The Neo-liberal Paralysis

Subhanil Chowdhury

The Indian economy is currently in a crisis. The growth rate of the Gross Domestic Product (GDP) is projected to be only 5% in the financial year 2013-14, inflation rate as per the Wholesale Price Index (WPI) is above 7%, with that of food being above 9%. In the external sector, the current account deficit (CAD) is at an unprecedented level of 4.6% of GDP. It is in this overall context that the Finance Minister of the country presented the budget on 28th February. Did the budget show any direction in terms of solving the problems plaguing the Indian economy? The article argues that the answer is no, notwithstanding the welcome given to the budget by the neo-liberal economists.

First let us start with a basic identity of economics:

$Y=C+I+G+(X-M)$-------(1)

Where, Y=output

C= Consumption Expenditure

I=Investment Expenditure

G=Government expenditure net of taxes (or crudely the fiscal deficit)

X=Exports

M=Imports

Now, with the ongoing global crisis, the growth of exports have come down, a point which is noted by the Economic Survey, 2012-13. Let us then assume that the export is given for the period. In other words, $X=X^*$. We also know that import is a function of income. In other words, $M=M(Y)$. Therefore, equation (1) can be written as the following:

$M(Y)-X^*=C+I+G-Y$----(2)

Now, the FM in his speech mentions that his biggest worry is with respect to the current account deficit or $(M-X^*)$. This deficit can be bridged if either exports increase or imports are reduced. We have already said that given the global economic crisis there is no scope for the exports to improve. Therefore, in order to reduce the CAD, imports have to be reduced. The issue is how do we reduce the imports? The imports can be reduced by perpetuating a recession in the economy, whereby Y is reduced which leads to a reduction in $M(Y)$ and improvement in the CAD. This route is however not an option for the government because the growth rate of the economy is already very low, hence any further reduction in growth would be unacceptable to the government.

However, there exists the possibility that the government would end up precipitating this very situation through its policy of reduction of the fiscal deficit (G). If G is reduced, then from equation (2) it apparently seems that this would lead to an improvement in CAD. But this may not be the case. With the reduction in G (government investment) the domestic absorption might decline, leading to a reduction in Y. In other words, with the reduction in the fiscal deficit, the growth rate of output might decline further leading to a recessionary situation in the economy.

This recessionary situation on the other hand will not be helpful in terms of reducing the CAD. This is because the main components of the CAD, according the Economic Survey, are oil and gold imports. The demand for oil is inelastic in nature. Therefore, even with fall in output, the import of oil may not decrease fast enough. Secondly, the FM knowing well that the import of gold is happening in the country mainly to satisfy the jewellery and investment demand of the rich did not impose any restrictions on its import. Therefore, there was hardly any attempt by the FM to restrict import in order to improve the CAD situation. This was clearly to satisfy the demands of the rich, which has been a major engine of growth of the economy in the past.

The question that arises from the foregoing discussion is what remedy the FM has in terms of dealing with the problem of CAD? The FM practically has no remedies for the CAD, since increasing the exports is beyond his capacity while he does not want to impose any control in imports, adhering to his belief in trade liberalisation policy. The only worry of the FM in this regard is how to ensure that foreign finance flows into the country, in the form of FDI, FII or External Commercial Borrowing (ECB). In order to woo foreign capital therefore he goes on to enumerate how the Indian financial sector would be more open towards allowing foreign capital into the economy. The Securities Transaction Tax has been reduced drastically, the definition of what constitutes FDI and what constitutes FII has also changed, debt instruments have been allowed to be traded in the stock markets, etc. Additionally, the government had declared much before the budget that sectors like retail, banking, insurance, pensions, civil aviation etc will be opened up for foreign investment.

This inflow of foreign capital is not merely to finance the CAD. The government claims that this inflow of finance will also help in reviving the growth process of the economy. In the years before the 2008 financial crisis, the inflow of foreign capital led to the creation of a domestic bubble in the economy in the various asset markets particularly the stocks and real estate. This bubble helped in the consumption demand of the rich, aided by the debt-financed consumption of the middle class, which became the main engine of growth. With the collapse of the global economy, India no longer remained a major destination for global finance and the domestic bubble collapsed along with the growth rate of the economy. The effort on the part of the establishment in India is to recreate the bubble once again which will solve the problem of growth as well as CAD.

All this invitation for foreign finance is being done in the country, when we are living in a world of globalised finance capital. In order to ensure that global finance remains in the country, it must be given sops and the state has to formulate policies which are to the benefit of finance, instead of the people. Therefore, the first casualty of a policy openly advocating a growth strategy based on foreign finance is the fiscal deficit and more particularly expenditures of the government. It is therefore not surprising that the government slashed expenditure by Rs 60000 crore in 2012-13, compared to the budget estimates presented in the last budget. The reduction in plan expenditure was to the tune of Rs 90000 crore. It is this huge cut in the budgeted expenditure that allowed the FM to peg the fiscal deficit at 5.2% of GDP in the last year. It is however instructive that far from alleviating the growth as well as the CAD position, both worsened in the last year. This fact has been given no importance by the FM as well as the commentators on the budget who are rejoicing at the FM pegging the fiscal deficit at 4.8% of GDP, at a time when growth rate as well as capacity utilisation in the economy has declined. Simple Keynesian economics would have suggested then an increase in public expenditure would have increased the growth in this situation. But an FM committed to neo-liberalism does not possess the theoretical acumen of seeing the obvious.

