

“Make in India”

The successful landing of *Mangalayan* on Mars, evidencing India's technological prowess, occurred on the eve of our Prime Minister's highly successful visit to the second largest democracy. After he left, the Supreme Court decision on cancellation of all the coal block allotments to the private sector since 1993, once again proved that there are no full stops in India. In a way, this follows the cancellation of 2G licenses and closure of iron ore mines a few years back, and many other similar cases. As for the latest incident, Mr. Modi has promised to clean up the whole system in the next six months. One hopes he succeeds!

While I am no legal expert, one thought about the series of decisions: are we following the US's and UK's "shareholder capitalism" ideology, or the "stakeholder capitalism" in say Germany and Japan? The former model focuses on the interest of the shareholders alone; the latter of all the stakeholders in a business. The cancellations have punished the promoters/shareholders, but, in the process, the interests of many innocent stakeholders have also been damaged, probably unwittingly. These surely include the employees; the banks which have lent the money; the citizens who will be deprived of power -- or forced to pay much more for imported coal!

Meanwhile, the tax disputes whose speedy resolution was promised in the budget, continue. (One reason could well be that the Finance Minister has been unwell for some time). If Mr Modi's "make in India" objective is to be achieved, if manufacturing as a percentage of GDP is to go up from 13% to 25% in a decade, the whole government machinery from policymaking to framing laws and regulations, to implementing them through the bureaucracy – will have to change gears, will need a "cultural revolution". Mr. Modi has the mandate; the energy to put in 16/18 hour work-days (even while living only on warm water!); the earthy commonsense; the articulation to "sell" unpopular measures; to create an environment of trust between the governing institutions and the governed. Else, "*Swachha Bharat*" and "make in India" will remain catchy slogans like Indira Gandhi's "Garibi Hatao". To quote from the 2014 Edward Said Memorial lecture

by Raja Shahadeh, a Palestinian supporter, *"Israel's struggle takes the form of persistent, low-level administrative actions; the PLO (Palestine Liberation Organization) - and now the Palestinian Authority - have lofty, abstract aims that have great resonance but are almost empty of practical meaning"*.

Unhedged Currency Exposures

The Governor has on several occasions, and rightly so, expressed concern over the extent of unhedged currency exposures of corporate India. The central bank has also asked lending banks to monitor the exposures, and the deterioration in credit quality they can lead to.

As somebody in touch with the corporate culture on the issue, and also looking at the overall picture, I have two perspectives to offer:

- ⇒ At the micro level, the mental approach towards hedging short positions, particularly medium/long term, is the experience of the last two decades. For much of the time, the cost of servicing foreign currency debt on an unhedged basis has generally been lower than the cost of servicing a corresponding amount of rupee debt, as the rupee has not fallen as much as the interest differential say between USD and INR, despite the sovereign risk component built into USD borrowings. In other words, since the interest differential broadly reflects inflation differential, INR has continued to appreciate in real terms. This is also the reason why bond funds abroad find the “carry trade” (borrow USD, invest in INR) so attractive!
- ⇒ The differing accounting treatment of interest costs and translation gains/losses;
- ⇒ At the macro-level, the huge and growing gap between potential demand and supply:
 - i. At the “flow” level annual expenditure in foreign currency exceeds income (or current account net of remittances) by \$ 100 bn.

- ii. At the stock level, the net international investment position is almost \$ 350 bn in the red. The corporate sector's buyer's/supplier's credits, external commercial borrowings and other short term credit total \$ 260 bn (data as on June 30, 2014, the latest available).

Overall, even if the corporate world heeds the Governor's cautions, and wants to hedge all short positions, where will the supply come from?

Learning from economists

As it happens, I am currently reading "The Dollar Trap" by Eswar S. Prasad: the theme is that the dollar will remain the predominant reserve currency for the foreseeable future. His credentials are impeccable: IMF, Brookings, etc. etc. I got a new "insight" on inflation and exchange rates on page 141 of the book: "*capital inflows lead to currency appreciation*", and "*worsen domestic inflation*". He repeats the same point later in the page, quoting Thailand as an example. Surely domestic currency appreciation lowers inflation by reducing the cost of imports, and forcing domestic producers to cut prices to compete with imports?

Another gem: in an article co-authored by him (Business Standard, June 23), Arvind Subramanian has argued that the rupee is undervalued by 30%! Strange that we should have a current account deficit of the order of \$ 100 bn, net of remittances which do not depend on the exchange rate! Incidentally, Dr. Subramanian (ex-IMF, Peterson Institute, etc. etc.) is being considered for being appointed India's chief economic advisor!

And, we are so happy when we get a pat on the back from American rating companies!

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