The State of the Economy*

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Newspaper headlines over the last few days have highlighted three facts which point to the current abysmal state of the Indian economy. The first relates to inflation, where the June 2018 wholesale price index was 5.77 percent above that of June last year; this is the highest inflation rate witnessed since December 2013. The second is a burgeoning trade deficit: the trade deficit in June, at $ 16.6 billion, was again the highest for any month in the last five years. The third relates to the industrial stagnation that has set in: the growth in factory output in May (the latest month for which we have data), measured by the Index of Industrial Production, was a mere 3.2 percent over May 2017, which is the lowest growth rate in seven months, exceeding only the 1.8 percent rate witnessed in October 2017.

Within industry, the manufacturing sector's performance has been particularly abysmal: it grew by only 2.8 percent over the previous May. India has been witnessing a virtual industrial stagnation for long, but even the very faint recovery that had come about in the last few months, has now faded. All this, let us remember, refers only to the factory sector. When we take account of the "informal" industrial sector which has been crippled by the blows dealt by demonetization, and the Goods and Services Tax, this picture of industrial stagnation gets greatly reinforced.

We thus have a remarkable combination of stagnation, inflation and a burgeoning trade deficit. At first sight all the three would be put down to the effect of the rise in oil prices. The rise in oil prices, it would be argued, has pushed up the trade deficit; it has also raised the rate of inflation, which in turn, through a squeeze in the real purchasing power in the people's hands, has had a restraining effect on industrial demand and hence output.

But this perception is erroneous. The industrial stagnation has been there for quite a while. The May 2017 growth in manufacturing output, over the preceding May was a mere 2.6 percent, and in June 2017, it was a mere 3.1 percent. It is a faint recovery from this abysmal record that had been witnessed over the last few months; but even this has come to an end. Likewise, a balance of payments problem, manifested in a drastic decline in the exchange rate of the rupee has been there for quite some time, a consequence inter alia of the rise in the U.S. interest rate. Earlier, when the U.S. interest rate had been close to zero, a huge amount of funds had come into economies like India which had offered much higher interest rates; and because of this fact not only had our current account deficit been covered but, additionally, our foreign exchange reserves had got swollen.

Now however there is a reverse flow, because the U.S. has increased its interest rate, and further increases are expected to follow. This has put pressure on the rupee, which the Reserve Bank's drawing down of foreign exchange reserves has been unable to stem. The decline in the value of the rupee for this reason has also been exerting a pressure on the domestic price level by jacking up the rupee prices of imported inputs. The increase in oil prices has only acted on top of this situation. It has in other words acted as a powerful additional factor in a situation that was already marked by stagnation-cum-balance of payments pressures-cum-inflation acceleration.

The combination of these two factors makes the current predicament of the economy so precarious.

Pro-government spokesmen never tire of making comparisons between India and China, taking pride in India's apparently higher growth rate of late (whatever that may signify). But there is a basic difference between the two countries that is invariably missed, namely that China has been enjoying for long a current account surplus in balance of payments while India has for long had a deficit. China consequently does not have to worry about attracting globally-mobile finance to make its balance of payments viable, which India necessarily has to. This worry which had abated somewhat as long as the U.S. maintained a near-zero interest rate, has now surfaced with a vengeance.

What this means is that in order to manage the balance of payments the government will have to make India even more attractive for globalized finance, for which interest rates have to be hiked further, government expenditure has to be cut back, and "austerity" measures in general have to be adopted. All of these would push the economy towards further stagnation, and impinge adversely upon the poor.

At the same time the impact of these measures upon inflation would be minuscule per se, since, by the government's own claim, the current inflation is of the cost-push kind which has accelerated because of the oil-price hike. As long as oil prices keep rising (and the general view is that this is likely to happen, even upto $100 per barrel), and the impact of any such rise is "passed on" in the form of higher prices for the consumers (which is the government's current policy), there is no reason, other things remaining the same, why there should be any let-up in inflation.

Not "passing on" the higher prices of imported crude to consumers in turn would require raising resources through some other means, and if these means are themselves to be non-inflationary, then through larger direct taxation or through larger borrowing, i.e. fiscal deficit. But any such means of additional resource mobilization would be anathema for globalized finance, appeasing which would be essential for managing the balance of payments. Hence the cost-push inflation arising from the oil price-hike will not, other things remaining the same, be countered in this manner.

It would be ensured therefore that other things do not remain the same: the operation of cost-push would be kept restricted by ensuring that there is no wage or salary push in response to inflation, i.e. that the working people are not compensated for the rise in prices. In other words, the effect of the rise in oil prices would be sought to be countered by reducing the claims of the working people including the salary earners on social output, which amounts to "controlling" inflation at their expense.

India's economic experience under the neo-liberal regime is thus set to undergo a fundamental change in the coming days. Neo-liberalism in India has always squeezed the workers, peasants and petty producers, even when it was not afflicted by any overt crisis; but now that it being afflicted by an extremely serious crisis, with globalized finance turning its back upon the economy, the squeeze on the working people will multiply many-fold, and even the salary-earners and urban middle class will not escape this squeeze. We are now going to have neo-liberalism with its fangs bared.

This however need not happen, if we follow an alternative set of policies that do not aim to appease globalized finance. But of course following such alternative policies could trigger a flight of finance, against which capital controls would then have to be imposed, and these would mean a withdrawal from the neo-liberal regime.

This alternative set of policies would include the following: controlling imports through higher tariffs, and some non-tariff restrictions, as a means of managing the balance of payments (which Donald Trump as the President of the world's most powerful capitalist country is doing anyway); controlling inflation inter alia by not passing on the rise in oil-prices to the consumers; using the instrument of direct taxation for raising government revenue, both to compensate for the revenue-loss incurred owing to not passing on the oil price increase, and also to enlarge government expenditure, especially on education and health (for instituting for instance a universal healthcare scheme along the lines of the National Health Service).

Higher government expenditure on the one hand, and protection against imports on the other, would enlarge the demand for domestic goods immediately (which will have to be followed subsequently, for a more sustained increase in domestic demand, by a revival of peasant agriculture); this will also serve to overcome the stagnation that has afflicted for long the material commodity producing sectors of the economy under the neo-liberal regime. (The claimed impressive growth in GDP has arisen entirely because of the service sector whose expansion is empirically questionable and theoretically of dubious merit).

To be sure, there would be transitional difficulties with such a policy-sift, as international capital and the Indian corporate-financial oligarchy that is integrated with it, puts up a resistance against any such shift; but with the neo-liberal regime in India coming to the end of its tether, there is no alternative to effecting such a shift if the working people are to be spared the viciousness of the "austerity" that would inevitably be imposed upon them.

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