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Column: The right way to Make in India

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The govt must retain the present prices for petro products and use the resulting surplus for capital expenditures

RBI Governor Raghuram Rajan's advice that the country must "make for India" than merely "make in India" is perceptive and with many policy implications. The potential of the 1.25 billion-strong Indian population, with the highest (and growing) proportion of people below 35, is tempting to the rest of the world. Given the receptiveness of the people to innovation and new technologies, India is tempting as a production-centre where labour costs are low and capability is high.

The other message that Rajan is giving us is that we must not tie ourselves to export-markets as the South East Asian nations and China did for many years. He is not saying that we should ignore world markets. We must export to the maximum. However, the message warns us of the deterioration in major economies. Remember that this is the man who warned the world three years in advance about the collapse of financial markets that occurred in 2008. We must take his prescience seriously.

What is happening to most of the developed economies? The long-term growth of Japan, Europe, even China, will be hindered by rapidly-ageing populations. This will contract their effective labour force and also domestic markets. The US escapes this fate because of immigration.

The current economic situation in the developed countries, except the US, is getting grim. The US expects 3% growth, sharply falling unemployment, revival in consumer confidence and retail purchases. Interest rates, at around zero now, need to rise and the Federal Reserve is making noises that they will. The economic revival in the US is fuelled to a great extent by the boom in production of oil and gas from shale. It has also led to a collapse in world oil prices, benefiting oil-short emerging economies like India. Despite efforts by Saudi Arabia to make the high-cost shale oil production uneconomic, and thus reduce domestic production in the US and increase crude imports, there appears little chance of this happening. The chances are that world crude oil prices will remain low for two more years.

Other developed economies are not in the same position. Germany, by phasing out nuclear power generation, and its rigid labour markets is becoming (as The Economist says), 'the sick man of

Europe'. Germany has been the economic engine for Europe. Its decline will hurt all Eurpoean Union countries. Spain and Greece are yet to recover after years of belt tightening and decline. The decline in the European economies will be accelerated by the decline in Germany. France is beset by the problems caused by a socialist government that is reluctant to demand more effort from its labour. Macroeconomic management in European countries appears to have been neglected in recent times. Japan appeared to be emerging under prime minister Shinzo Abe's leadership from years of economic stagnation and deflation. However, that appears to have been stalled by a premature rise (long overdue) in consumption taxes. China is showing signs of a slowdown. Its overall fiscal situation is suspect because of the deficits of provinces and local authorities. Declining world commodity prices are also a result of falling Chinese demand.

Russia is in serious trouble, with a collapsing rouble, declining growth, rampant inflation and large increases in interest rates. It has not diversified its economy and continues to be heavily dependent on its crude oil and gas production. The collapse in world crude prices, therefore, has hurt Russia very badly. The economic sanctions of the West on Russia, too, have hurt it badly and there is no sign of their being eased.

Russia is unlikely to recover soon and may initiate warlike adventures to divert peoples' attention from their plight. India has to wonder if it is safe to advance large sums to Russia for defence equipment and new nuclear plants. The situation in other two BRICS economies, Brazil and South Africa, is hardly better. African economies, too, are also struggling.

For India, collapsing crude oil prices have immensely benefited the NDA government. Consumer purchases are rising, inflation figures are dropping, and lower crude prices will help the balance of payments. It would be wise now for the government to retain the present consumer prices for petro products and use the resulting surplus in the Budget for urgent capital expenditures. Secondly, India cannot depend on any sharp rise in exports, especially since we are so dependent on minerals (iron ore) that will not be in as much demand, with the world economies battling declines. Exports of agricultural products might do well if the weather gods are kind and government minimum price support price policies are more flexible. Third, foreign direct investment might rise as India could be a beacon in an otherwise depressed global economic environment. Fourth, we must be much more cautious in large dealings with Russia, which has, in the past years, unceremoniously raised prices sharply, in the middle of working on contract (for example, the aircraft carrier Gorchakov).

Fifth, we must tackle energy supplies and costs. The law on unlimited liability of nuclear equipment plant suppliers, in the case of accidents, must be modified to limit the liability. Other countries like Japan, the US, and South Korea, could then supply their nuclear technology, and help reduce our dependence on coal. Construction of the new hydro plants in Nepal agreed recently must move apace. We must improve the technology in coal mining so that productivity and production can rise. This will require ultimate denationalisation of Coal India.

The Indian market is huge and can grow rapidly. Yet, manufacturing in India is less than a fourth of the GDP. This must rise. This will also help to increase jobs in organised manufacturing (presently around 6% of total employment). Manufacturing jobs are mostly urban. These new

jobs will meet the expected surge in migration to urban from rural areas. We must become less dependent on imports of what we can make in India.

These include defence equipment, silicon chips, and solar panels, to name some large imports. The cap of 49% on foreign direct investment must be raised. Investors must feel that they have control, even though it is illusory. Once the factory is established in India and there are Indian employees, the desired technology transfer is automatic. What else does India need? Imports will decline and we will learn the technology. Coal imports can fall if we move with vigour to change our energy policies as described. Coamercial operations of mines, ultimate denationalisation can also sharply reduce the imports of coal. An early introduction of the goods and services tax will stimulate all domestic purchases.

The RBI Governor has encapsulated in Make for India a whole range of economic policies, some of which have been discussed here. The government must now move quickly to make the difference.

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