THE HINDU

Monetary and real aspects of economy

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How flexible is the Indian rupee? What is driving OFDI (outward foreign direct investment) by Indian corporates? Are there alternative uses for India's international reserves? Should India adopt an inflation targeting framework? How have the export structures of India and China evolved? What is the impact of exchange rate movements on inflation in India?

For detailed answers to these and more questions, dip into 'Monetary, Investment, and Trade Issues in India' by Ramkishen S. Rajan (www.oup.com). The collection of essays, co-authored with experts from around the world, focus on both the monetary and real aspects of the Indian economy, Rajan notes. "The chapters concentrate on important policy issues, but are informed by data and empirics… The book also provides accessible overviews of recent research on the questions explored," he introduces.

Take, for example, the chapter on outward FDI, where the author observes that while India has become an attractive destination, the country is also becoming a significant source of outflows, as many Indian enterprises view outward investments as an important dimension of their corporate strategies.

Foremost among the strategic drivers behind the internationalisation thrust, particularly via acquisitions, is resource-seeking, says Rajan. "This has been the primary motivation behind overseas acquisitions by ONGC's and GAIL's oil-related equity abroad, the overseas acquisitions by India's Suzlon Energy Ltd… and Hindalco's acquisition of copper mines in Australia."

He states that most of the overseas acquisitions undertaken by Indian companies recently have been aimed at accessing high-growth markets, buying brand names, acquiring technology, processes, management know-how, and marketing and distribution networks, and consolidating existing markets.

Rajan expects OFDI from India to grow in importance as Indian companies are beginning to face intense foreign competition at home and are intently looking to expand their overseas market shares. An example he cites is of State Bank of India, which has forayed into Mauritius, Indonesia, and Kenya.

Similar drivers are seen behind the decision of software companies establishing facilities in developed countries such as the US ('reverse outsourcing') in order to acquire domain knowledge of clients and seek out new business opportunities. Likewise, "India's pharmaceutical companies have been attempting to seek new unregulated markets for their generic drugs, while also looking to acquire facilities that already have regulatory clearance in regulated markets like the US and western Europe."

The author draws attention to the fact that the policymakers in many Asian countries, like China and India, have been particularly keen on promoting an internationalisation thrust and have facilitated OFDI through a gradual liberalisation of rules governing capital account outflows and, in many cases, providing a financing mechanism to domestic firms looking to invest abroad.

Those watching the exchange rate fluctuations and wonder where the rupee is headed in the near future will largely benefit from the opening section in the book. The degree of flexibility of the INR against the USD has decreased steadily since 1996-97, the author observes, in the first chapter. He estimates that India has been sterilising about 70 per cent of the reserve accretion between 1998 and 2006.

As the country continues to liberalise its capital account, continued heavy management of the exchange rate will invariably complicate its overall macroeconomic policies, Rajan fears.

He argues that the more flexible the exchange rate regime, the keener will be the incentives for agents to undertake appropriate foreign exchange risk management techniques in response to the higher element of exchange rate risk, while simultaneously reducing the extent of moral hazard which could lead to 'excessive' unhedged external borrowing (referred to as a 'fixed exchange rate bubble').

"The introduction of these transaction costs and exchange rate risks may also help moderate the extent of capital inflows, consequently dampening the intensity of boom and bust cycles."

Imperative read.

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