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SETTING FINANCIAL TONES

Economy and its Many Travails

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DESPIET ITS SPIN, THE economic Survey presented to the Parliament, presents a picture that is far from rosy. The growth rate has hit a new low of 6.9 percent, one of the lowest since 2004. As the Economic Survey tells us, this decline in growth rate is due to slow down in the two "real' sectors of the economy, namely agriculture and industry. The growth rate in agriculture has fallen to 2.5 percent in the current year from 7 percent in 2010-11. While this growth for agriculture may be considered satisfactory or even good (coming as it does after a year of 7 percent growth), the rate of growth in industry and manufacturing has been very disappointing. The manufacturing sector grew by only 3.9 percent compared to 9.7 percent in 2009-10 and 7.6 percent in 2010-11; what is worse the mining sector shows a contraction of 2.2 percent (negative growth).

This poor performance of the economy has to be seen in light of the other growing imbalances in the economy. The two most important of these are the rising fiscal deficit of the Central government and an unprecedented current account deficit. The government's last budget (2011-12) had promised to reduce the budget (fiscal) deficit to 4.8 percent of the GDP, though the actual deficit is likely to be more than 6 percent of GDP. The rising government expenditure has also raised the total demand in the Indian economy. This seems to be one of the factors that have fanned inflationary expectations in the economy (along with depreciating rupee and rising global prices of basic commodities). Prices have been rising at double digit even with bumper crop and easy imports.

The buoyant demand conditions have also resulted in an unprecedented foreign trade (merchandise) deficit which in the first 10 months of the current year (April-Jan 2011-12) touched an all time high of US $ 150 billion, equal to 10 percent of India's GDP. The current account deficit (after taking into account large remittances by Indian workers abroad) was also the largest since 1991 and is running at an all time high of 3.8 percent of GDP. To understand the risks with this level, let us recall that in 1991, with a lower current account deficit (only 2.8 percent of GDP) India had to mortgage its gold and prostrate itself before the IMF.

This time, the Indian government has been spared the ignominy of bending before the IMF, because it has long ago embraced the ignominy of prostrating before global finance capital. Policies to make India an attractive destination for global investors—an essential condition for running these large current account deficits, since they are financed by private capital inflows—has meant that all economic policies will subject to their approval. If they think that no taxes be levied on their profits, then so be it. If they want retail trade to be open to foreign chains where they are major investors, then the country should ignore the cry from small retailers. These investors constantly demand opening of new sectors—in the name of reforms—to invest and buy up. Or else, they threaten to walk out.

India's ability to finance its increasing current account deficit (gap between foreign currency earnings and expenditure in current year) has also been helped by the huge liquidity sloshing around the world economy. With interest rates close to zero in western countries (to stimulate and promote growth and investment as their economies stagnate); large funds can be attracted to India if government continuously opens up new sectors for them to invest. This is where the contradiction with local petty producers and domestic small capital becomes sharp. Foreign investors are keen to capture sectors and "modernize them' with technology and capital and extend the sway of capital over producers and workers, while local producers struggling to make a living resist. This is being played out on our television screens as fight before reformers and conservatives (sic).

But there are obvious dangers in this game of brinkmanship. There is a crisis in Greece (as Greek working class resists costs imposed on it by global finance capital) and in panic finance capital begins to run out of India. That is how during the last year there have been three "episodes' of so called capital flight when foreign investors panicked and pulled out their money from Indian stock markets. Each time this pushed the value of rupee to a new low. Though low value of rupee may be good for Indian exporters, the depreciating rupee also imposes costs on the working class. As India imports all its energy, and the poor use kerosene to cook their food, and also increasingly depend on imported edible oils and pulses, depreciating rupee raises their cost of living. Also, given that import intensities have increased particularly in intermediates, a depreciating rupee also causes the cost of manufactured goods to rise.

The large foreign inflows have also to be seen against the light of declining investment in the economy. As Reserve Bank has raised interest rates to check inflation, private sector has cut back on new investment, while the government with empty coffers too has been forced to scale back investment in infrastructure. Thus railways have shown a negative capital formation during last year, implying that the new investment is not even equal to the depreciation of fixed assets. So what really are these foreign capital inflows financing? A look at the structure of demand and sectoral growth shows that consumer durables have been an important driver of even this decrepit industrial growth, with large import content in what is manufactured even within India.

This ballooning current account deficit and India's precarious dependence on foreign inflows not only threatens economic and social stability, it undermines economic independence and sovereignty as well. Greater the sway of international finance capital on a country, the more vulnerable and fragile its sovereignty and greater foreigners hegemony and control.

Part of the blame must undoubtedly be laid at the door of government finances, as the central governments' fiscal deficit balloons and it increasingly resorts to borrowing. What is the reason for this ballooning deficit? Why has the government failed to manage its finances and lower the deficit as promised in the last budget?

If the pink press (business newspapers) is to be believed, then the government has been irresponsible in its subsidies and in financing social programmes like NREGA. Representatives of the mutual funds and Foreign Institutional Investors (FII) were all over the TV channels, warning the Finance minister to stay away from adding to such social expenditure . Do not go ahead with the Food Security Scheme they warned, as it will worsen your deficit. And union finance minister listened. He not only did not provide a paise for food security bill, he even cut the allocation for NREGA.

But a close look at the government's income and expenditure shows a picture that is far from what the pink press has been telling the nation. As Table shows, since 2007-08, government has abdicated its responsibility to collect taxes from the rich. As the global financial crisis set in, and Indian private capital faced shrinking global demand, government set about tax concessions, both in direct and indirect taxes. Simultaneously it raised its own expenditure on infrastructure to boost demand. Some of this expenditure was dictated by clear private lobbies. Thus when the commercial vehicle industry—controlled entirely by Tatas and Hindujas—faced rising inventories, central government diverted resources under Nehru Urban Renewal Mission to state road corporations to buy buses and bail out the industry. Such examples can be multiplied.

As the table shows, central government's revenue receipts have fallen by full two percent of GDP. The revised estimates are even worse than shown in the table above (for 2011-12 it shows the budget estimates and not the actuals which are yet to come). The Central government has already hinted that its corporate tax and excise actual are likely to be lower than the last year's budget estimate by more than Rs 80,000 crore. Net of states share, central tax revenue has fallen from about 9 percent of GDP to 7 percent, while non-tax revenue has fallen by more than 0.6 percent of GDP. This decline is seen in both the direct and indirect taxes.

The table also busts the myth that the government's fiscal crisis is due to subsidies as the business press argues. The subsidies as share of GDP have similarly been declining. What is even more significant is that the quantum of subsidies, including those on food, fertilizer and kerosene etc. too have fallen. Nor has interest or defense expenditure played any mischief. Overall too government's revenue expenditure as percent of GDP as hovered around 13 percent (lower than 14 percent in 2007-08), showing that there is no increasing trend.

Hence to genesis of the crisis facing the country and the government lies within realm of political economy. The rich who have gained most from the process of liberalization, and been pampered by numerous tax holidays and special zones, have managed to use the charade of global financial crisis to extract more concessions from the state. Today when the freebies are not there they are unwilling to invest. Their share of taxes has fallen in the name of boosting demand. The government's own capacity to invest is held hostage to falling tax revenues and the FRBM—the deity of finance capital. With nobody else to blame they fall back on the poor—squeezing their real income that have been eroded by rising prices and increasing indirect taxes and taking away the few crumbs they have won through subsidies and job guarantee schemes.