The Government-RBI stand-off

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The stand-off between the Modi government and the Reserve Bank of India has generated a false discourse on the one hand and an illusion on the other. In this discourse the RBI's position, articulated by its Deputy Governor, is that central bank policy has to be guided by financial markets rather than by a government headed by politicians with electoral compulsions and "populist" agendas. This is obviously an undemocratic position, for it amounts to saying that crucial decisions affecting people's lives should be outside their sphere of intervention through the electoral process.

It is also a dangerous position, since financial markets are dominated by speculators. As Keynes had pointed out, not only are markets incapable of distinguishing between enterprise and speculation, but speculators, far from being "bubbles on a steady stream of enterprise" create instead a "whirlpool" upon which enterprise itself becomes a mere bubble. The livelihood of over a trillion people cannot be made "a by-product of the activities of a casino".

As against this RBI position we have the government's position that is equally questionable, which wishes to make the RBI into a virtual government department. To be sure, since the RBI is meant to serve society, its activities must be socially controlled. But the government's position makes government control synonymous with social control. This would not matter if the government itself was socially accountable, through for instance being subject to parliamentary oversight; in that case there would be some restraint on its using its control over the central bank for furthering the interests of its crony capitalists. But, as we know, the government is refusing to divulge the contents of Raghuram Rajan's note on major bank defaulters even to the Estimates Committee of the parliament, just as it is refusing to divulge the pricing formula on the Rafael deal even to the Supreme Court. Both refusals suggest attempts to hide bonanzas made available to crony capitalists. Government control over the RBI in such circumstances would amount to an undermining of the institution.

Sadly, the current discourse around government-RBI relations suggests as if the choice is only between these two conceptions, one where the "market" determines RBI policy, and the other where the government, in cahoots with crony capitalists, determines RBI policy. This discourse in short rules out any possibility of democratic control over the RBI: the only choice according to it is between control by global speculators and control by the government's crony capitalists.

But even if we get out of this false discourse, and institute democratic control over the RBI, its policy choice, within the present neo-liberal economic regime, would still be, as it were, between "plague" and "cholera". Lowering the interest rate and expanding liquidity in the economy, apart from the moral hazard problem it would create in the context of loan non-repayment to banks, would almost certainly be unacceptable to global finance. This would reduce financial inflow, accentuate the fall of the rupee, and thereby both accelerate inflation and increase the financial strain on companies that have borrowed from the international market. On the other hand maintaining the current monetary stance favoured by the RBI threatens a liquidity crisis for the economy, resulting in enterprise closures and a reduced level of economic activity with consequent unemployment.

The root of the problem lies in the structure of the neo-liberal regime itself, and to believe that it is only a matter of choosing the right policy within it is an illusion. Within this regime there are simply too few policy instruments to achieve the number of objectives we have. With fiscal deficit targets fixed firmly; with taxes on capitalists, or the rich generally, for financing larger government expenditure eschewed, to avoid driving away globalized finance; and with spending financed by indirect taxes, which largely impinge on the poor, incapable of generating any net expansion in aggregate demand; fiscal policy becomes virtually irrelevant for stimulating larger activity. Likewise tariff policy or quantitative restrictions get ruled out within the neo-liberal trade regime for managing the balance of payments. Exchange rate policy in any case takes too long to work and can create great instability in the interim, not to mention its cost-push inflationary consequences. In effect therefore interest rate policy becomes the only instrument for achieving larger activity (via influencing the cost and availability of credit), and also a manageable balance of payments (via attracting or at least not repelling financial flows). But it is impossible to use one instrument to achieve two objectives simultaneously.

The number of instruments, as the renowned Dutch economist Jan Tinbergen had shown, must be no less than the number of objectives. But the opposite is the case under a neo-liberal regime. This fact does not matter when finance is flowing into the economy, as was the case in India earlier, for then one objective, namely balance of payments stability, is automatically achieved, leaving some elbow room for lowering the interest rate to stimulate activity. But when finance stops flowing in, and instead starts flowing out, then the impossibility of making one instrument achieve multiple objectives, manifests itself.

Hence even if the government and the RBI were noble to the core, and there was no question of any cronyism on one side and subservience to international finance capital on the other, there would still be a conflict between the two because of this contradiction within a neo-liberal regime. What we are thus witnessing is neo-liberal chickens coming home to roost: both the objective fact of the economy coming to a sorry pass and the tussle over what to do about it, are reflections of this, though of course the BJP government's ham-handedness in economic matters compounds the problem.

What is required is adopting direct measures, such as import controls (to restrain the payments deficit), price controls (to tackle inflation), wealth taxation (to enable larger government expenditure), and restrictions on capital outflows (to prevent any ensuing financial crisis), to cope with the economy's travails. But these would mean stepping out of the neo-liberal regime.