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PERENNIAL CRISIS

FAKE CONCERN REGARDING INFLATION

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WHILE THOSE OPPOSING the interest rate hikes are thus merely pressing their private interests, equally dubious are the claims of those who call for interest rate hikes in order to curb inflation. They firmly ignore cost-push causes of price rise (when the price of an important good such as foodgrains or oil rises sharply, and causes the prices of other goods to rise), and insist that excess demand ('demand-pull') is the cause. For example, even as the RBI hikes interest rates in order to curb inflation, it calls on the Government to hike domestic prices of petroleum products. The RBI, the Chief Economic Adviser (Kaushik Basu), and the Prime Minister's Economic Advisory Council (PMEAC) all argue that not hiking petroleum products prices would mean a higher fiscal deficit (i.e., Government borrowing)—and that would add to excess demand, and thus result in higher inflation. In other words, so firmly and religiously do these gentlemen advance their theory of excess demand, that they are willing to directly bring about cost-push inflation (by raising petroleum prices) in order to avoid the indirect (and imaginary) threat of demand-pull inflation! The latest increases in the prices of petroleum products have thus given overall prices another boost when people have been reeling under relentless price rise.

In fact, of course, there is no need to either incur a higher fiscal deficit or hike petroleum products prices. The Government made much of the fact that, along with the price hike, it reduced some of the indirect taxation on petroleum products, thus reducing the extent of the latest hike. All it needs to do in order to avoid any hike in petroleum prices is to further reduce, or eliminate, these giant taxes. The contribution of the petroleum to the central exchequer rose from Rs 112,000 crore in 2009-10 to Rs 136,000 crore in 2010-11; state government taxes were an additional Rs 72,000 crore and Rs 80,000 crore, respectively. In order to make up the revenue it would lose by such a reduction, the Government could simply hike direct taxes on the corporate sector and the rich, or hike indirect taxes on luxury commodities (additional taxes on automobiles and their use would also help to curb the waste of petroleum). That, however, would go against the class interests the rulers represent and so is ruled out.

Why do people find that the rulers' only response to inflation today is a hike in interest rates? It has little to do with the causes of inflation in recent years. The fact is that, as a result of the post-1991 liberalisation, privatisation and globali-sation policies, the crisis of Indian agriculture has deepened. At the same time, speculative forces have been strengthened by these very policies: regulations on movement and storage have been eased, State agencies' intervention in agricultural markets has been withdrawn, commodity futures markets have been set up to host speculation, and finance has been made easily available for speculators. As a result, any period of sustained growth tends to trigger inflation. Moreover, the greater integration of the Indian economy with the world economy means that speculative surges on international commodity markets send signals to speculators here, too.

Under a pro-people order, inflation could be curbed by direct State intervention to boost agricultural investment and production, suppress speculation, expand public procurement and distribution, ration scarce essentials (especially if these are imported), reduce the burden of taxation on petroleum imports, and insulate the domestic economy from global swings. However, the present dispensation and reigning policies rule out such State interventions. As a result, the only instrument left with the rulers to address inflation is to raise interest rates in order to curb growth and depress demand. If this does succeed in bringing prices under control, it would do so in the most painful way possible, by reducing employment and wages, and thus demand; but in fact it may not be successful in doing so, as people have seen over the past 15 months, several interest rate hikes with little effect on prices.

CONTRADICTION

The dispute between the anti-inflation and pro-growth camps—the former calling for more interest rate hikes, the latter for a halt or reversal—relates to the differing interests of the industrial and trading sectors on the one hand, and the financial sector on the other. Industry and trade are generally opposed to interest rate hikes. Demand for industrial products gets depressed when credit gets dear or scarce, and the interest costs of industry and trade too rise, eating into profits; whereas large industry and trade are generally not troubled by inflation—in general, they can pass on the hiked prices of inputs and protect most of their profit margin. In fact, they even gain a windfall from price rise: they hike the prices of their products as soon as input costs rise, but wages do not rise to the same extent, or do so only with a lag. In such a case the firm's revenues would rise faster than its costs, resulting in higher profits.

The contrary is the case for financial interests: since financial assets are denominated in, say, rupees, when the real value of the rupee falls with inflation, so does the value of financial assets. Hence holders of financial assets abhor inflation. For obvious reasons, they promote deflationary policies, which will lead to the value of financial assets rising. If the Indian government were to disobey the dictates of foreign financial investors, and decline to raise interest rates today, foreign investors would start taking their money out of the country, triggering a crisis. Hence the interest rate hikes are in particular a sign of the increasing domination of foreign finance over India's economy.

It should be noted that even if the economy is sent into recession as a result of deflationary measures, financial interests stand to make certain other gains: In a recession, financial investors, particularly foreign financial investors, are able to buy up physical assets - land, factories, mines, and physical infrastructure - at rock-bottom prices. Thus the deflationary IMF packages imposed on East and Southeast Asia after the 1997-98 crisis handed US and other foreign investors a bonanza, as they took over firms and other assets throughout the region.

However, the interests of the two camps cannot be entirely demarcated. After all, financial investors stand to gain when industrial/commercial firms make big profits: dividends flow and share prices rise, firms engage merchant banks for share issues, mergers/ acquisitions, and raising debt. The same holds for the other side: most big industrial/commercial groups now also have their fingers in the financial pie, owning financial firms and placing their idle cash in the share market whenever possible. The rulers, in balancing the two sets of interests, adhere to the broad directions of financial interests in monetary and fiscal policy, even at the cost of triggering a slowdown, but compensate large industrial and commercial interests by carving out special profit-making opportunities, subsidies and outright gifts to them. □□□

[Source : *Aspects of India's Economy*, No. 50]