Inflation, Hot Money, and Sleaze Paralyze Indian Economy

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Despite the Prime Minister's avowed commitment to develop basic infrastructure, such as power and water, vast parts of the rural areas, where India's food is grown, have remained without electricity or water-management. These villagers are building a water storage pond, using Stone Age methods.

The Indian economy is in trouble. Although the economy continues to show high GDP growth, there is a growing disparity between India's sea of poor people and the few at the top of the heap. Out-of-control inflation, caused by the inflow of billions of dollars in hot money, combined with poor productivity due to weak physical infrastructure, has resulted in corruption of unimaginable proportions, which has eaten away the gains made earlier. Prime Minister Manmohan Singh, who heads a group of disparate political parties under the banner of the United Progressive Alliance, is busy keeping the coalition government in power by doing little to prevent further deterioration of the nation's economy.

On June 16, the Reserve Bank of India (RBI) raised its benchmark lending rates for the tenth time in 18 months, as a monetary measure to slow down the rampaging inflation monster, which has already greatly hurt the poor, and is now beginning to hit the middle class, which had benefitted in recent years from the GDP growth and wage rise. The earlier nine such monetary measures within the past 18-month period did not slow down inflation. It is inevitable that the high interest rates will attract more short-term hot money into the country, spurring a faster rate of inflation in the coming days.

India has earned the distinction of incurring the highest inflation of major emerging markets. On June 14, the Singh government said inflation had increased 9.1% in May, compared with a year earlier, a rate higher than expected. High inflation was first observed two years ago in the rise of food prices that affected India's poor the most. But since India's hundreds of millions of poor have little voice in directing New Delhi's economic policies, for the greater part of the last two years such inflation was pooh-poohed by Indian economists, accusing the growing army of the middle class of "overconsumption of food." Now, inflation has shown up everywhere, once again, proving the shortsightedness of those economists.

What this picture, which I elaborate below, underscores, is the inescapable truth that if a fundamental shift away from the monetarist system is not initiated in the United States, and soon, we are looking at the literal devastation of the largest population centers in the world, such as India and China. This is, in fact, the concern of *all* humanity—and must be stopped.

The Growing Anti-Poor Bias

Unwilling to change course, and stubbornly defending the failed economic policy, New Delhi is still harping on India's high GDP growth rate. The *New York Times* reported on June 15, that Kaushik Basu, the government's chief economic advisor, said, in an interview on June 13, that inflation was a problem that all developing countries were facing. "If you look at emerging economies around the world," Basu said, "India's performance looks pretty run of the mill."

But, neither Basu nor others in the Singh government are interested in taking a good look at the damage done by their strictly money-obsessed policies. "The last two years have been a lost opportunity" for India's governing United Progressive Alliance party, Citigroup said this month in a research report.

This monetarist obsession has given rise to full-blown inflation across the spectrum. The unprecedented price rise in basic food items is severely impacting hundreds of millions of Indians. Despite the shouting by the globalizers, investment bankers, and their followers within India, millions of Indian families live on a daily diet which consists of cereal—-rice, or wheat flour, or both—some vegetables, including onion, and a variety of lentil, or other similar items. Lentils provide the only significant source of protein they have access to, since they cannot afford to buy other high-protein foods, and this includes a large number of people who are non-vegetarians.

The latest figures indicate food price inflation is at 9.13% for the week ended June 11, on top of costlier fruits, milk, onions, and high-protein items. This figure is based on the Wholesale Price Index (WPI); the consumers buying from the retail market pay significantly more.

During a recent visit to India, which was prior to the release of the June 11 inflation figure, I took note of prices of some of the items which the poor have to consume in order to stay alive. The prices made me wonder how they survive. The urban poor have been forced to resort to criminal activities in order to procure food money in a cash-loose town.

What I discovered is that the cheapest variety of rice now costs twice as much as it did four years ago; wheat flour has also doubled during the same period; onion prices went up three- to fourfold; potato prices doubled, as did the price of eggs. The price of lentils (called pulses in India) has gone through the roof, and the cheapest variety, called the masoor, has gone up at least threefold.

Milk, an essential requirement in a country where milk is the most frequently consumed drink, now costs Rs.28 (about $0.65) a liter. Chicken costs close to Rs.120 (about $2.80) a pound. Really, there is no food item, including fruits and green vegetables, that is not selling at twice or more the price it sold three or four years before. Needless to say, cooking oil, an extremely expensive item, has gone beyond the reach of the poor.

Now, consider what almost 40% of Indians earn daily. These are the poor, and they earn, on average, about Rs.70 ($1.60) per day. With those earnings, a family of four is left with just rice or wheat, a little salt, and a piece of onion for its meals, or a single meal with lentils and vegetable. This is the state of affairs for a huge part of India that is rarely seen, since it shames the middle-class and the academics, and the state of existence of the poor is denied.

The callous neglect of the agricultural sector, where most of the poor reside, has also exposed them to the global speculators. For instance, the abominable productivity of pulses and oilseeds, two necessary items for the poor to survive, forces India to import these items in large volume from the international market.

