The Way Forward for the Economy*

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The Indian economy is currently saddled with a bizarre combination of three distinct problems: there is inflation, almost at a double-digit rate, which has been going on for a long time; in an economy where the bulk of the working population does not have money wages indexed to prices; such inflation extracts a heavy human cost. Secondly there is a significant slowing down of the rate of economic growth, which is accompanied in particular by an absolute industrial stagnation: in fact the year 2013-14 did not witness any absolute increase in the level of industrial output over the previous year. Thirdly, there is a balance of payments crisis that has been temporarily kept at bay because of the continuation of “quantitative easing” by the U.S. Federal Reserve Board (which brings large amounts of dollars to India) and because of controls over gold imports (which in turn have been effective because the easing of pressure on the rupee has somewhat restrained wealth-holders’ rush to gold). At the first sign of a drying up of dollar inflows, however, the pressure on the rupee will resume and the balance of payments will once again become unmanageable, as they had become in August 2013.

The government’s response to this combination of problems, articulated by Finance Minister Arun Jaitley who has become well-tutored by now by the Fund-Bank bureaucrats cramming his ministry, is to reduce the fiscal deficit and provide greater incentives to capitalists, both domestic and foreign. This would effectively mean cutting government expenditure on some of the welfare schemes which the UPA government, against the wishes of Manmohan Singh, Chidambaram and the rest of the neo-liberal crowd, had introduced.

This combination of “austerity” and “incentives” to capitalists, however, is likely to be counterproductive. Since the current inflation is not caused by excess demand relative to available supplies, cutting the fiscal deficit, which works by reducing aggregate demand, will not alleviate inflationary pressures. On the other hand, the reduction in demand will make the industrial stagnation even more acute, which in turn will dampen private investment despite the government offer of “incentives”. And if these “incentives” entail further “liberalization”, of a sort that leads to a substitution of imported for home produced goods, then the core balance of payments problem will only get aggravated. And in any case the vulnerability of the balance of payments to speculators’ behaviour will continue to remain.

Such an approach could conceivably cause some revival of growth, if it initiated a new “bubble”-based boom. But the fact that the stock market is already booming without having any positive impact on the real economy, suggests that even this route will not lead the economy towards overcoming its current problems. Since this combination, of “austerity” and “incentives” for capitalists, essentially means a regressive redistributive policy, the point being made here is that such regression, apart from its human cost, does not even constitute a way forward for overcoming the economy’s current crisis.

In fact the way to resolve the economy’s crisis lies precisely in the opposite direction. Let us take inflation first. The inflation currently affecting the economy is particularly acute for food items, including food grains where the rise in cereal prices (other than wheat) has been quite sharp over the last one year. This rise paradoxically is not because of any reduction in output and an associated dwindling of stocks with the government, as is usually the case; it is for precisely the opposite reason, namely, because the government is holding excessively large food grain stocks. By June 2012, the food grain stocks with the government had reached a whopping 82 million tones, inducing it to export as much as 40 million tones over the two years 2012-13 and 2013-14 (according to the Chairman of the Commission on Agricultural Costs and Prices).

The reason why in a country afflicted with mass hunger that is even more acute at present than in sub-Saharan Africa, food grain stocks are either exported or left to rot in go-downs, being consumed by rats, is simple: the government fears that any distribution of food grain through the public distribution system would push up its fiscal deficit, since the PDS price is much lower than the procurement price plus the costs of transport and storage. Its obsession with reducing the fiscal deficit makes it pursue this bizarre policy of exporting food grains from a hungry nation.

Suppose however that the government does distribute food grains through the PDS by enlarging the fiscal deficit. Even by the most orthodox neo-liberal logic, this cannot possibly accentuate inflation: the funds given to the peasants in lieu of the crops procured from them have already been injected into the economy. Any dis-hoarding of government stocks would add only to the aggregate net availability of goods in the economy and nothing further on the demand side. This cannot possibly worsen inflation.

