems may be the same, but they have become much worse than anyone could have imagined. And when Sinha says things are difficult *(see interview on page 40)*, the truth is that they may be next to impossible.

Bad news for Yashwant Sinha, India's top money man. He is the person who, ultimately, has the responsibility of trying to get India out of the morass. If he can pull it off, he will probably get a Nobel Prize for economics. If he cannot—which is more likely—effects of the likely recession will last into the next century.

Consider the following:

■ There is a shortage of essential commodities such as edible oil, a staggering ten lakh tonnes. Prices, fuelled by shortages, have risen by a quarter in the past year or so. To bring them down, the government is importing edible oil. But this, in turn, is using up precious foreign exchange, which is down to Rs 2,500 crores, worth a mere 20 days of imports. "The lowest ever," says Union commerce minister Subramaniam Swamy, "in the history of India."

■ In the past one year, prices of onions, pulses, sugar and durable cloth, among other things, have risen by anything between 20-50 per cent. In the past, the fix was to import—sugar, for example. Now, there is no money to spare. Prices are expected to keep going up, and the rate of inflation could well touch 15 per cent this year. "Prices have risen in a phenomenal manner," says Surinder Kumar Goyal, the PM's friend, key policy-maker and a professor of economics at New Delhi's Indian Institute of Public Administration.

■ For the financial year 1990-91, Rs 6,000 crores was the estimated cost for petroleum imports. With the Gulf crisis, international crude petroleum prices zoomed up, and the revised import bill looks more like Rs 12,000 crore-plus. Besides, India has lost 2.4 million tonnes of domestic crude oil production, thanks to problems in its Assam oilfields. Things are bad enough, and if war breaks out in the Gulf, oil prices will zoom again. The effect on India's economy and its people: "It will be a disaster," admits Sinha.

■ The government is heading for a massive revenue shortfall. Till November 1990, the revenue shortfall was as much as Rs 27,223.08 crores. From customs duties, central excise and direct taxes—on personal incomes, gifts, wealth and companies. This figure is close to half the budget estimates of about Rs 57,000 crores. Again, a dubious record. Since November, says deputy finance minister Digvijay Singh, who looks after revenue, "a lot of improvement has taken place", and more money is expected to roll in around February-March, when most companies and individuals cough up their taxes. Still, say government officials and economists, the shortfall will be around Rs 18,000 crores.

■ Most of the money the government earns is spent in ploughing it back into the insatiable—and inefficient—public sector, a defence expenditure which could hit Rs 16,000 crores this year, on politicians, bureaucrats and salaries of lakhs of government servants. "The government sector," says Y.Z. Bhatty, director of New Delhi's National Council of Applied Economic Research (NCAER), "eats it all up." The earnings are not enough, so the government has taken a simple way out: in the absence of enough money, it has printed more money, the essence of a budget 'deficit'. This deficit is projected to be Rs 14,000 crores by end-March, double of what was estimated for the 1990-91 financial year. This paper money is not backed by anything of value, and is actually worth three-quarters less than what a currency note claims it is. This is fuelling inflation.

■ As there is no money for development projects, barely any foreign exchange to pay for imports, India has to go to bank consortiums abroad, such as the International Monetary Fund (IMF) or to various countries such as Japan or the UK for money. Even Chandra Shekhar, who has constantly decried the fact that India has sold itself lock, stock and barrel to the IMF and consequently, are pressured by the agency to open up the country to multinational business, says there is no way out. India will be borrowing US $ two billion (Rs 3,600 crores) from the IMF alone. And, will need anything up to three times that amount to get through 1991. It will bring India precious money. On the other hand, it will add to our external debt of a staggering Rs 1,30,000 crores.

■ And nobody is even venturing to think what will happen if the monsoons give India the go-by this year. When ministers, government and private economists, businessmen are quizzed about this, they either shrug or look up resignedly. The prospect—memories of the 1986-88 drought are still fresh—is simply too frightening. It means that food stocks can get wiped out, inflation soars, India imports and borrows still more, people purchase less and therefore, industry sells less. Misery all around.

This is India—battered and bankrupt.

How on earth did we get into this mess, this bankruptcy?

The blame lies squarely on the Government of India, not the people of India. This is something that even the government admits, though somewhat reluctantly. And the conventional wisdom says that India is not bankrupt, but the government is.

