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INDIA INC. AND THE NEW ECONOMIC ORDER 2021

The rules of economics have changed – from thinking that inflation is a problem that needed to be contained to the Central Banks now viewing low inflation as the problem.

ET Edge
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Dr. Raghuram Rajan

Katherine Dusak Miller Distinguished Service Professor of Finance at Chicago Booth - University of Chicago, the former Governor of the Reserve Bank of India and the former Chief Economist and Director of Research at the International Monetary Fund

The whole of last year saw near complete standstills which severely compressed economic activities across the globe. Having combated the uncertainty with tenacity, the consensus is to now step onto the revitalization road. In line with this, ET ILC had hosted a high-impact interaction with Dr. Raghuram Rajan, the former Governor of the Reserve Bank of India and the former Chief Economist & Director of Research at the International Monetary Fund. This session was moderated by Prof. Errol D'Souza, renowned Economist, Professor of Economics, and Director at Indian Institute of Management (Ahmedabad). The conversation primarily discussed broad recovery roadmaps for a positive and progressive economic resurgence.

The prevailing paradigm shifts

Prof. Errol D'Souza began by summarizing the status quo, stating that - Just a year ago, there was an increase in credit spreads, the fastest fall in equity markets in history, the Financial Market was in turmoil, oil prices plummeted, and governments across the world, including India, went on a double barrel with fiscal deficits rising and Central Banks trying to support the situation. As of now, the IMF is gung-ho and almost tongue-in-cheek in telling everyone to simply stimulate the economy and use the fiscal stimulus as much as possible. Even in India, there is less emphasis on the negative and the thinking is that fiscal deficit or debt is

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Prof. Errol D'Souza Economist, Professor of Economics and Director at Indian Institute of Management, Ahmedabad

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not an issue and we just need to come out of the crisis. Going forward the questions are – Should we be fearful of the inflation problem? Will governments have to face, in the future, issues of indebtedness? Is it good to forget about the historical lessons we know of what deficits have done?

To this, Dr. Rajan pointed out that maybe the rules of economics have changed in developed countries – from thinking that inflation is a problem that needed to be contained to the Central Banks now viewing low inflation as the problem. This is a factor we have to take action on even to the extent that we must ignore the old rules of the game. That said, he felt that by the time we see inflation in the eyeballs it could be too late and thus we have to act pre-emptively against it. One of the worries the more conservative economists have is that as soon as the Central Bank indicates that inflation is not a problem, and if the government spends as if there's no tomorrow, then there could be potential for higher inflation. Why does that matter? Because higher inflation would push-up longer-term interest rates and should that happen, then there would be a fall in the value of financial asset prices making investors risk-averse. Should this spread around the world, then the outcome would be a version of the taper tantrum not driven by Central Bank policy, but by anticipation of it. That is why Central Banks are attempting to ward this off by clearly asserting patience without panic. But the general fear is that given all sorts of stimulus, should the market get a sense of inflation to be more permanent, there would be massive capital movements. The big debate is that is this likely at all or are we in an era of permanently low inflation? Coming to India, the issue was that we were spending too little given the magnitude of the crisis, and especially that the support given to households, and small and medium businesses was insufficient.

Dr. Rajan thought that the budget has slightly remedied some of this with the emphasis on infrastructure spending. The remaining question now being how much will also be needed to bolster the weaker segments of society going forward?

Another issue, according to Dr. Rajan, was that the Federal Reserve has been a part of the enhanced volatility in markets. In response to this, he stated that – "I did not want India to be labelled a currency manipulator because we were building reserves in a big way anticipating that when the money flowed in, it would flow out. I think the RBI has continued doing this - reserves are at an all-time high and I think we have to emphasize that this is part of what we need to do in order to protect against volatility."

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The overall outlook for organizations

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Dr. Rajan was of the opinion that the pandemic shook businesses across industries to reconfigure the entirety of their work processes with an accelerated adoption of things like automation, new technologies and Work-from-Home (WFH). He stated that while it was unlikely that people would want to continue WFH, there is likely to be a change in the number of work-in-office days. This would lead to major changes in the office needs such as big meeting rooms, inter-office functions – all benefiting from the productivity increase brought on by technology. He further stated that this could provide opportunity for countries like India, which have a skilled workforce, to think about new structures by which they could build confidence, give comfort to the customer about site security and skill quality, and create value-added services to

