Indian ruling elite in economic bind

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In the run-up to next Monday's budget speech, longstanding tensions between India's hard-right Bharatiya Janata Party-led government and the country's central bank, the Reserve Bank of India (RBI), over how to revive India's flagging economy have intensified.

Prime Minister Narendra Modi routinely boasts that India's 7 percent-plus annual growth rate is the highest of any of the world's large economies. But his claims that India is on a high-growth trajectory are belied by numerous key economic indicators, causing many economists and even RBI head Rahuram Rajan to question the veracity of the growth numbers.

Figures relating to capital investment, exports, industrial production, agricultural output, and bank profits all paint a picture of an economy that is severely stagnating or in decline.

India's merchandise exports have, for example, fallen for 14 months in a row. During the first 10 months of the current 2015-16 financial year, which commenced April 1, 2015, India's total exports suffered a precipitous decline, falling to $218 billion from $264 billion for the same period in 2014-15.

That the real situation differs sharply from the government hype about a resurgent India is also demonstrated by the clamour from big business, especially manufacturers, for both monetary and fiscal stimulus.

The BJP government has itself been pressing for the RBI to lower interest rates to stimulate growth. Moreover, in recent weeks, Finance Minister Arun Jaitley has strongly hinted that the government will exceed its deficit target of 3.5 percent of GDP for the 2016-17 fiscal year, so as to boost public sector investment in transport, power generation, and other infrastructure projects. "When you fight a global slowdown, public investment has to lead the way," declared Jaitley last month.

This has further strained relations with Rajan, a former senior IMF official, and the RBI.

Rajan's fear is that a low interest rate policy and/or a "pause" in the government's "fiscal consolidation" program could provoke capital flight, causing the rupee to tank. This would in turn drive up the real interest rates on Indian corporations' large dollar-denominated debt, threatening the viability of many of India's major business houses, and thereby further imperilling India's troubled banking system. The possibility that such a scenario could become reality was demonstrated in 2013, when the rupee rapidly depreciated in response to signals from the US Federal Reserve Board that it might soon end quantitative easing and raise interest rates.

The rupee has already come under heavy pressure in recent months, due to major capital outflows and heavy domestic demand for dollars from banks and businesses. It is currently trading at more than 68 rupees to the dollar, very close to the all-time low of 68.85 set in August 2013.

India's business houses are, for their part, desperate for quick growth so that they can reduce debt and shore up their balance sheets. So severe is their debt load, many are already technically in default. As a result, 14 percent of the assets of India's public banks were deemed "stressed" in September, up from 6 percent in 2011.

According to press reports, Rajan has sent a "clear-message" to the BJP government that it shouldn't look to the RBI to provide economic stimulus through lower interest rates. Rather, it should concentrate on getting its "math right" in the upcoming budget, i.e., on meeting or at least not deviating significantly from its original deficit target of 3.5 percent of GDP.

After its first bimonthly monetary policy meeting of the year in early February, the RBI released a statement that tied any further cuts in interest rates to a budget that delivered further pro-investor reforms, while continuing to cut social spending. "Structural reforms in the forthcoming union budget that boost growth while controlling spending," declared the RBI, "will create more space for monetary policy to support growth."

The RBI did not stipulate the requisite "structural reforms." But domestic and international capital have formulated a long list of "big bang" neo-liberal measures, including the shifting of more of the tax burden onto working people through a regressive national goods and services tax, further privatizations, the gutting of labour law restrictions on plant closures and mass layoffs, and probusiness amendments to the 2013 Land Acquisition Act.

Rajan has previously urged the dismantling of regulatory and policy barriers to the entry of speculative capital, including eventually opening up the government bond market. Prior to becoming RBI governor, he also urged the removal of all interest-rate ceilings, claiming that this would make bank lending “more efficient.”

The RBI’s early February statement also noted that despite it having reduced its base lending rate, the “RBI repo-rate,” by 1.25 percent over the past 13 months, the banks have refused to pass the reductions on to borrowers. This is because the banks, already heavily burdened by bad loans, are anxious to increase their profit margins on new loans so as to make up for the losses from the non-performing loans already on their books.

Shortly before the RBI’s early February meeting, Rajan delivered a lecture in New Delhi where he warned the government against taking on more debt to kick-start growth through increased government investment in infrastructure. He cited the example of Brazil, which is mired in economic slump, after artificially boosting its growth through massive debt-financing over the past decade.

“Brazil’s experience suggests,” said Rajan, “the enormous costs of becoming an unstable country far outweigh any small growth benefits that can be obtained through aggressive policies. We should be very careful about jeopardizing our single most important strength during this period of global turmoil, macroeconomic stability.”

International capital is largely supportive of Rajan’s stance. Moody’s, in a statement issued this week, said that even if the government sticks to its deficit reduction plan, “India’s fiscal metrics will remain weaker than rating peers in the near term, because of the relatively high level of India’s state and Central government deficits and debt.”

While the RBI and international capital are pressuring the government not to go deeper into debt to boost capital spending, the major domestic business lobby groups, including the Confederation of Indian Industries or CII are.

Said CII Director General Chandrajit Banerjee, “Considering that broad-based revival of private investment is being constrained on account of a weak order book situation, resulting in capacity overhang, there are hopes and expectations that the budget (will) increase spending by the government, public sector and by quasi-government bodies.”

Capital investments by Indian businesses, including government-owned Public Sector Units, have declined precipitously since the 2011-12 financial year, and are now some 60 percent below the level of five years ago; falling from US$73 billion (Rs. 3.7 trillion) in 2011-12 to US$58.7 billion (Rs. 3.1 trillion) in 2012-13, US$45.7 billion (Rs. 2.7 trillion) in 2013-14 and just $30 billion (Rs 1.9 trillion billion) in the 2014-15 financial year. According to all projections, the fiscal year ending this April 1 will see yet another capital spending decline.

T here are also mounting political pressures on Modi and his BJP, which won election 21 months ago by promising to deliver high growth and jobs to India’s tens of millions of unemployed and underemployed, to t a ke measures to stimulate the economy. (See: “India: Mounting death toll as army deployed to end caste-based job agitation”)

The government’s room to do so, however, is constrained by a multiplicity of other factors. These include: the need to inject money into India’s banks to shore up their balance sheets; the government’s commitment to vast new military expenditures, in keeping with the Indian bourgeoisie’s ambition to be a major player in world geopolitics, especially in the Indian Ocean; and the recent recommendation of the decennial Pay Commission to raise central government workers’ wages and allowances (benefits) by more than 20 percent.

Assocham, one of the country’s major business lobby groups, has already urged the government to take the virtually unprecedented step of trashing the recommendations of its own Pay Commission, so as to funnel money via infrastructure projects to corporate India. Denouncing the Pay Commission report as economically unsupportable and a trigger for a private sector “wage spiral,” Assocham Secretary-General D.S. Rawat echoed the aforementioned plea of the CII director for the government to bail out big business. “Economic revival,” said Rawat, is contingent upon (capital) investment which should be spearheaded by the public finance given the fact that the private sector is reeling under a heavy leverage (i.e. large debts and poor balance sheets).”

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