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# AN ECONOMIST ABROAD

By R. K. HAZARI

**(Dr. R. K. Hazari, Deputy Governor of the Reserve Bank and Chairman of the Agricultural Refinance and Development Corporation, recently visited Paris, New York, Washington and London. His article is on the state of economy of these countries.)**

I went first to Paris where a visiting Indian is still regarded as a lost sheep strayed from the English flock. Visiting Paris after nearly 5-1/2 years, my first impression was that it was bursting with tourists but that the historic drive of Andre Malraux for maintaining the grandeur of monuments was under some degree of strain. The bankers were quite explicit about their feeling that the French economy would be under external and internal pressure in the near future. As you would be aware, interest rates there are being kept at high levels, and the balance of payments position is not as strong as it was sometime back, mainly due to a turn-round in agricultural exports which, it is hoped, will pick up again when the effects of the drought are over. The rate of inflation is causing anxiety. Political developments are of absorbing interest; mainly, the victory of the Left in the municipal elections (parliamentary elections are due next year) and the likely impact of that victory on the French franc and on the balance of payments. Almost everybody having anything to do with official policies assured me that the franc would not be devalued. Since devaluation is no longer fashionable—one only depreciates or appreciates these days—and the franc has already depreciated by approximately 15 per cent since it left the snake, I asked them what precisely that statement meant. The reply was that the franc may well "move in the normal course" but a policy devaluation could not be contemplated for a long time. French prestige and the prospects of the present government seem to hinge on what happens to the exchange rate. Officials feel it necessary to keep money tight and the interest rates high in order to safeguard the franc.

On the question of attracting money from outside, the Bank of France was very clear: it did not want an inflow of foreign money. But it had no objection to French commercial banks accepting money from outside and deploying it outside France. This is, of course, a sanitary concept but, if the money is deployed somewhere, shall we say, in the EEC, and each member-country has equally sanitary ideas, I don't see how the money can be altogether outside of all the member countries. If the franc proper is kept relatively sanitised, but there are plenty of Euro-francs in circulation, I find it difficult to believe that the Euro-franc would make no impact at all on the position of the franc. From the narrow viewpoint of our self-interest, I was, nevertheless, happy to hear from the French commercial banks that they would welcome balances being kept with them by our banks, and that they would be willing to negotiate the rates of interest. I was given to understand that the interest rates are higher than those offered on Euro-francs in London, and that it is possible to get still higher rates by negotiation.

There was a general uneasiness about the developments in both Western and Eastern Europe. In respect of EEC, the uneasiness reflected the French feeling that the movement towards closer economic relations between members was all right but that there was no need to proceed further with closer political relations. Having introduced myself as a political economist, and asked them how they could de-link economic from political relations, I found it difficult to get a clear answer. As in my visit last year, I did have the feeling that there are widespread and acute strains in the EEC and that the questions in dispute do not relate just to agriculture or monetary matters, but to much larger issues. Among these issues is the question of how long Germany will continue to be the Big Brother, how the smaller members like Benelux will be able to fare, how a high cost but large agricultural producer like France itself will fare, how Britain and Italy will continue to be accommodated, and how the poor countries — Greece, Spain and Portugal — are to be treated. There is certainly great uneasiness about the prospects of economic growth, investment in particular, and with the feeling that Germany is not willing to go farther down the path of growth with inflation. Eastern Europe is now known to be a larger debtor in the Euro-currency market and the servicing of its past and future debt obligations appears to be a source of worry. The political implications of the growth of Euro-Communism are considered on the whole de-stabilising on both sides of the divide.

There was also a certain degree of uneasiness over the proposed capital gains tax. From what I could make of the modified proposal — every country as you know has a complicated tax system — it was a very moderate proposal compared with the heavy capital gains tax to which we have been accustomed in this country. I was told that the proposal was very upsetting. The classes that had been supporting the present government felt very annoyed while the Left dismissed it as an insignificant patch on the generally regressive French tax system. Alongside of this, the inability of government to step up grants for educational institutions is causing discontent, particularly among the teachers. Students are restive and so, incidentally, are bank clerks whose demonstrations outside their offices while I was in Paris reminded me of similar diversions at home. Unemployment is high and is expected to worsen further. On the whole, I was left with the feeling that the Establishment was apprehensive about the shape of the future.

