# Rajan’s Exit*

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An absurd debate has been going on for some time in India. On the one side are those who blame Raghuram Rajan, the governor of the Reserve Bank who has just decided not to seek an extension of his term, for keeping interest rates high and thereby pushing the economy into stagnation (and they embellish their argument by invoking images of the sufferings of the unemployed); on the other side are those who applaud his courage for keeping interest rates high and thereby keeping at bay the scourge of inflation in the country.

The absurdity of this debate lies in the fact that minuscule changes in the interest rate (which are what the participants in the debate are talking about anyway) have little effect either on growth or on inflation. If a fall in the interest rate from its current level by 0.25 or 0.5 or even 1 percent could stimulate growth in the economy, then the United States would not have been saddled with stagnation and an unemployment rate exceeding 10 percent, even by conservative estimates, when its long-term interest rate, which is what matters for investment decisions by capitalists, is close to zero. (This still continues roughly to be the case even after the Fed raised it recently). And the fact that retail inflation has again started inching up in India despite Rajan’s firmness in keeping up interest rates, suggests that factors other than interest rate are at work, and, by inference, were at work when the rate of inflation came down earlier. All the hullabaloo about interest rate therefore is really quite beside the point.

This is not to suggest that interest rates do not matter at all, but they matter in a way very different from what is commonly imagined. To understand this, we must distinguish between “entrepreneurs” and “rentiers”: the former undertake physical investment and operate physical assets, while the latter only hold financial claims upon such assets. Among “rentiers” again we must distinguish between those who hold financial claims because of the income streams they get from such claims (among whom are “widows and orphans” and retired people), and “speculators” who buy financial assets not for “keeps” but for selling them off at the earliest opportune moment for capital gains. True, the distinction between “entrepreneurs” and “speculators” is invariably blurred with the former too engaging in speculation; but a distinction between these two activities is nonetheless important.

Now, a fall in the interest rate is supposed to stimulate demand, and hence output and employment, primarily through larger investment, which is supposed to occur because of cheaper credit; a secondary effect is through larger credit-financed expenditure on consumer durables. But investment does not depend only on the cost of credit; it depends above all on the expectations of “entrepreneurs” regarding growth in market-size, which in turn depends on the overall growth performance of the economy. And the same is true of expenditure on consumer durables, since uncertainty about job prospects and future income streams deters such expenditure, even if credit is available cheaply.

In a situation of bleak expectations therefore interest rate cuts have little impact on activity and employment, which is why the U.S. is still languishing in stagnation. With the world economy in the doldrums and the global crisis spreading to “newlyemerging" countries like India, entrepreneurial expectations are so bleak at present that no amount of interest cuts would help in stimulating the economy.

True, a lowering of the interest rate could work via a different route (which indeed has been the more practically significant route of late), namely, through the behavior of speculators and not entrepreneurs: it could cause an asset-price "bubble" which stimulates larger spending by asset-owners because they feel richer. But here too, in the context of the current world crisis, caused originally by a collapse of the U.S. housing "bubble", and compounded subsequently by collapses in Chinese and Indian asset price "bubbles", an interest cut would scarcely generate any new "bubble"; such a cut therefore would not have provided any stimulus to activity in the Indian economy via this route either. Blaming Rajan for the stagnation that the Indian economy is experiencing is thus absurd: it amounts to blaming one individual for the crisis of the system.

By the same token, however, lauding Rajan for the dip that occurred in India's inflation rate is equally absurd. The way that a high interest rate is supposed to bring down inflation is by curtailing expenditure in a situation where inflation is caused by excessive demand. India's recent inflation however has not been caused by excessive demand; on the contrary it has occurred in the midst of an industrial stagnation and of an accumulation of massive foodgrain stocks. This inflation has been of a cost-push kind, caused by the withdrawal of subsidies on a number of goods, and hence a rise in their prices, which then have got "passed on". And the reason this inflation came down to a certain extent earlier (though it is now picking up again) is primarily because of the fall in oil prices.

Rajan in short is as little responsible for controlling inflation as he is for causing stagnation in the economy. The entire debate around monetary policy and Rajan's role in formulating it therefore is a red herring; and the absurdity of the current situation lies in the intensity with which participants in this debate are pursuing this red herring.

