

THE HINDU Business Line

INTERNET EDITION

Financial Daily from THE HINDU group of publications

Thursday, Mar 04, 2004

Opinion

Economy

Lessons from US recovery

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The greatest strength of the Americans is their willingness and ability to learn from their mistakes. Whether it is corporate governance, streamlining the supply chain, outsourcing or manpower restructuring, the Americans discuss their problems openly and find structural solutions.

IN THE year to the third quarter of 2003, the US' GDP grew by 3.5 per cent. In the third quarter of 2003, it grew by an annualised rate of 8.2 per cent (BusinessWeek, January 26).

The index of manufacturing activity computed by the Institute of Supply Chain Management hit a 20-year high during November 2003. The US, after hitting a rough patch during 2001, has staged an impressive recovery. It is now clear that the 2001 recession has been the shortest in living memory in the US. In fact, applying the strict definition of recession, (two consecutive quarters of negative growth) some economists believe it was not a recession at all.

Peter Drucker remarked recently in an interview with Fortune (January 12) that: "What we have been going through these past three years is most definitely not a recession. It is a transition — a transition with a lot of incongruities."

There are some useful lessons that India's policymakers can pick up from the US. The Federal Reserve's aggressive monetary policy, the government's timely fiscal stimulus and favourable microeconomic factors have combined to turn the US economy round in a quick time.

There are some who believe that the US' huge budget and trade deficits cannot be sustained for long. Indeed, there is a school of thought which holds that the US is still to get rid of many of its excesses built up during the boom of the 1990s. Some of the economic indicators do seem unusual for the beginning of a boom — low savings, heavy household borrowing, record house building and high P/E.

But this is not, strictly speaking, the initial phase of a new business cycle. It is almost a continuation of the old one.

The reason why the current upturn is perceived as a new business cycle is the furious pace of restructuring and downsizing pursued by American companies in the last two years. The recession is over but cost-cutting efforts continue.

Indeed, if history is evidence, these so-called excesses and imbalances are unlikely to stop the American juggernaut. Unlike many other countries, the US can afford big budget deficits as there is plenty of excess capacity.

The country's capital market is also well developed. Money is available for any entrepreneur with a bright idea. The crowding-out phenomenon, a logical consequence of huge government spending is, thus, the last thing Americans need to worry about.

The US can also run up huge trade deficits, as the dollar is still the world's reserve currency. It would not be an exaggeration to state that macro economic concerns hide the true strengths of the US. It is not for nothing that the country has built up its image as the land of opportunities.

American productivity grew by over 2 per cent per year in the 1990s. Today, Americans work about 300 hours more per year on an average than the Europeans. Americans, more than the citizens of any other country, believe in individual initiative. They are also very positive about the contribution of immigrants to society. Unlike the Europeans. Indeed, one

of the most important reasons for the success of the US has been its ability to attract the most talented people of the world. This has helped the country retain its position as the world's technology leader. Each year, more patents are applied for in the US than in the entire EU. The country has almost three times as many Nobel Laureates than the UK. An estimated 90 of the world's top 100 universities are in the US. According to Peter Drucker, the US is the only country with a significant continuing education system.

The US has succeeded remarkably in fostering a climate which supports risk-taking and innovation. That is how people like Andy Grove, Bill Gates and Larry Ellison have made it big. The US is the global leader in innovation-driven industries such as computer software, microprocessors, biotech and pharmaceuticals. As Peter Drucker says, the US remains the most cost-effective location in the world for many of the advanced industries.

Though the US believes strongly in private initiative, its government does intervene where it feels it is necessary. We have seen the role played by aggressive monetary and fiscal policies in boosting business confidence.

Another good example is the US housing finance market, which is characterised by fixed rate loans. Yet borrowers can refinance their loans when interest rates drop, at a little extra cost. While this system benefits home-buyers, it is very risky for the lenders. So, the government has created two institutions. Fannie Mae and Freddie Mac which buy mortgages from banks and sell them off to sophisticated investors.

The close linkage between refinancing and falling interest rates also means that the Federal Reserve can really stimulate the economy through loose monetary policies.

In countries such as France and Germany, where fixed rate mortgage refinancing is comparatively difficult, monetary policy has less impact. That also explains why the US has a far more vibrant housing market than France and Germany. The greatest strength of the Americans is their willingness and ability to learn from their mistakes. Whether it is corporate governance, streamlining the supply chain, outsourcing or manpower restructuring, the Americans discuss their problems openly and find structural solutions.

They also know how to respond quickly and take corrective action. Between January 2000 and November 15, 2003, some 6,00,000 jobs disappeared in the US telecom industry. Some 1000 dotcom firms went bust. Erring companies like Enron faced severe penal action and extravagant CEOs like Mr Dennis Kozlowski of Tyco were punished.

Quick responses create pain in the short run but lead to real benefits in the long term. Even The Economist (November 15, 2003) has grudgingly remarked, "The key to the recovery is the persistence of America's extraordinary dynamism. Labour and capital are quickly recycled and recombined with ever-improving materials, energy and information technologies to advance growth."

Contrast this with what is happening in India, which is going through a phase of euphoria when there is actually little to celebrate.

Recently, not one large company can really claim to have restructured in a big way. We have only paid lip service to improving corporate governance. Even as we become euphoric about the forex reserves crossing the \$100-billion mark, vast tracts of the country cry for better infrastructure.

The celebration over low interest rates is also misplaced. Low interest rates have not kicked off investment. They have only ensured that many entrepreneurs are virtually shut off from the capital market. Several distortions and excesses built up over four decades of a controlled economy still remain.

India's corporate leaders are no great visionaries. They continue to lobby the government for such artificial props as low interest rates.

Meanwhile, the Government is sending confusing signals by planning to intervene in the functioning of the IITs and the IIMs, which are truly world-class educational institutions. To pretend that the economic liberalisation programme is proceeding smoothly is mere wishful thinking.

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