Devastation of the Farmers

A recent Reuters article, "India's food chain in deep change," said that since the mid-1990s, an estimated 150,000 small farmers have committed suicide nationwide, most of them over debts, according to a survey by the Center for Human Rights and Global Justice at New York University. Behind that chilling figure, is the fact that nearly 100 million farmer families not only do not benefit from growth and high prices, but have become victims of the cannibalistic economic policy of the present Administration.

Despite the high food prices in the market, farmers are finding it ever more difficult to make ends meet. The introduction of high-yielding seed varieties and increased use of fertilizers and irrigation spawned the Green Revolution in the 1960s, which allowed India to become self-sufficient in grains. Over the years, however, agriculture innovation and efficiency have stalled due to the Singh government's absolute neglect. As a result, farmers are getting squeezed by rising costs and inefficient agronomy.

But, New Delhi continues to turn the proverbial blind eye to conditions in rural India, where hunger is endemic among the country's more than 500 million poor. James Lamont, writing for the *Financial Times,*

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As prices have doubled and tripled, putting healthy food out of reach for huge numbers of Indians, farmers are also sinking under the weight of debt; only the speculators are benefitting. Here, a poorly stocked food market in Vellore, Tamil Nadu.

last February, cited a Punjabi farmer: "A good farmer with a good piece of land can just about break even," but the small farmers can no longer do so. While Punjab has remained the breadbasket of India, throughout the region, small farmers are sinking under the weight of debt. In India's fast-growing economy, costs are rising for agricultural inputs such as fertilizer and transport. The water table has fallen dramatically, and the cost of irrigation has risen, as farmers use more powerful pumps, consuming more electricity.

Despite the Prime Minister's avowed commitment to develop basic infrastructure, such as power and water, vast parts of rural areas have remained without electricity, and due to the non-implementation of a comprehensive water-management plan for the rural areas, many farmers have remained wholly dependent on monsoon rains for growing their crops. Farmers are bitter over the fact that the rural poor are subsidizing the urban classes in New Delhi, Mumbai, and other mega-cities.

The farmers are also under pressure from the government to hold down food prices. By keeping food prices down while paying for increasing production costs, these farmers are becoming increasingly indebted, as the cost of borrowing rises precipitously. Lamont was told by the Punjabi farmers that borrowing costs are now upwards of 24%. They are forced to sell their land to pay debts. But in a state with little industry, most are trapped on the land with few alternative livelihoods. As a result, suicide rates have soared. One reports shows that, in Punjab alone, as many as 60,000 farmers have committed suicide in the past 20 years. The Singh government, presiding over this sordid state of affairs, remains in a state of denial, trotting out the official statistics that show 132 suicides in the past five years.

Inflation Everywhere

It is not only the rapidly rising food prices that are causing serious problem to the millions of poor in India. Real estate prices are also soaring. An analyst pointed out that one of the causes of this is the huge sums of black-market money (from drugs, smuggling, etc.) pouring into India. Land purchase scams have become quite common with senior politicians, top bureaucrats, and even senior military officials being involved. Also, the government has allowed foreign money to come into the real estate market.

At the same time, an inflationary spiral has engulfed the education sector. The cost of primary or secondary schooling has gone up two and a half times between 2005 and 2011. A survey carried out by the ASSOCHAM, one of India's leading chambers of commerce, shows the rising cost of education has become a major concern for parents. The survey showed that parents living in major Indian cities invest on an average 40% of their income in their children's education. The cost of education is increasing every year, parallel with inflation.

The survey pointed out that over 40 million children are now educated in private schools, where fees rise annually well above the overall rate of inflation. Seventy-eight percent of the parents said that, in an average family where only one parent works, it is impossible to pay even for one child's education.

Not long ago, pharmaceutical drugs, like education itself, were priced to help the poor. But, things have since changed, to accommodate the global players. New Delhi's decision to allow large foreign pharmaceuticals to increase their control over domestic drug companies has hiked up the price of medicines well beyond the reach of the poor.

The Singh government has reportedly taken note of this, and yet, the government's control of drug prices is restricted to only 74 essential medicines. The National Pharmaceutical Pricing Authority (NPPA) recently conducted research on cancer drugs of similar configurations. What they found startled them: prices have gone up 10 times during the last few years!

Hot Money

The government's neglect of the agricultural sector, immoral as it is, is not the only reason that the curse of high inflation is now taking its toll in India. High interest rates, globalization, the government's penchant for foreign exchange to build infrastructure, and the inadequately regulated bourses, have made India the haven of dirty money, flowing in from all directions.

One major inlet of hot money is the African country of Mauritius, considered a tax haven. The total amount of foreign direct investment (FDI) that came through Mauritius has surpassed $50 billion, accounting for 42% of the total FDI inflows, according to the latest official data.

India has a Double Taxation Avoidance Treaty (DTAT) with Mauritius, under which the corporations registered there can choose to pay taxes in the island nation. Companies prefer to route their investment through Mauritius because the effective rate of corporate tax on foreign companies incorporated there can be as low as 3%. Moreover, an investor routing his investments through Mauritius into India does not pay capital gains tax in either country.

