

NOTE

AMERICAN CRISIS AND INDIA

B J writes :

The decline of the US economy is likely to persist. The bailout of crisis-ridden banks and insurance companies by the US Government does not solve the underlying problem of loss of competitiveness. These bailouts only spread the burden over a wider population. The whole American people will bear the losses due to the collapse of these institutions instead of fewer shareholders. The bailed out banks are not likely to survive for long.

The East Asian crisis was caused by reduced demand from the US. This downslide was arrested by the sudden demand created by the internet related companies. The NASDAQ was booming and lifted the American economy. This lasted for a few years. Such an invention is not visible on the horizon at present hence the crisis is likely to get deeper.

The impact of the American crisis on India will depend on policies implemented by the Manmohan Singh Government. It has been previously said that the combination of cheap labour and advanced technologies in China and India is the cause of American crisis. Therefore, high growth rates in China and India; and downslide in America are two sides of the same coin. But the immediate impact is a bit different. American banks and investment companies are facing a liquidity crisis. Their receipts are less due to defaults by borrowers but they need to meet their payment obligations. They need to raise funds to compensate for lesser repayments. They are selling securities in India to raise these funds. This is the cause of decline of the sensex in the last few months.

The long term impact of this liquidity crisis can be different. High prices of oil are creating a flow of global wealth towards oil-exporting countries. These countries will have to invest these incomes at some place. The US, Europe and Japan are all floundering. The dollar, euro and yen will all decline against other currencies. As a result oil-exporting countries are less likely to invest in these countries. They can invest in India if the Government follows the right policies. The decline of the rupee in the last few months is wholly due to the burden of oil subsidies. The public sector oil companies are buying oil expensive and selling cheap. The loss is being transferred to future revenues of the Government through issue of oil bonds. The Government will have to impose huge taxes on domestic companies to raise funds to redeem these bonds. The foreign investors are recognizing this future burden and discounting the future of the Indian rupee for this reason. The situation will be entirely different if the Government desists from this destructive policy. An increase in the price of oil will lead to reduced consumption and save India from such future burden. The rupee will, then, rise and become an attractive destination for petrodollars. □□□