It is at this point that the commentators, who are either rejoicing or wondering on the FM's decision not to indulge in 'populism' even in an election year, are horribly wrong. The Indian economy has been running on a high growth path by strongly adhering to a neo-liberal growth trajectory. The last UPA government rode that high growth path and provided some relief in the form of NREGA etc to the people. However, after the crisis, this space has been reduced. With the reduction in the growth rate of the economy, the government has become totally obsessed with enticing foreign finance. It was easy during the last UPA government to both entice foreign finance and go for some pro-people policies, since the world economy as a whole was buoyant and finance was moving into the economy. However, such enticement of foreign finance in the current conjuncture cannot come simultaneously with pro-people policies because of the following. With the global crisis, finance is under tremendous stress even in the advanced capitalist countries. In this situation, to entice finance into a developing country like India, it becomes mandatory to put a leash on public expenditure, welfare expenditure etc to satisfy finance. This commitment to neo-liberalism and enticement of global finance capital creates a barrier towards undertaking any policy aimed at ameliorating the current condition of the Indian economy.

This becomes all the more evident if we delve into the issue of inflation. As has been already pointed out, inflation rate in India is very high. The Economic Survey points out that one of the reasons behind such high inflation rate, particularly food grains, has been supply bottlenecks. What is however absent from the analysis of both the Economic Survey as well as the Budget is the increase in input costs of cultivation. With the withdrawal of fertiliser subsidies and other input subsidies including diesel, the cost of cultivation has gone up. This has resulted in an increase in food prices. In cases where the farmers have not been able to increase their prices they have left cultivation or committed suicide due to debt burden or living in utter misery. This withdrawal of subsidies is again a direct result of the neo-liberal policies pursued by the government. On the other hand, in such an inflationary pressure on the economy, the government has further decontrolled petroleum products and plans to dismantle the Public Distribution System replacing it with the controversial Cash Transfer Scheme. All these measures are only going to increase the inflationary pressure on the economy. Such inflationary pressures can only get mitigated if the demand of a section of the population is squeezed. The unemployed, unorganised workers or the landless or small peasants are the buffers which dampen the inflationary pressure through a further squeeze on their demand. It is interesting to note that the growth rate of consumption of food and beverages, clothing, furniture etc have gone down in 2012-13 along with the growth rate of overall private consumption. However, the growth rate of consumption of miscellaneous goods and services has witnessed a sharp increase. These miscellaneous goods and services consists of items of personal care, miscellaneous services etc which are mainly consumed by the rich. In other words, the reduction in consumption demand has been mainly led by a reduction in the demand of essential items consumed by the masses while the consumption of items of rich has increased. In other words, the adjustment in demand due to the inflationary pressure has been mainly by the common people.

It is also interesting to note that the Economic Survey blames the Reserve Bank of India (RBI) for reducing the growth rate of GDP through its policy of tight monetary policy to combat inflation. The tragedy however is that the RBI's policies have been basically unsuccessful in lowering the rate of inflation while the growth rate of GDP was reduced because of the bursting of the Indian bubble. The failure of the Economic Survey as well as the RBI to pinpoint the causes of the problems of the Indian economy is again because of their commitment to neo-liberalism. On the one hand, the RBI was trying to control cost-push inflation through interest rate adjustments, while the Economic Survey is stuck in its orthodox economic theorising failing to pinpoint and address the real problems plaguing the Indian economy.

Notwithstanding the above discussion the question is whether the Indian economy can reach a high growth path through the policies announced in the budget. There exist sufficient grounds for doubting any dramatic revival of the growth rate, as envisaged by the FM. Firstly, it is not clear as to why the growth rate should improve while there has been no significant announcement of the FM aimed at boosting growth apart from wooing foreign capital. On top of that, he has announced a reduction in the fiscal deficit with increase in tax revenue collection which is highly suspect. What may happen is that he will resort to cutting back on expenditures as he has done this year to tame the deficit. Moreover, last year, even the revenue mobilisation fell short of target, which might be repeated this year too. Secondly, the announcements of the government in terms of building infrastructure is not matched by adequate financial commitments apart from allowing foreign investors to buy infrastructure bonds or announcing some more sops to facilitate financing of infrastructure. Here again, there is a singular absence of any effort by the government to step up infrastructure building. Lastly, the global economic scenario continues to be bleak and can further turn negative jeopardising the growth of the Indian economy.

It is not the case that alternative policies do not exist. The obvious alternative policy would be to step up public investment financed by a higher tax on the rich, putting into place capital and trade controls, massive investments in agriculture etc. However, all these policies are anathema to finance capital. As long as India is stuck into the policy framework of neo-liberalism, it has to remain in the policy paralysis of banking on speculation through finance capital to produce another bubble. The consequences are bleak on both sides—if indeed the bubble gets generated, it will undoubtedly lead to a financial crisis in the future and hardships for the poor of the country when the bubble is produced; if the bubble is not produced, then Indian growth story will come to an end. The neo-liberal paralysis is the inability of the policy makers to break free from such an eventuality. The only way to do so is to move away from neo-liberal policies and adopt policies aimed at benefiting the people and not finance.

* This article was also published in Pragoti, March 6, 2013.