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Editor

BABUDDIN KHAN

THIRD CONCEPT aims at providing a platform where a meaningful exchange of ideas can take place among the people of the Third World. The attempt will be to communicate, debate and disseminate information, ideas and alternatives for the resolution of the common problems facing humankind. We welcome contributions from academics, journalists and even from those who may never have published anything before. The only requirement is a concern for and desire to understand and take the issue of our time. Contributions may be descriptive, analytical or theoretical. They may be in the form of original articles, reactions to previous contributions, or even a comment on a prevailing situation. All contributions, neatly typed in double space, may be addressed to:

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INSIDE

Currency Crunch

India's current currency crisis is indicative of yet another major emerging market economy, along with Brazil, China, and Russia, that is already slowing markedly. In recent weeks the Indian rupee has plunged by over 14 percent bringing its total decline over the past two years to almost 30 percent. Part of this decline is to be explained by a widening in India's external current account deficit to almost 5 percent of GDP.

Some observers feel that the more important source of foreign exchange pressure is emanating from outward capital flows by both domestic residents and foreigners, who are becoming increasingly reluctant to finance India's external account imbalances at a time that India's economic reform effort has stalled. Resultantly, economic growth, which had averaged around 8 percent in the decade prior to 2009, has now slumped to barely 5 percent. At the same time, led by rising import prices, consumer price inflation has reached to almost 10 percent.

Economic growth is sputtering and a slowdown has hit the economy. Recent data shows that economic growth decelerated to 4.4 per cent in the April-June quarter this year, its slowest rate since the first three months of 2009. India suffered decade-low growth of 5 per cent in the fiscal year that ended in March, and many analysts surveyed by Reuters during the past week expect this year to be worse. Weak growth, a record high current account deficit and concerns about the government's finances are proving a toxic mix for the rupee. The rupee's defence so far has largely rested on a strategy from the Reserve Bank of India to drain cash from domestic money markets and raise short-term interest rates. But that has made it more costly for struggling corporates to raise money, putting another brake on growth.

Viewed in a broad spectrum, the Indian government's piecemeal response to the foreign exchange crisis has been addressing the symptoms rather than the underlying causes of the crisis. A slew of measures adopted in this regard inter alia include increased tariffs and tighter restrictions on gold imports as well very much tighter restrictions on corporate and household capital outflows. However, these measures have failed to stem the tide of the Indian rupee depreciating in the market to record low levels. This process of depreciation can be attributed to absence of a coherent plan to boost investor confidence to stabilize the currency as well as for the apprhensions of further capital controls. Other contributory factors include lack of any serious indication on the part of the government to raise interest rates in defense of the currency and lack of its readiness to take measures to redress the country's basic savings and investment imbalance.

The present currency crisis needs to be addressed by a basic shift in the overall macroeconomic policy approach, which ought to aim at restoring domestic and foreign investor confidence in the Indian economic growth model. Implementation of such a policy shift should not be allowed to wait till after the scheduled May 2014 parliamentary elections. For in the absence of an early restoration of investor confidence, India's currency could go into a real tailspin. The present dispensation needs to evolve a strategy to demonstrate to investors that India was serious about getting the country back on a rapid economic growth path and there would be a redoubled effort to restore momentum to the country's stalled structural reform program and to reduce the public sector budget deficit. Bold steps are required to ensure tranparency in the system as well as to improve the functioning of the labor market.

However, in view of impending May 2014 elections, there is little realistic prospect that India will take the bold economic measures needed to defuse the country's currency crisis since political parties will be loath to introduce painful economic reforms that might lose them votes at the polls. There is all likelihood that country's economy will slow further over the months ahead as domestic interest rates will have to be hiked in an attempt to stabilize a weakening currency.

India still has time to work towards insulating itself from the vagaries of global finance causing much weakness in the currency and the current account by reducing non-essntial imports and boosting its exports and judicious harnessing of natural resources.

—BK