Growth Vs Social Justice?

The budget proposals for fiscal 2011-12 to be announced later today may throw some light on the policy level thinking about the eternal debate on the relative emphasis between growth and social spending; between the politics of production and the politics of distribution. Prof. Jagdish Bhagwati's Hiren Mukherjee Memorial Parliamentary Lecture in December 2010 emphasized economic growth as the principal means to reduce poverty. On the other hand, Prof. Amartya Sen has characterized as "stupid" the aspiration 'to double-digit economic growth without addressing the chronic undernourishment of tens of millions of Indians'(Financial Times December 22, 2010). The Prime Minister has added his own weighty voice to the debate by saying that, while inflation needs to be curbed, this should not be at the cost of affecting growth. He and the Cabinet have also opposed several proposals from the National Advisory Council for further extension of food security and the NREGA. While one is in full sympathy with the idealism of the proponents of distributive justice, they also need to take into account two points:

- ⇒ The resources for increased outlays on social programs can come only through rapid economic growth (while on the point, it seems that the Prime Minister has succeeded in curbing the license permit raj, re-birthed under the Minister for Environment);
- ⇒ Even more crucially, the administrative/managerial resources of the government are nowhere near what are needed to deliver even the existing programs with a minimum acceptable degree of efficiency and honesty. Larger outlays are unlikely to yield any better outcomes; in fact, reports suggest that in several segments even the existing allocations in the budget are not being used.

In my last Monday's column, I had listed a large number of factors which can lead to major social unrest, as several countries in the Middle East have witnessed in recent weeks, and which are equally present in India. Is there any specific factor in the Indian macro economy which could trigger a major problem? To my mind, there is – and it is not very minor either. It is the external account of the economy, a point on which I have commented on numerous occasions in this column. In recent weeks, one is finding concerns on the subject being voiced by several weighty policymakers:

⇒ In its report on the economy released last Monday, the Prime Minister's Economic Advisory Council has emphasised the need to stabilize the current account deficit "*at a lower level of around 2.0-2.5 per cent of GDP*";

⇒ In a speech at the Special Governor's Meet in Japan (BS, February 1st), the RBI Governor said, "*our reserves comprise essentially borrowed resources, and we are therefore more vulnerable to sudden stops and reversals as compared with countries with current account surpluses*".

⇒ RBI's Financial Stability Report (December 2010) cautioned that "*a potentially worrying feature of capital flows to India has been the dominance of portfolio flows and debt flows as compared to the more stable investment flows on gross basis. Such flows require watchful management as they are prone to sudden stops and reversals ……. the ratio of short term external debt to foreign exchange reserves and of total external debt to foreign exchange reserves having risen to their highest level since the foreign exchange crisis during the early 1990s*."

One is apprehensive that the "*potentially worrying feature*" may become an actuality in 2011-12, particularly if the crisis in the Middle East extends to more oil producing countries, and the price shoots up. Even otherwise, the merchandise trade deficit is unlikely to be less than 7-8% of GDP (it was less than 1% in 2004-05). Remittances could also be adversely affected by the situation in the Gulf countries, and net invisibles actually fell in the first half of the current fiscal year as compared to the corresponding period last year. (In this connection, the export jump in December and January has puzzled me and I am still pondering on the implications.)

On the capital account, the position is far from reassuring. FDI is falling – and the propensity to unilaterally alter or re-interpret contracts invoking "sovereign rights" will not improve the position. A recent J.P.Morgan research report suggests that the prospects of emerging markets getting larger portfolio inflows in the current year are not very good. And, a Bank of America – Merrill Lynch survey of global investors has found India as the least favoured economy in the Asia Pacific region.

It is high time that Delhi gives up its complacency on the external front, looking merely at the level of reserves. Financial markets are prone to function in “feedback loops” which tend to exaggerate price movements in either direction. Policy-makers also need to be reminded that like the current account, savings and investment in an economy are not independent of the exchange rate; that the deficit also implies loss of huge potential output and jobs. I expect to revert to the issue in the context also of the strange pronouncement on exchange rates at the recent G20 Finance Ministers' meeting in Paris.

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