A Bull in a China Shop*

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The BJP government, like a bull in a China shop, is wrecking the economy. A neo-liberal regime, even at the best of times, i.e. even when the economy is booming, brings misery to the vast mass of the working people by imposing upon the petty production sector a process of primitive accumulation of capital, through a withdrawal of State support from it and through leaving it to the mercy of the "spontaneous" working of untrammelled capitalism. When the economy slows down, with the inevitable collapse of booms which are typically sustained in such a regime by asset-price bubbles, the misery of the working people only gets compounded.

The BJP government however, not content with such a process of "spontaneous" neo-liberal immiserization, has decided to unleash its own additional initiatives in the same direction. If demonetization dealt an entirely unwarranted additional blow against the petty production sector, whose consequences alas were utterly predictable, the introduction of the Goods and Services Tax, which is a completely anti-Constitutional measure to boot, as it takes away the Constitutional rights of the state governments, has only accentuated the process. As a result, we are witnessing today a rare co-occurrence of three phenomena: a stagnation of the economy, a revival of inflation, and a yawning current account deficit on the balance of payments.

The first of these, namely the looming recession, which is itself the product of three factors, viz. the world crisis being imported into the domestic economy, the demonetization whose effects continue to linger, and the GST which has suddenly readjusted tax-burdens in a manner detrimental to small producers and traders, has already been discussed by me in an earlier article in the pages of this journal.

The revival of inflation, and that too at a time when world oil prices continue to remain subdued, is again a result inter alia of the new tax regime. This new regime has had a direct effect on inflation arising from an increase in the tax incidence on necessities. This is because the government's effort to achieve "revenue neutrality", i.e. no loss of revenue through the shift to GST, despite having just a few (common) rates across commodities, takes the form of increasing the rates on necessities which have an inelastic demand (and therefore fetch larger tax revenues) while lowering rates on luxuries which have an elastic demand; but the latter whose prices come down as a result have a lower weight in the Consumer Price Index compared to the former (apart from not being the sort of goods the common people consume), so that this adjustment pushes up the inflation rate.

But the new regime has additionally an indirect effect as well upon inflation: since revenue neutrality is not actually being achieved under the GST regime, and the total revenue is actually declining instead, to shore up its revenue the government is resorting to indirect tax-hikes on petro-products (which are outside the ambit of GST); and these are being "passed on" to the consumers through higher inflation.

It is however the last of the three above-mentioned phenomena, namely the sharp widening of the current account deficit of the balance of payments, which needs to be discussed at some length. On Friday the 15th of September the Reserve bank of India came out with the figures for the current account deficit for the April-June quarter of

2017, which showed this deficit to be $ 14.3 billion, or 2.4 percent of the quarterly GDP. This is a huge jump from earlier: the corresponding figure for the April-June quarter of 2016 was a mere 0.1 percent of GDP, and for the preceding quarter itself, i.e. January-March 2017, 0.6 percent of the GDP. In fact the first quarter current account deficit is almost equal in absolute value terms to the deficit for the entire financial year 2016-17, which was $15 billion.

This enormous jump in the current account deficit did not of course pose any immediate problem with regard to its financing. There was a jump in the inflow of Foreign Direct Investment and, even more pronouncedly, of Foreign Portfolio Investment, because of which not only was this deficit easily financed, but India even added $ 11.4 billion to its foreign exchange reserves in this quarter, taking the total of such reserves to over $ 400 billion. But the point to ask is: what does this widening deficit portend for the future?

Most analysts have pointed to two factors as being largely responsible for the jump in the current account deficit. These are: a rise in gold imports in anticipation of the shift to a GST regime which was to occur on July 1; and a drag on exports arising from the uncertainties associated with this shift to GST. They have therefore implicitly underscored the culpability of the BJP government for the widening of the deficit but have suggested that this widening is only a passing phenomenon.