After all, industry is doing well, corporate financial results for the first half of 1990-91 (April-September) have been perhaps the only good thing in a year replete with political upheavals, communal tension and rabid militancy in Jammu & Kashmir, Punjab and Assam. India's gross domestic savings rate, which accounts for the money householders all over the country have stashed away, is at a healthy 21 per cent of earnings. The consumerism and profligacy that is both the boon and the bane in a country like the US, is not true of India. Yet.

All fingers point to the government, and its policies.

The mess started getting messier when Rajiv Gandhi was Prime Minister *(see box: How we got into this mess)*. The drought, which wiped out our food stocks and forced the government to import food as well as grant ad hoc relief to affected farmers—a Rs 500 crore tab—was not Rajiv's fault. But feeding the state sector with increasing amounts of public money, announcing grandiose development schemes, increasing defence expenditure, were.

Rajiv took the easy way out when he discovered the treasury was emptying. He did not cut government expenditure, politically crucial subsidies on agriculture, fertiliserand food (which eats up about Rs 30,000 crores of government money). He just printed more money to take care of government expenses, as even increasing taxes did not help too much. And borrowed from abroad to take care of development projects and imports. The Seventh Five Year Plan between 1985-90 did meet most of the targets, but almost entirely on borrowed funds. "You can't have the household and corporate sector save money," says NCAER's Bhatty, "and the government eat it up."

But that is precisely what happened. And with the advent of Vishwanath Pratap Singh as Prime Minister, things just became worse. The Raja did nothing to cut subsidies, and in fact, allowed his deputy, Devi Lal—who is also Chandra Shekhar's deputy—to announce a hair-brained scheme: Rs 10,000 crores worth of loan waivers to farmers. The amount was later reduced to about Rs 2,500 crores. But Lal is still around, and is very much a threat to the economy.

VP did nothing to extend his tax net, either. Taxing agriculture was taboo, and the top ten per cent of India's population continued to pay all the taxes. All he did was increase indirect taxes—customs duties and excise—which heaped more pressure on industry and in turn, the consumer.

To top that, the Raja did something bizarre. He refunded excise dues to companies, who merely made their money twice over. Because, the companies never refunded the money to the consumers. This tab is worth Rs 300 crores. His government also passed around a circular saying that these refunds should be stepped up—currently, a staggering Rs 10,000 crore-plus in excise refund is tied up in courts. "If an enquiry becomes necessary," says finance minsiter Sinha, "we shall certainly not shirk from holding an enquiry." (In Parliament last week, when questions were asked about excise refunds, Sinha's predecessor Madhu Dandavate kept mum. The Raja was not in the House.)

VP also single-handedly let the Mandal Commission agitation go haywire, communalists run riot and Punjab, J&K and Assam fall to pieces. The trouble affected revenue collection. He was so busy battling political crises and protecting his own vote banks that crucial decision on the Eighth Five Year Plan (1990-95) is still in limbo. So are the industrial policy proposals.

On the positive side, the Raja did not create the Gulf crisis. He did try to reduce petrol and diesel consumption by cutting back on supplies, and raised petroleum product prices to bring in revenue. Only, it was too little, too late. The move served to make transportation more expensive, which meant goods became more expensive, which meant, very simply, that the citizen of India was paying through his nose for anything he bought.

"Total drift, drift on every front, whether it is the economy or anything else." This is how Yashwant Sinha describes the achievements of the V.P. Singh government. His deputy, Digvijay Singh, is as critical. "The previous regime could not think beyond certain limits. As a government they should have thought what kind of future we will have in the ministry of finance."

Fine, but Rajiv did not give two hoots about the mess he was leaving behind for V.P. Singh to clean up. Similarly, it is very unlikely that the Raja felt any pangs of remorse for messing things up still more. Politicians are short on memory. And are equally short of any conscience. If this rule applies to Rajiv and the Raja, it applies equally to Chandra Shekhar and his money men.

"This government, or any government that is in power, can go on laying the blame for sometime on the past governments," says Goyal, the PM's freind and policy-maker. "But that should end. They can't live on the past, they will have to live with the future." He adds: "It's true that inflation is there, the IMF loan, these are well-known problems. You can't go on saying that the previous government did it."