From these sophisticated matters, I moved to agriculture. Credit Agricole is located away from the financial district, but its management, like that of other financial institutions in France, is an integral part of the civil service set-up. Unlike our co-operative system, it has a very large volume of surplus funds and these surplus funds are eagerly looking for investment elsewhere. I was asked whether the ARDC would be interested in discussing an invest ment proposal, to which my reply was that I would not presume to trespass upon the territory reserved by my government but that we would certainly relish the idea of exchanging more information about each other. They do finance some working capital requirements through their various agencies but most of their business relates to investment finance. Their main problem is that not enough investment propositions come to them: their agricultural infrastructure is already very strong, most of their agriculture is already developed and, therefore, the funds that flow into the institution do not easily find employment within domestic agriculture. Therefore, apart from looking after French agriculture, they are interested in agricultural propositions in other countries. They do not have anything like project financing as we have tried to do in ARDC. Their financing is wholly on an individual client basis. They feel that there is hardly any scope for project lending, that projects, if any, are formulated by government and looked after by government, and that this is a field that they need not enter. I availed myself of this opportunity to acquaint Credit Agricole with the development of our agricultural banking, especially the working of ARDC. The discussion at Credit Agricole was incidentally the only one where an interpreter was used: in all other places there was no need for an interpreter because the French officials spoke English fluently and without hesitation.

## LONDON

In London, the atmosphere was visibly less sombre and grim than last year. The pall of gloom seemed to have lifted, and the state of morale was much better. I had discussions at the Bank of England and much longer discussions at the Treasury.

They expect that this year the economy would grow about 1 or 1½ per cent and that the current rate of inflation running at 16 per cent might come down to 10 to 12 per cent but not less than that. Next year also, the national income growth is estimated at only 1½ per cent. These forecasts appeared, on the whole, realistic though, in regard to inflation, one can only wish the British good luck. North Sea Oil has started making a considerable difference to the balance of payments and the impression is—and this is shared in Washington—that the British have turned the corner on balance of payments. But that is very far indeed from turning the corner on inflation, productivity, employment and investment. One does not see much prospect of an increase in investment—the policy aim is to keep it at best constant. Even investment in the North Sea is now past its peak. I got the same uncomfortable answers that I had got last year; the rates of return are low, the capital costs are going up, the environmental factors are negative, business people do not have enough confidence, government cannot step up expenditure because it would run into budgetary and inflation problems. Part of the high level of unemployment is attributed to the narrow differential between wages and unemployment benefits but also indicates, among other things, how low British wages are by Western standards. Continuance of the low level of investment implies that productivity, too, will remain low, unless there is a significant change for the better in restrictive labour practices.

I have come back this time somewhat relieved that my despondent forecast of last year has, in retrospect, proved to be more pessimistic than the realities have turned out to be. I would still assert, however, that there is no reason to turn very optimistic. One has to be very cautious about world economic prospects. There is great uneasiness everywhere about inflation. And there should be greater uneasiness about investment. I see great danger in the competitive pressure for inflation among the rich countries, namely, that those who have less inflation now should step up their inflation in order to have some equilibrium with those who have more inflation. Britain and France are quite loud in making this demand and they, unfortunately, perceive no other alternative path to international equilibrium. The Americans and the Germans would not like to be pushed into having to increase their growth rate or inflation rate or imports beyond what they have.

(To be concluded)

**In the concluding portion of his article Dr. R. K. Hazari deals with the US economy. His impression is that underneath the fair degree of optimism about income growth, there was considerable uncertainty and uneasiness about the growth of investment in the US. Dr. Hazari had occasion to discuss India and he did not fail to repeat his 'favourite statement' that water utilisation in India deserved an even higher priority than petroleum... Page 6**