On the contrary it would have a doubly-salutary effect on the economy. The first is by alleviating hunger. Secondly, any injection of food grains through the PDS, by adding to available supplies, would necessarily lower the weighted average price that a person will pay for his or her total grain intake. This lowering of the average price will increase total purchase and absorption of food grains (which is why hunger will be alleviated). But because the demand for food grain is “inelastic” (i.e. a 10 percent fall in the average food grain price leads to an increase in demand by less than 10 percent), the total amount which the beneficiaries of the lower average price will pay for their higher overall food grain purchase will come down compared to the initial situation (when the government was holding stocks).In short, the dis-hoarding of food grain stocks by the government will both feed people better, and also release purchasing power for spending on other goods.

This purchasing power, it should be noted, will be accruing to the working people, whose demand at the margin is for simple manufactured goods which have high employment intensity but low foreign exchange content. To appreciate the point, suppose that a rupee is given at the margin to a rich person or a capitalist. A part of it will not be spent at all, which would constitute “savings” and create no demand for any goods; and what is spent might be spent, say, on a holiday on the French Riviera, or on a trip to Brazil to watch World Cup soccer, and such other luxuries, which generate very little employment inside India but which entail substantial foreign exchange outgo. By contrast, if a rupee is given to the working poor, then it would, first of all, be almost entirely spent; and spent on locally-produced goods. Hence the foreign exchange outgo on account of such expenditure will be negligible while employment generation will be large. (Some MGNREGS workers in Kerala had disclosed in an interview that they spent their initial wages on buying locally-produced stone grinders for making dosa paste).

The expenditure of purchasing power accruing to the working poor, in short, will generate demand for, and hence call forth supplies of, a range of goods which, without in anyway worsening the balance of payments, will increase employment (and hence have further demand-generating "multiplier" effects). It would not only raise industrial output, but also do so in a manner which increases employment (unlike what recent growth, even during the "high growth" phase, has entailed). At the same time, apart from alleviating mass hunger, it would also bring down the effective rate of inflation by lowering the weighted average price of food grains.

The question may be asked: even if it does all this, surely the government's debt would go up as a consequence of such a policy; and if such a scheme is repeated every year (which is what implementing the food security legislation will imply), then the ratio of government debt to GDP will increase over time. Is this not problematical?

A simple arithmetical answer can be given to this question as follows. Since the increase in fiscal deficit on account of such a scheme (of procuring food grains from peasants and surplus farmers on the one hand, and distributing it to the people through the PDS at low prices on the other), is linked to the magnitude of food grains distributed, its rate of increase too is linked to the rate of increase of food grain production. On the other hand, if industrial growth is stimulated by this scheme, then the growth of government revenue will also be stimulated; the rate of growth of government revenue will be linked to the rate of industrial growth. Since the latter growth will be higher than the former growth, the increase in the ratio of public debt to GDP on account of such a scheme will only be a temporary phenomenon; this ratio will come down after some time.

But a more basic answer is that while we have talked in terms of an increase in the fiscal deficit, there is no reason why a fiscal deficit should be resorted to for financing the distribution of food grains. In fact if taxes on the rich, including an enhanced stock exchange transaction tax, are used for financing such food distribution, then not only would all the beneficial effects mentioned above remain unimpaired, but public debt too will not increase; and the balance of payments may even benefit, in so far as higher taxes on the rich result in reduced expenditure by them, and the import content of this expenditure is large (as argued above). Besides, if larger food distribution to the people is financed not by a fiscal deficit but by larger taxes (on the rich), then there is no obvious excuse for agencies of international finance capital, like Moody's, to "downgrade" India's credit rating, and thereby trigger a capital flight.

To be sure, even with no increase in the fiscal deficit they may still "downgrade" India's credit-rating. And even if they do not, finance capital may still flow out of the country if greater taxation of the rich is resorted to for financing food distribution to the poor. There is therefore no escape from the imposition of capital controls if any such redistributive agenda is followed; but given the nature of India's economic crisis there is no alternative to the pursuit of such a redistributive agenda. Flogging the dying horse of neo-liberalism will take the economy nowhere.

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