Hot money in the form of Foreign Institutional Investment (FII) is growing, while the annual FDI flow is slowing down. In 2010-11, inbound FDI fell by as much as 28%, the second consecutive year of decline, and the first such large decline since the opening up of the economy in 1991-92. The present level of $27 billion in FDI inflows is the lowest in four years. By contrast, FII flows into India have been on the rise over the past two years on an annual basis, with only 2008-09 being a year of sharp outflows. In fact, the outflow of $15 billion was more than made up by inflows of $29 billion—the highest ever—in 2009-10. This level was largely maintained in 2010-11 as well, with a small increase.

As the Reserve Bank has jacked up the interest rate once more, with the intent to slow down inflation, India is becoming more and more an attractive destination for hot money from abroad, thanks to the prevailing high-interest-rate regime, with foreign institutional investors (FIIs) continuing to pour cash into short-term bonds issued by Indian companies.

FIIs are taking advantage of the substantial interest rate differential between India and the big money markets in the West. The probability that more money might come to Indian shores in the form of debt has risen sharply in the past couple of weeks, as a majority of the central banks around the world, excepting China, have shown an inclination to continue with their easy-money policy.

Interest rates in Europe are at 3.15%, while the rates in the U.S. are between zero and 0.25%. In Japan, they are about zero to 0.01%. This leaves enough scope for funds to raise money overseas and invest in Indian debt paper, even after taking into consideration the risk of currency fluctuation.

One report shows that, in 2011 to date, FIIs have invested about $3.09 billion in India, of which only about $85 million is in equities. The remaining portion has been invested in debt issued by government and corporate entities. As of June 3, FIIs have poured $20.66 billion into rupee-denominated debt in India, as per the Security and Exchange Board of India data, much of it in short-term bonds. It is this money that threatens to fly out overnight should arbitrage opportunities improve in the West or other competing markets.

In other words, whatever is coming in by way of foreign funds flows into debt, because of interest rate arbitrage opportunities made possible by borrowing cheaply in overseas markets and investing in top-rated Indian debt instruments at attractive coupon rates.

Most investors who play with hot money are constantly seeking short-term profits rather than long-term investments. They shift hot money from one place to another quickly, in tune with changing interest rates. The rapid flow of hot money across borders of nations can cause fluctuations in the foreign exchange markets, reaping quick profits for those who control the funds; but the moment the same funds begin to flow out of the country, its economy takes a beating. India has become increasingly vulnerable to that.

What Has Gone Terribly Wrong?

Prior to the appearance of Manmohan Singh on India's economic scene as a financial guru, in his first official incarnation as Finance Minister, and now, for the last seven years as Prime Minister, with his majordomo, Montek Singh Ahluwalia, an IMF product, the Indian economy had a slow growth rate, very little foreign exchange reserves, and a lower disparity of income. The economy was handled badly, causing untold misery to the millions, but at that time, India had a political economy—i.e., its economic decisions, though badly handled because of poor understanding of how to generate physical wealth, were in the hands of the politicians, who were accountable, since they were elected by the people.

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Under the Singh government, which has become a tool of the imperial monetarists and globalizers, India's income disparity has soared, between the handful at the top, and the hundreds of millions at the bottom, like these migrants, living in temporary huts, and unable to afford an education for their children.

The ushering in of monetarist "reformers" and globalizers as the policymakers has changed all that. India's economic decisions are no longer in the hands of the politicians, but firmly in those of such large corporations as the Tatas, Ambanis, Ruias, Jindals, et al. These are global investors, beholden to the foreign financial institutions from which they raise money. In other words, they are nominally Indian, but consider that their business interests come first. They are not accountable to the people of India, nor, for that matter, to the people of any nation.

As the transition occurred, the politicians became "facilitators" for one business house or the other. Some of them are facilitating many business houses. This has given birth to what many Indians call "crony capitalism." Whatever that term means, the fact remains that by facilitating these business houses, which are worth billions of dollars, these politicians and their families enrich themselves immensely.

The process does not stop there. It goes way down. The Indian bureaucrats in high positions usually know a lot more than the relevant Cabinet minister, who was elected by the people, about the project he or she is handling. So that, after the politicians take their cut, the bureaucrats get their share from the businesses. The process of facilitation, in essence, corrupts one and all.

The Singh government is presently presiding over one of the most corrupt administrations that India had ever seen. Teresita C. Schaffer, a retired U.S. ambassador with long experience in South Asia, and co-founder of the web magazine southasiahand.com, posted an article, "Cleaning up India's Culture of Sleaze," in which she described the rampant corruption of "scam-o-ramas," in which the Singh government's ministers and bureaucrats are steeped.

Describing one of the "scam-o-ramas," in which the minister-bureaucrat-business houses together fleeced an estimated $40 billion, according to the government's comptroller and advocate general, Schaffer writes: "Corruption is hardly unique to India—and it is not new there. Past cases that have risen to the level of public scandal have generally involved kickbacks or sweetheart deals. What distinguishes the present situation is the confluence of several major scandals at about the same time, creating an atmosphere of sleaze that appears to permeate all aspects of public life in India."