One of the impressions I got in the USA was that a number of schools was closing down, at least along the East Coast. School registrations have declined steeply because of changes in the age composition of the population. In New York, the city authorities are cutting down expenses quite drastically. The closures of schools, the cutback in school registrations and steeply rising costs in universities are having an adverse impact upon teachers and young graduates. A much larger number of women have been going out to work or are seeking work. This has boosted the unemployment figures. Thanks to the demographic bulge, a large number of school-leaving boys and girls are looking for jobs for the first time. Another acute social problem relates to the ethnic minority immigrants in urban areas, the Hispanics in particular. The Wasps who have been settled in New England for two countries or more are not terribly upset about these immigrants but the Blacks, the Irish and the Italians, with whom the fresh immigrants compete, are quite sore. There are tensions and strains within each of these communities also. Many of the ethnic problems that have come up along the East Coast in the USA look very similar to our caste-cum-class problems. Many people in New York City feel that the immigrant problem should be transferred to Washington because it is a national problem and should be tackled as such. On the whole, however, New York did not look as besieged as it did last year. There has been some lifting of the gloom and people sound more hopeful than before.

Talking about the economy, the pandits in Boston, the bankers in New York, the officials in Washington, all seemed to agree that the growth rate of real national income in 1977 would be around 5 per cent average or about 6 per cent on a year-end to year-end basis. Investment is expected to increase by 8 per cent and prices by 5 per cent. One of the reasons for their optimism about income growth is that, in the first quarter of 1977, they did better than they had expected. During my visit in April-May last year, I had encountered similar optimism but soon thereafter the economy slide down towards the end of the year. I wanted to know how they felt reasonably sure that the experience of 1976 would not be repeated in 1977. The answers were not entirely convincing. There has certainly been a revival in housing. This is partly because of the age composition of the population, partly it is speculative in the sense that people expect prices to rise still further and, therefore, they would (if they could) buy a house now rather than after three or five years. There has been a revival in automobiles and there is some increase in automobile investment. There are several other sectors also where there is a modicum of revival but the main impetus during the first quarter seems to have come from an increase in inventories. In regard to long term investment proper, it was conceded that investment in Alaskan oil had passed its peak. There could be another investment boom when it comes to invest in shale but there the cost is roughly estimated at $17 a barrel of oil. Ecologists are still in a very strong postition and their influence would prevent a much larger investment in nuclear energy. Coal would suit the East Coast but it also creates some environmental problems. Investment in electricity appears a little better than last year, but it would not go very far. I asked about the prospects of investment in rail-roads which, I thought, would be consistent with the new energy programme. Nobody sounded enthusiastic about these prospects. At best, I was told, the decline of railroads might be slowed down. The western railroads are fairly strong financially and could take care, if necessary, of a small increase in coal freight The eastern lines would require such heavy investment of public funds in strengthening and re-alignment of track that it was difficult to contemplate their revival within the private enterprise system. Moreover, some coal could be moved as slurry through pipelines but this is still to be explored.

The new energy programme just then announced was enveloped in uncertainty, though it was the prime subject of conversation everywhere. Mr Carter was on TV almost every day while I was in USA, reminding the nation about the importance of being earnest in conserving energy. Last year, Candidate Carter's toothful grin from ear to ear nearly covered the TV screen. This year the teeth were missing; one saw a grim and serious President, instead. The US concern about energy is timely: motor spirit in that prosperous country sells at about 60c a gallon against nearly $2 here and offices and houses are cozy with heat. It is premature to assess the likely impact of the programme on investment and income generation. (Reading through the text of the President's speech, I was greatly impressed by the systems approach of the remarkable staff work that had gone into the programme; I wish we could have similar organised inputs for our policy formulations and announcements). The oil producing States will try to drive a hard bargain. The shifts required in pricing and in consumption patterns would be painful. The first impact, I was told, was an increase in business uncertainty and, therefore, further postponement of investments. On the whole, Americans seem reconciled to a higher price of fuel and saving on household use of energy, but they do not seem reconciled to the prospect of moving away from the private motor vehicle despite its large consumption of energy.

