Indian elite hamstrung as the economy falters

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The prospects for India's economy have deteriorated dramatically in recent months, forcing the government to slash its growth projection for the current fiscal year to 6 percent, far below its long-term target of 9 percent per annum growth.

Many economic analysts believe even the 6 percent projection highly optimistic. Moody's Analytics, for example, recently pegged India's economy to grow just 5.5 percent.

Adding to the prospects of tepid growth are the latest figures for industrial output and exports. In June industrial output was 1.8 percent less than in the same month in 2012 and in July exports were down 14.8 percent on a year-to-year basis. The decline in exports— they had already fallen by 5 percent in the April-June quarter—is primarily due to falling demand for Indian manufactured goods and IT services in the U.S. and Europe, India's most important overseas markets.

Other economic indicators also point to mounting crisis. Inflation remains stubbornly in double digits, because of the combined impact of a shortage of goods, high energy prices, and a steep decline in the exchange value of the Indian rupee against the US dollar.

Citing the deteriorating growth prospects and the government's failure to meet its targets for reducing the government budget deficit to GNP ratio, the Fitch credit rating agency recently announced that there is more than a 50 percent chance that it will slash India's sovereign credit rating to junk status within the next 12 to 24 months.

Amidst this gloomy outlook, the Indian elite finds itself in a state of policy paralysis largely because of India's crippling economic weakness. The government has neither been able to lower interest rates, currently among the highest in Asia, to promote borrowing and economic activity, nor can it stimulate the economy by increased government spending.

Manufacturers have been pressing for some time for the government to lower interests rates, but the Central Bank has resisted this pressure, fearing it would exacerbate the recent steep fall in the value of the rupee against the US dollar, further stoking inflation, and possibly provoking large-scale capital flight.

Keynesian fiscal stimulus measures are also out of the question as the government is already running a huge fiscal deficit. The budget deficit for the 2011-12 fiscal year, which ended in March 2012, climbed to 5.8 percent of Gross Domestic Product (GDP) against a target of 4.6 percent.

Even were the deficit not rising, the funds at the disposal of the Indian government hardly allow it to deliver much fiscal stimulus. The Finance Ministry is predicting total tax revenue for the 2012-13 fiscal year of just $175 billion.

Reflecting the helplessness of the Indian elite, the Reserve Bank of India (RBI) late last month decided to leave its repo rate—the interest rate at which domestic banks borrow from the RBI— unchanged at the high rate of 8 percent.

As noted earlier, the value of the rupee has declined sharply over the past year. It has fallen to a record low of around Rupees (Rs.) 56 to a U.S. dollar, after having traded within a relative narrow range of around Rs. 44-46 per dollar for the past decade.

This fall has been fuelled by declines in both longer-term FDI (Foreign Direct Investment) and the shorter term and more volatile FII (Foreign Institutional Investment), which goes mainly into stocks, bonds and other financial securities.

Complaining of poor infrastructure and the government's failure to overcome opposition to further pro-investor reforms—particularly opening up the retail sector to giant multi-brand retailers like Walmart and gutting labour laws to make it easier to lay off workers and close factories—foreign investors have soured on India. This change in sentiment was typified in an *Economist* cover-story last March titled "India's economy losing its magic."

The recent massive power failures that on successive days paralyzed areas of India that are home to 300 and 700 million people respectively was a further major blow to India's attempts to drum up foreign investment, highlighting as they did the antiquated and dilapidated character of Indian infrastructure.

Adding to the economic woes is a severe shortfall in rainfall during the current South-West Monsoon season that began in June. Monsoon rains irrigate at least 55 percent of India's farmlands and in some parts of India the dependence on the monsoon is nearly total. According to official figures the monsoon this year is 20 percent deficient and this is sure to bring down agricultural output, further fuelling inflation.

Inflation at the consumer level has remained in double digits over the past several years with the official figures showing a slight improvement to a 10.02 percent annual rate in June 2012 as compared with 10.36 percent in May. Even these figures understate the problem and this in a country where hundreds of millions of people are already malnourished. Food price inflation is significantly higher than the general rate. Vegetable prices have shot up by an annual rate of 28 percent, milk and milk products by 12.75 percent, and oils and fats by almost 17 percent.

Serious as is India's economic predicament—Moody's Analytics has declared India to be mired in "stagflation"—there is increasing concern it could get substantially worse.

The RBI governor himself addressed this possibility earlier this year, when he denied that contemporary current economic conditions were comparable to those in 1991 when India had to obtain emergency IMF support and abandon state-led economic growth in favor of full integration into the world capitalist market.

The decline in foreign exports, a crucial source of foreign currency, is exacerbating the current account deficit (the difference between the country's total exports and imports including monetary transactions).

And the tanking of the rupee has panicked the Indian big business, which now has a total loan exposure of about $220 billion to foreign banks and financial institutions. Since much of the borrowing occurred when the Indian currency was trading at about Rs. 45 to the dollar, the fall in the value of the rupee has effectively boosted the amount borrowed in rupee terms by about 20 percent.

Two years ago, India's ruling elite was boasting that India had weathered the economic storm unleashed by the 2008 financial crisis. But subsequent events have strikingly revealed the inherent weakness of the Indian economy, with its structural dependence upon foreign currency flows to finance its huge oil imports and current account deficit, and upon U.S. and European markets for its exports.

In response to the avalanche of gloomy economic news, the corporate media, business lobby groups, and domestic and foreign financial analysts have united in piling pressure on the Indian government to accelerate "economic reforms", that is to provide further tax cuts and other sops to private investors while gutting whatever remains of the abysmal social programs that maintain some 800 million Indian workers and peasants in desperate poverty.

On July 17, U.S. President Obama lambasted the Indian elite for what he termed as the deteriorating climate for investment in India and urged another wave of reforms. Obama was speaking as the supreme spokesperson of U.S. big business and on their behalf he complained that, "[I]t is still too hard to invest in India. In too many sectors, such as retail, India limits or prohibits the foreign investment that is necessary to create jobs in both our countries, and which is necessary for India to continue to grow."

Obama then claimed that "there appears to be a growing consensus in India that the time may be right for another wave of economic reforms to make the country more competitive in the global economy."

The Congress Party-led UPA government is no less enthusiastic than Obama and the world financial elite about implementing pro-big business economic reforms.

But since the Congress Party does not command a majority in the parliament, it is compelled to seek a political consensus with its coalition partners, many of them smaller parties which fear being punished at the polls under conditions of mounting popular anger over rising prices, chronic poverty, and deepening social inequality. The political constraints on the Congress Party-led government are dismissed as dithering by the representatives of domestic and international capital, for whom no time is to be lost in imposing the burden of the global economic crisis on the working class and rural toilers.

In his Independence Day address Wednesday, Prime Minister Manmohan Singh was at pains to reassure international big business that his government will heed their demands. "To attract foreign capital, we will have to create confidence at the international level that there are no barriers to investment in India," he declared. At the same time, he urged his elite political opponents to stop frustrating his government's policy initiatives, affirming that "issues which affect our development process" should be viewed "as matters of national security."