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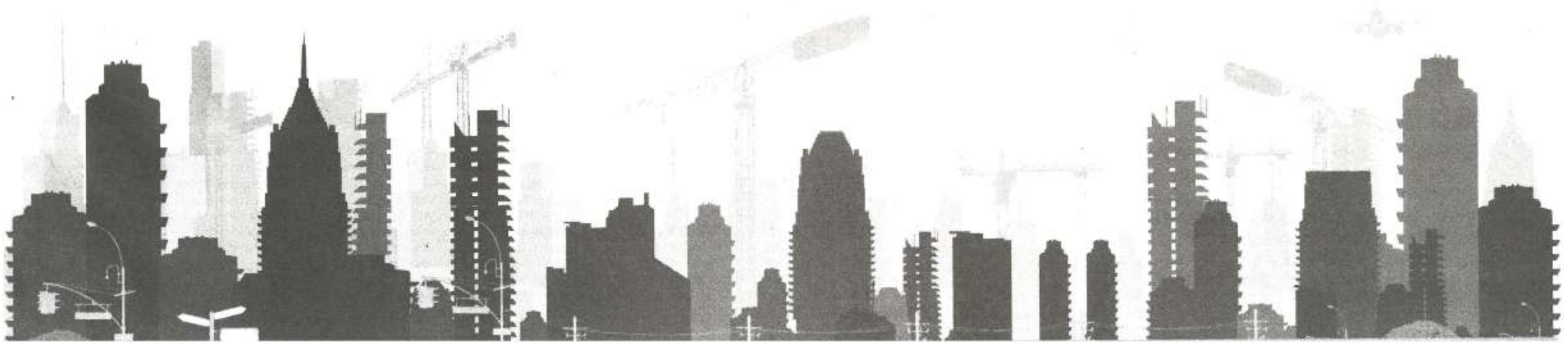

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the rest of the world.
Although agreeing with the possibilities of technology, Prof. D'Souza's worry was that the growth of technologies such as AI for India meant that it would actually displace work. He referred to an interesting incident in India where an IP was filed by AI and not a human. The point he underpinned was that in a country with such a large labour force, it would create problems for industry as well as governance if the displacement happened at high-end skill sets and not just routine work.
Dr. Rajan responded that a greater cause for concern was the division of society between the 'haves' and 'have-nots.' As could be seen during the pandemic, students at the lower rung lost a year due to no accessibility to online facilities. He felt that if there was no strong education plan to bring them back, the consequence would be many more lost years and a loss of skill. Shifting gears to the high-skilled, he said that jobs could not continue as is and there would a time of forced adaptation. However, machine can beat man on some things but machine plus man or woman is often better than machine alone. He underlined the importance of sorting the hype of AI from the reality – the reality being that we are still some distance away from displacing the capabilities of the human brain with a machine. The real question, according to him, should be - how do we use technology as a useful aid to produce true value for society.

Sustaining self-reliance with self-belief

In the final leg of the discussion, Prof. D'Souza spoke of the growing protectionism across the world with one of the debates in India being - is Make in India protectionist? The huge increase in tariffs over the last couple of years and the favouring of certain groups of industries over the others, to him, felt like we were going back to the days of import substituting industrialization. The thought was what seeds could be planted for upgradation to sustain us in the long run.
Founded on old school economics,
Dr. Rajan felt that the problem, to some extent, has been the low growth which has caused countries to look for scapegoats.
In doing so, they point fingers at other countries and find reasons to elevate tariffs. The economist would say that you can't really export without importing. No country makes everything inside. And as soon as you put tariffs on imports, you're increasing the cost of exporting in a sense. Given the vibrant markets for a country like India, the one-sided trade pipe dream cannot happen. Keeping out imports also prevents competition for domestic industries. He cited the well told tale of the Morris Oxford showing up as the Ambassador car and not changing for a long time except for the front grill. The Auto industry was forced to come up to international standards after liberalization and did so very successfully; so ancillaries are now sold to the rest of the world along with exporting cars. According to Dr. Rajan, liberalization has value because it opens up the World Market.
Speaking of the selectivity of tariffs and the uncertainty associated with it, he said that we risk going back to the days where there was a lot of lobbying by industrialists for 'protection' with each budget. He believes that we should stay away from the kind of economic policy where domestic competitors fight each other based on tariffs. He stated this as something to reflect upon and rectify.
Remarking on the mindset of the industry, Dr. Rajan felt that in the early 2000s there was a strong sense that India had arrived – companies were doing brilliantly globally, and every business person was considering the international markets as something they wanted to conquer. There was a sense of Atma Vishwas – a belief that we could do it. While he held there were some fantastic cases of people still fighting the good fight such as the brand Royal Enfield, he also felt there was a slight dull in the shine of spirit. Dr. Rajan's parting words were – "We need to have greater self-confidence that we can stand up to the competition and do what it takes to succeed. Relying on tariffs to protect ourselves implies that we would shut out the global market and that, to my mind, is certainly not the path for us. Every quintessential Indian should strive for Atma Vishwas for collective progress."

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