Brave words, and noble, coming from someone who is as closely associated with the government as Goyal is.

But what exactly is the government planning to do, to ease out of its own bankruptcy and therefore, do away with the spectre of the whole country going broke sooner or later? And, is there a way out?

This is where the problem comes in. The government is agreed only on the broad outlines of policy: debt should be reduced. Government expenses need pruning. Revenue should be raised. Imports should lessen and exports should increase. Investment should be encouraged. Inflation should come down and the people of India—both rural and urban—deserve a better life. But there are various ideas floating around about how these changes should come about. In this respect, there is a sense of confusion in the government. It appears that the magnitude of the problem is so great that there is a danger of expedient moves at the expense of coherent thought.

Reducing government expenditure: "Ten per cent cuts on government expenditure have been imposed by the last regime," says deputy finance minister Singh. "We are enforcing it." This basically means continuation of a policy which will save the government Rs 300 crores or so.

While this is good money, the government is totally undecided on how to cut other expenses. On the public sector and subsidies, for example. Government incentives on exports are crucial because, as Bhatty says, "you need exports desperately". Fine, but the government is totally unwilling to reduce subsidies on agriculture, fertiliser and food—the ration shop system—because it has political overtones. These together eat up the government's revenue collection till November, or Rs 30,000 crores. From all the people involved in policy-making *(see box: The piggy-bankers)*, only Goyal thinks fertiliser subsidies should be reduced. The ration shop system should be modified, he feels, because the better-off also buy groceries there, when it should be only for the poor.

And while commerce minister Swamy and a handful of others talk about selling off 40 per cent of public sector equity to private shareholders, in the hope of reducing government cost and increasing accountability, there is as yet no concrete measure on the horizon. Not much is likely to happen here. In fact, agriculture subsidies may actually increase.

Increasing revenue: No new taxes, the PM promised last month. Then, he did a George Bush and imposed levies on income tax, customs and excise, which will fetch the government Rs 2,200 crores in revenue. Raising money is not a bad thing, but there is no point going on increasing levies if expenditure is not reduced.

The government is working on a simple—and time-honoured—logic. Those who can pay, tax the hell out of them. Those who cannot—or those you *think* cannot, leave them be. Which means agriculture, entirely. And the increasingly powerful, and pampered, small-scale industry. "You can't just throw up your hands," says Bhatty, the economist. The government, however, is doing just that.

Digvijay Singh, for example, justifies new taxes by saying the matter is "urgent" and Sinha does his bit by claiming it is all to "reduce the budget deficit". Sinha also hedges when asked if the budget for 1991-92 is going to be harsh on people. His you-will-have-to-wait-and-see attitude is a portent of more taxes, more excise, more everything.

Reducing inflation: Another problem area. Everybody is agreed that inflation is bad for the country. But they are totally split on how to reduce it. The easy way out, again, is to borrow from abroad—as this government will do—pump the money into the economy, pay for imports, and so on. The debt position is so bad that borrowings cannot sustain us forever.

Another idea is to pull in black money. But nobody has any ideas on how to go about doing it. When the entire structure is so full of loopholes, corruption and bad policy, it is very unlikely that anything will happen. Pulling in Rs 500 denomination notes will not help much at all.

Yet another idea could set off a storm. There is talk in government circles that a good way to reduce inflation is to pull out huge amounts of over-rated money from the economy. Freezing dearness allowances for employees on the one hand and freezing dividend payments by companies on the other, is an idea. If this comes through, it is sure to set off a massive furore. So, says the government, create a bank fund of sorts for people, where allowances and dividends can be deposited, and return them to the people after the economic situation becomes better.

Encouraging foreign investment: Alright, says the government. But multinationals can go to hell. This is one of the few counts that everyone is agreed on. Another point of agreement: non-resident Indians (NRIs) are preferable to multinationals *(see box: The last laugh)*. But nobody knows exactly how to. The proposals—unofficial, as yet—range from the practical to the pathetic.

Give NRIs incentives, ranging from buying companies to participating in joint ventures with either private industry or the state-run one. Cut red tape. These are practical. A little less practical is to grant NRIs the privilege of holding dual citizenship—of India and their present country of residence—for a price, say, US $10,000. Now, for the pathetic: send out an SOS worldwide for NRI donations with the catchline "save your country".