It appears however that the upsurge in gold imports has not abated in the subsequent period after the introduction of the GST. In fact the merchandize trade deficit, which, at a whopping $41.2 billion in the April-June quarter, was the main reason for the widening of the current account deficit, continues to remain wide even in the current quarter; and continuing large-scale gold imports are certainly contributing to it. The merchandise deficit for the month of August for instance is estimated to be $11.6 billion; at this rate the merchandise deficit for the second quarter toowould amount to about $35 billion.

Indeed the total current account deficit for the financial year 2017-18 is likely, according to estimates by various agencies, to be anywhere between $30 to $40 billion, as compared to just $15 billion for 2016-17. The yawning deficit that we find in the first quarter in short is not a mere temporary aberration, but a phenomenon that will characterize at least the current financial year as a whole.

There are two additional factors to consider here. One is the gradual pick-up in world oil prices, which, even though these prices may continue to remain modest in view of the ongoing world capitalist crisis, will certainly worsen India's merchandise deficit, and with it the current account deficit.

The second factor is monetary policy in the U.S. It is generally expected that the Federal Reserve will raise interest rates in the U.S., despite the fact that recovery from the crisis still eludes that economy, because of rentier pressure. Since other advanced capitalist countries too had lowered their interest rates dramatically to zero or near-zero levels in tandem with the U.S., they too would now raise their rates if the U.S. does; the era of cheap money in short is coming to an end.

And once this happens, which may be quite soon, India will find it difficult to finance its current account deficit. Indeed this fact itself can stimulate a flight of capital from

India, as had happened in 2013, which even the large reserves that we currently have will not suffice to stem. (In fact since such reserves could disappear overnight if the government made a futile bid to stem the flight, it may not even dare to use them at all for stemming such a flight).

The conventional view in such a situation is that a depreciation of the currency that would ensue would automatically close the current account deficit, so that if only some temporary finance is arranged through the IMF or other financial institutions to tide over the transitional difficulties, then the economy would overcome the crisis.

But this view is palpably wrong for three reasons: first, in a situation of world crisis and shrinking world demand, an exchange rate depreciation, while it may prevent any further worsening of the current deficit, is unlikely to reduce this deficit itself. Second, an exchange rate depreciation will increase the domestic inflation rate, which, apart from its adverse impact on the poor, will also give rise to expectations of a further exchange rate depreciation (because domestic costs of production would rise as a consequence), and thereby trap the economy in a spiral of inflation and exchange rate depreciation.

And third, several Indian firms are now in a situation where they have borrowed in foreign exchange in the international market. Any fall in the price of the rupee will damage their balance sheets, since their liabilities which are in foreign exchange will increase in value compared to their assets. This would jeopardize their solvency and again cause a spiral of exchange rate depreciation-cum inflation, apart from accentuating the recession. This incidentally is exactly what happened during the East Asian crisis twenty years ago: in South Korea for instance several firms (and banks) had borrowed in foreign exchange to invest domestically and a run on the currency had damaged their solvency.

The question therefore is not whether India's current account deficit will eventually come down or not, when the dust has settled on the introduction of the GST. The real question is : will the era of cheap money in the U.S. and elsewhere come to an end before India's current account deficit has closed somewhat. Even if India's current account deficit closes, an increase in the U.S. rates would still cause a capital flight from countries like India which will put them into great difficulty. But if this happens when India's current account deficit itself is extremely wide, then the problem becomes that much more acute.

When such a fate overtakes a country, the only policy a government can adopt under a neo-liberal dispensation, is a combination of extreme "austerity" and "de-nationalization" in the sense of handing over domestic assets to foreign capital in order to entice it not to leave the country's shores, but rather to come into the country to keep its economy afloat. Such "denationalization" again is what happened in East Asia, and this alas is the kind of fate that awaits us when the Fed raises the rates in the U.S.

The Modi government however, as the proverbial bull in the china shop, is totally oblivious not only of the world economic situation, but even of the consequences of its own actions. And perhaps it does not even care if Indian assets pass into foreign hands. This is to be expected: the political formation to which Modi belongs that did not lift a finger for the freedom of this country from colonial rule, is hardly likely to get much exercised over such “denationalization”. Ironically however they are the ones who call everyone else “anti-national”.

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