THE OBSERVER
OF BUSINESS AND POLITICS

Impart momentum to structural reforms

Upgradation in sovereign rating is a potent instrument for enabling Indian corporate bodies to borrow more from abroad and perhaps, even at reduced cost. These potential gains had relevance when India faced a crisis situation. But no longer now, when the problem is of a reverse nature, that is, of too much foreign exchange, says Uttam Gupta.

COMING as it does close on the heels of the decision of the Japanese Bond Research Institute (JBRI) to upgrade India's credit rating, the announcement by Moody's investors' service to put India "on review for a possible upgradation" of its sovereign credit rating may have boosted the morale of the mandarins in the finance ministry.

This is notwithstanding the wait and watch attitude of Standard and Poor, another US-based international credit agency which still considers India's as a high fiscal deficit and external and internal debt burden an impediment to an early upgradation.

To the Indian companies, the contemplated upgradation in the rating from BB+ to BB by the Moody's may not be of much consequence as they are already borrowing large sums in the international market. In fact, they are facing a problem of an altogether different nature. First, the Government of India is seeking to restrict mobilisation of funds by them abroad by way of Euro-equity or foreign currency convertible bonds (FCCB). Second, the companies do not have productive avenues even to fully utilise the funds already mobilised because of domestic constraints of demand. Even where demand limitation does not exist, implementation of projects is held up because of infrastructural problems and bureaucratic impediments.

In one case, the company mobilised Euro-funds to support, amongst others, expansion of an existing Ammonia-Urea plant based on assured availability of extra gas as feedstock. The expansion plan is held up because the government has backed out of its commitment to supply gas.

Upgradation in sovereign rating is a potent instrument for enabling Indian corporate bodies to borrow more from abroad and perhaps, even at reduced cost. These potential gains had relevance when India faced a crisis situation.

But no longer now, particularly when the problem is of a reverse nature, that is, of too much foreign exchange which by itself is making macro-economic stabilisation difficult.

It might, however, be argued that India may plunge into a crisis situation again and at that point of time, the investment grade recognition by the international institutions would be of some help in avoiding a catastrophe of the kind that India experienced in 1991. But, what is the guarantee then that they would not again downgrade us.

There is, therefore, no reason for the Government to get overwhelmed by what Moody is contemplating; instead, there is need to review our economic fundamentals.

Why the rating agencies downgraded us in the very first instance and whether the change of fundamentals warrant upgradation in the rating now is a moot question.

When Moody decided to put India on the "credit watch" in August, 1990, followed by actual downgradation to below investment grade in two successive rounds i e October, 1990 and March, 1991, the justification offered was that India's BoP was vulnerable to the point of making it default on external payments, and that any consequential adjustment measure implemented in the short run to get over this problem would seriously jeopardise structural adjustment process in the medium to long run.

Besides, the rating agency doubted the capability of the Indian economy to successfully launch a fiscal stabilisation programme. Although lack of political stability was also cited as an important reason, the same should not be viewed in isolation from these fundamentals.

The present situation is not very different from what it was three years ago, even though the bulging foreign exchange position now may give a contrary impression. One need not labour hard to find that in the immediate run, there is absolutely no question of sovereign India defaulting on its payment obligations.

A lot of dollars have come in from a variety of sources hitherto unknown to the Indian corporate world — FIIs, NRIs and overseas corporate bodies; Euro-issues and FCCBs by Indian companies, etc. Besides, there has been substantial import compression over the last few years which has resulted in reduced payment liabilities on current account.

There is hardly any scope for getting elated about this, much less for projecting this as a vindication of the success of the structural adjustment process. If a person starts eating less or cuts spending on other bare essentials and thereby shows a surplus, this is far from being a healthy situation.

Between 1991-92 and 1993-94, industrial activity, and consequently, overall economic growth has remained depressed. In fact, but for the consecutive good monsoon years, which resulted in good performance on the agricultural front and which had nothing much to do with reforms, GDP growth could even have been negative.

Investment in financial terms increased only marginally. In real terms, it declined. Besides, even the growth in employment decelerated during the reform years.

We could have derived comfort from the increasing foreign exchange reserves only in a situation of robust economic growth, increasing investment and rising employment level, which is far from being the case.

When economic fundamentals are weak, what difference does it make even if we have a large amount of dollars in our kitty. The latter have not helped in maintaining growth, containing inflation, increasing employment and improving the living standards of the poor.

> **The biggest stumbling block before the structural reform process is the highly unionised labour in public sector enterprises. Neither does it let things move within the existing dispensation, nor does it allow a new arrangement to transplant the existing one.**

Even as these basic economic issues are being seriously debated within the World Bank, some of their economists have strongly voiced concern that the structural reform process in India is yet to bring the poor within its ambit. But, we in India, are yet to spare some time for these.

When sovereign India was downgraded in 1990-91, our capability to achieve fiscal stabilisation was suspected by the rating agencies. The fiscal deficits in 1992-93 and 1993-94, have clearly demonstrated that *de facto* we believe in fiscal destabilisation.

Recently, the financial wizards in the finance ministry and RBI invented a tool — a ceiling on ad hoc treasury bills — to prevent automatic monetisation of the budget deficit. It remains to be seen how far this arrangement would work, particularly when the factors contributing to the latter — subsidies, pay/DA hikes to Government employees — are being allowed to rise unchecked.

Moody's sudden change of heart seems to be based on the assumption that "structural changes in the Indian economy since 1991 are not going to be reversed." This calls for serious introspection as to whether any significant advance has at all been made on this front.

The question of reversibility or irreversibility is only secondary. As already mentioned, on fiscal adjustment, we are back to square one. Restructuring of public sector enterprises is being kept on hold.

So is the exit policy. Reforms in the insurance sector has been put on the back burner. In the telecommunication sector, the Government expects the private sector to play a role and yet, continues to control the levers.

The proposed Telecom Regulatory Authority of India under the new policy will have to work under the Department of Telecommunications. In power, private companies are indeed required in both generation and transmission but the Government cannot gloss over state electricity boards.

Needless to mention, the biggest stumbling block in structural reforms is the highly unionised labour in PSUs. Neither does it let things move within the existing dispensation, nor does it allow a new arrangement to transplant the existing one.

Therefore, even if the international credit rating agencies upgrade us, these issues will still have to be addressed. Only this would make structural reforms meaningful.

Notwithstanding what JBRI has already done or what Moody is contemplating, we only need to look at foreign direct investment to understand, from an external yardstick, that we have not done enough.

FDI, as measured by the approvals during the first 5 months of the current year, are down by 38 per cent over the corresponding period in 1993-94. Hence, the need for being on the guard and imparting momentum to the structural reforms process to avert a 1990-91 like situation in future.