Right now, however, NRIs are so sceptical about India that these ideas may just end up in the garbage bin.

The good thing with this government is that they are actually thinking about solutions. However wrong.

bizarre—and yes, laudable, even—they may be. This fact alone is enough reason for the people of India to rejoice: they have seen thoughtless approaches for far too long.

And here, they can thank Chandra Shekhar for at least trying to do something to stem the mess. And thank Yashwant Sinha for taking the same tack. For encouraging suggestions from his colleagues and bureaucrats on how to beat the bankruptcy problem.

There are a few hitches, however, besides the fact that not everyone is agreed on everything. One: all governments live for political justification for their actions, and this government is not expected to be any different from the others. Two: though the government appears to be increasingly acceptable in the minds of the people: they are a minority government, with no mandate to back it and enough people who would love to see its demise.

Three: the imponderable nature of the Gulf situation which is totally out of India's hands. Finance minister Sinha cannot exactly wave a magic wand and wind up the hostility between Iraq and the US. And four: the odds are against Sinha, and the chances of him and this government messing up are greater than the chances of success.

Yes, there is a way out of the mess, but things are so bad, and actions so politically interlinked, that it is difficult to predict anything with certainty. 1991 could well be the year India breathes again. It could also be the year when it goes down the drain.

Happy Nervous Year. •

Sudeep Chakravarti/New Delhi and Calcutta with Godfrey Pereira/Bombay

HOW WE GOT INTO THIS MESS

It is difficult to pin down exactly when and where things started going wrong, but Rajiv Gandhi's reign and spiralling government expenditure are a good place to begin.

• Expenses on feeding the inefficient public sector, defence, agriculture and fertiliser subsidies, became problematic when Rajiv was Prime Minister.

• Anytime—and practically anywhere—government employees went on strike. To pacify them, the government offered a pay hike, or an increase in dearness allowances to get them back into line. A deteriorating relationship with Pakistan meant Rs 10,000 crore-plus expenses a year for the armed forces and purchases. (For 1990-91, defence expenditure could be as high as Rs 16,000 crores.)

• Soothing the rural vote-bank meant increasing crop procurement prices and fertiliser subsidies. The government also picked up tabs for the frequent 'air-dashing' that politicians countrywide indulged in. Not to forget foreign junkets.

• These trends continue.

• The two years of drought between 1986-88 knocked off more than the growth rate of the economy. Food stocks dwindled, down from a few months' worth to a few weeks'. Public sector banks stretched themselves granting rural credit, a lot of which ends up as bad debt. And after Rajiv the government—incredibly—took to waiving farm loans. Devi Lal's brash move when he was deputy to the Raja would have cost the exchequer Rs 12,000 crores, a figure later pruned down to Rs 2,500 crores. Lal is still deputy, though to Chandra Shekhar, and loan waivers are still a threat.

• Right through successive administrations, the government never cut its own burgeoning expenditure. It merely raised more taxes to feed it. But the revenue was not enough to pay for development projects, imports or annual and Five Year Plans. So, the government borrowed. And borrowed a lot. For example, most of the Seventh Five Year Plan was financed through borrowings from home and abroad. Currently, the government's external debt is close to Rs 1,30,000 crores and it pays out 30 per cent of this massive sum a year as interest payments.

• Borrowing, however, is still inadequate to cover such exercises as the Union budget. Government income never matches its expenditure, irrespective of how much it raises in taxes. So, it resorts to 'deficit financing'.

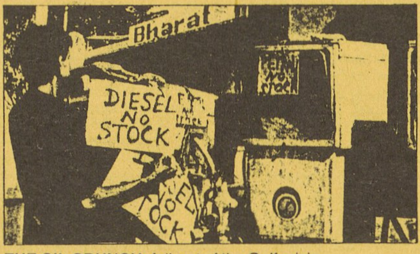
• Very simply, it is like going to a bank for an overdraft on your account. Or even more simply, spending more money than what your salary fetches you. Only, in the government's case, as it is the ultimate overlord of money in India, it cannot exactly borrow from its own pocket. So it prints more money without backing it with anything of value, like gold assets, for example.

• This is the norm, but it went haywire with Rajiv. For the financial year 1989-90—during most of this period Rajiv was PM—the budget deficit was Rs 11,700 crores. For 1990-91, mostly V.P. Singh's era, it is estimated to be as high as Rs 14,000 crores.