My principal curiosity related to where investment would increase in future but this curiosity remained unsatisfied. There has been some revival in orders for machine tools over the year but, on one of the charts shown to me, I noticed a recent dip for which I could get no explanation. I think that machine tool orders are an invaluable advance indicator of investment and their trend last year was a clear advance indicator of what actually happened to the US economy towards the end of 1976. Given a 5 per cent growth rate this year and a similar growth rate in 1978, relatively moderate inflation as compared with other Western economies, and the prospect of some investment being promoted by the new energy programme, US industry may move only a little beyond the present level of capacity utilisation (the FED Index stands at a little above 80). That level is unlikely to trigger off a significant rise in investment. When I asked a high official about the approximate expected pattern of investment, the answer was that we are concerned with the total level of investment. we believe in free private enterprise and that the composition or location of investment need not bother us. I let the discussion rest at that.

Generally I could see that, underneath the fair degree of optimism about income growth, there was considerable uncertainty and uneasiness about the growth of investment. Corporate profitability is slightly bettter than in the last two years but is still much lower than in the mid-sixties. The consequent larger business liquidity has not yet led to a substantial revival of investment. Policy-makers and policy-thinkers still look to private consumption for uplifting investment and are fortified in this belief by the nagging fear that larger public expenditure would boost inflation. Employment is increasing but the number of unemployed is expected to grow further and the unemployment percentage to remain constant. I did not come across any idea for special employment programmes but I was greatly impressed by the general opposition of businessmen, academicians, officials and housewives to inflation and any official measures having inflationary possibilities. Nowhere else, certainly not in India, have I heard of such strong business feelings against inflation. This coincidence of business motivation and social responsibility is very touching indeed. In Boston, New York and Washington I congratulated FED authorities on their successful stance against inflation: since our tribe does not work for popularity, it requires one central banker to praise another. The compliments were gladly accepted.

There is a feeling in academic and quasi-Government circle that the future emphasis of US aid programme should be on the Mediterranean area, principally, Spain, Portugal, Turkey and Greece—apart from Italy which has to be kept afloat. Yugoslavia is not mentioned explicitly but I could feel that this country was very much on the minds of policy thinkers. It would be interesting to watch the impact of this new emphasis on the attitudes and policies of OECD countries generally.

Talking to the IMF, the World Bank and various US official agencies in Washington involved mainly updating them about recent events and trends in India, particularly the revival of inflation. It was my unfortunate duty to tell them—as I had warned last year—about the practical absence of any increase in national income during 1976-77 and the large price increase that had taken place. There was a lot more awareness, however, of the spurt in our foreign exchange reserves. There were inevitable questions about why the reserves were increasing. Speaking to officials, bankers and informal audiences in Boston, New York and Washington, I did not list the spurt in foreign exchange reserves as one of the major achievements of the Indian economy during the last two years. I made it clear that I regarded the increase in reserves, like excess cash accumulation in a firm, as indicating either inability or unwillingness to invest or both. I also asserted that as in most other countries, much of the demand recession in India was due to inflation in recent years and the fact that our real level of investment had been slack or almost stagnant for the last ten or 12 years, and the annual growth of per capita income had been about 1·25 per cent since the early sixties. Unlike the rich countries, we have many investment possibilities open to us and the solution lay in substantially increasing the level of real investment in agriculture, irrigation, power, railways and roads. In particular, I was optimistic about the prospects of technological change in agriculture, especially in the larger Ganga valley. I also opined that the new Government would take at least six months to settle down. Major economic decisions could be expected only after that and, therefore, a visible increase in the level of investment could be expected only towards the end of 1978 or early 1979.

Questions in the World Bank related to projects in the pipeline. They wanted to know when the planning process would be revived. While they appreciated India's keenness to retain a 40 per cent share in IDA allocations, they hoped that enough programmes and projects would be lined up for assistance for India's own sake and in order to enable them to fulfil their performance budget. Their feeling was that there were not enough projects in the pipeline—barring the honourable exception of ARDC, which I was proud to find, enjoyed high rating. ARDC is now the largest corporate client of the World Bank. I thanked the authorities at various levels for their appreciation. Talking to the Indian staff, I envisaged the possibility of concerted international effort in the Ganga basin and the need for investment in hydel projects, besides minor irrigation. I also repeated my favourite statement that water utilisation deserved an even higher priority than petroleum and that the Eastern region in India required sustained and systematic attention.

(Concluded)

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