Rajan's stance on interest rates, while it has little bearing on growth or inflation in the Indian economy, did attract funds from speculators to finance India's current account deficit on the balance of payments. While in 2013, shortly after Rajan took over at the RBI, there was a sudden collapse of the rupee because of a withdrawal of funds by foreign speculators from the Indian economy, this was soon overcome through a combination of direct controls over gold imports which had skyrocketed and high interest rates (to lure foreign finance back to India). In fact, with the current deficit having gone down since then because of low oil prices (despite a fall in remittances for the same reason), the inflow of funds into the country has been large enough to boost India's foreign exchange reserves after covering the current deficit, and even to make the rupee appreciate vis-a-vis several other third world currencies. (This is one of the factors behind the continuous fall, relative to the corresponding figure for the previous year, in India's merchandize exports for seventeen consecutive months till now). Rajan's insistence on high interest rates therefore had more to do with managing the balance of payments than with either growth or inflation.

This being the case, the reason for the government's dithering over an extension of his term, which led to his decision not to ask for one (so that the dithering on the part of the government amounted in effect to an implicit sacking), cannot be attributed to his stance on interest rates; it is more closely linked to his unsympathetic attitude towards Hindutva which he made no secret of. (Subramaniam Swamy's accusation that he is not an "Indian at heart" refers precisely to this, since in Swamy's view "Indianness" is synonymous with an acceptance of Hindutva).

Rajan's "sacking" then is significant not so much because of the loss of "economic expertise" that it is supposed to entail (neo-liberalism under the current dispensation would run its course no matter who is at the helm of the RBI); it is significant because it shows that the Hindutva forces cannot tolerate even the mildest implicit criticism from a liberal intellectual, no matter how high his standing in the global financial community.

But precisely because of this standing, the Modi government has announced a slew of concessions for foreign direct investment almost on the morrow of Rajan's announcement, so that speculators' "confidence" in the Indian economy remains unimpaired and there is no significant capital flight. Allowing 100 percent foreign ownership in defence, pharmaceuticals and civil aviation is a major set of concessions; and though it may have immediately blunted any adverse fall-outs from Rajan's exit, it amounts to a return to the days of colonialism.

The country had with great difficulty and determination sought to extricate itself from a situation at independence where several major commodities were either imported from abroad, or produced by foreign capital at home; the technology in these sectors in either case had been under the monopoly ownership of foreign companies, which had used this fact to fleece the Indian people. Building up the public sector as a bulwark against foreign capital, and developing technological self-reliance through publicly-funded R&D, had been a painstaking effort. It had been designed to ensure that political independence was accompanied by a degree of freedom from economic arm-twisting by foreign capital.

This, notwithstanding the known limitations of the dirigiste regime under whose aegis it had occurred, had brought palpable benefits to the people, and also built up the country's productive and technological base. A world in which control over technology is with the advanced countries while the developing countries merely provide locations for plants where their cheap labour can be exploited by capitalists from these advanced countries, remains a highly unequal world, no matter how rapidly the GDP in the developing countries grows as a consequence. The dirigiste economic regime in India had sought to change this unequal world. Imperialism on the other hand was always relentless in its efforts to push the country back into this unequal relationship; and the imposition of neo-liberal policies through its agencies like the World Bank and the IMF is part of this effort. The BJP-led government has shown itself to be fully complicit in this imperialist project.

What this episode, involving Rajan's sacking and the FDI announcements following it, reveals is that to push Hindutva this government is more than willing to make concessions to imperialism. If Rajan has to be sacked because the Hindutva forces dislike him (as they would since they want Hindutva acolytes everywhere) then he will be sacked; and if foreign capital demands a price from the country for such sacking, then the Hindutva forces will make the country pay that price. It is ironic that those who keep harping on “national pride” are perfectly willing to make the nation economically, technologically and militarily subservient to imperialism.

**∗ This article was written when Raghuram Rajan announced an unexpected move to step down as RBI governor after being criticized for keeping the interest rates high. This was originally published in the People’s Democracy, on June 26, 2016 edition.**