• Now, things look hairier still. One way to cut deficit—besides the overwhelmingly logical but overwhelmingly ignored way of cutting government expenditure—is to increase revenue.

• In 1990-91, however, things have fallen apart. Till November, the revenue shortfall was as much as Rs 27,223.08 crores—from customs dues, central excise and corporate, income, gift and wealth taxes—close to half the sanctioned budget estimates.

• With the situation calmer these days, revenue is coming in again, and the traditionally money-mad months of February and March, when people pay taxes to beat the deadline, should also see some income. But despite all this, the revenue shortfall could still be as high as Rs 18,000 crores.



THE OIL CRUNCH: fall-out of the Gulf crisis

• More trouble. Import bills have been rising steadily. Both to pay for oil, India's single largest import item, and to pay for capital goods—needed for industry—among other things.

• In mid-1990, with Saddam Hussein jack-booting over Kuwait, a consequent United Nations-sponsored trade embargo on Iraq and jacking up of oil prices by the Organisation of Petroleum Exporting Countries, India's import bill went through the roof. The budget for 1990-91 had estimated Rs 6,400 crores for oil imports. Now, it could be as high as Rs 12,000 crores. The government now talks about a trade deficit—when the value of imports exceed export earnings—of Rs 10,000 crores or so for 1990-91. But few people in government and industry will be surprised if trade deficit hits the Rs 18,000 crore mark.

• US President George Bush is talking about 15 January as a deadline for peace talks with Iraqi counterpart Hussein. But if the Gulf deadlock persists, or if war breaks out, India's oil import bill could jump by half. This is a reason for which the Indian government cannot be blamed. On the other hand, however, India's oil exploration efforts have been so lazy that if things had gone according to plan, we would not have to import quite so much oil.

• Edible oils, something that no Indian can do without, is in short supply. Government sources admit the shortfall is 10 lakh tonnes. The result of bad oil seed crops, rising consumption and a national mission on oilseeds that has gone haywire. Like the other national missions: telecommunications, literacy, immunisation, *et al*. Now, the government will import edible oils. The bill goes up.

DEVI LAL: squandering public money?

THE BOFORS GUN: rising defence expenditure

• The government—whether Rajiv ran it, the Raja ran to the ground or, Chandra Shekhar is running out of ideas with—has consistently messed up with policy. Saying it had an eye on the future but looked at it with its head buried firmly in the ground. The result: India's economy has more to do with political expediency than monetary mien. If economists have ever suggested a way out, then the government has either ignored it—as with the previous regime's industrial policy proposals—or implemented it in a half-baked manner—as with the rationale of cutting subsidies, or making the public sector more efficient. Or bringing in non-resident Indian (NRI) investment.

• The idea may seem difficult to grasp, but every time riots break out, people kill each other, militant groups cry for regional 'freedom', the economy is hurt. Politically, India is probably in a worse mess than its economy. But as the political situation affects the economy, the race for first place will be a close one. Successive governments have talked about pacifying people, but done nothing. Political stalemates do not help the economy. And the tragedy of Indian polity is: governments do not realise that a healthy political situation means a healthy economy, and a healthy economy, in turn, means a healthy political situation.

Tabling the nightmare

Revenue shortfall
Now, the collection is Rs 27,000 crores short of the Rs 57,000-crore target. Even if things improve, the shortfall could be as much as Rs 18,000 crores.

Inflation
Last year, inflation crossed two figures, from nine per cent. In '91 it could go as high as 15 per cent.

Budget deficit
Stunning. The Raja estimated Rs 7,206 crores for 1990-91. Now, it could go as high as Rs 14,000 crores.

Foreign debt
At Rs 1,30,000 crores, the highest ever. It is likely to increase as India borrows more to pay for survival as well as interest.

Export growth rate
Down, says the government, though the general impression was that it had gone up. From 35 per cent to 24.

Foreign exchange reserves
Down to 20 days worth of imports, or about Rs 2,500 crores. In mid-1990, it was at Rs 5,787 crores. The lowest-ever buffer.

Trade deficit
Is generally around Rs 8,000 crores. But this year, with more oil imports and a lazy export growth, it could go over Rs 10,000 crores.

aus: Sunday, Calcutta, 12.1.91