“The will of the people is not adequately reflected in macroeconomic choices made by Indian governments” – Jayati Ghosh

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The debate over the state and future of the Indian economy has been rife over the last couple of years but increasingly there is a sense that the time to determine the course of its future is now or never. The current government was arguably elected on the mandate of economic reforms and development but the two most decisive steps have been taken by the Reserve Bank of India, led by Governor Raghuram Rajan. Earlier this year a new monetary policy framework that for the first time sets the agenda of the central bank as inflation targeting (CPI 4% with a band of +/-2% from financial year ending in March 2017), came into place and in September this year a surprise rate cut of 50 bps was announced, that added considerably to the 75 bps cut made gradually over the course of the 2015.

*In this context, Pragya Tiwari spoke to **Jayati Ghosh** about the potential of this rate cut and about the role of monetary policy in the current state of the Indian economy. In the second part of this two-part interview they discuss savings, transmission and the need for greater public spending.*

Click here to read part one where Jayati Ghosh critiques inflation targeting and wage-led demand.

Do you see any cause of concern from inflationary pressures in the context of the current monetary policy stance?

At this point, no. The problem globally is deflation, and even though I don’t think we are likely to get deflation in India, except for asset deflation in some areas, I don’t see inflationary pressures being a problem either, so I think there is a plenty of scope to go further in terms of monetary policy. My problem is that I don’t think it’s going have the desired positive impact.

What about savings? Savings have been declining- particularly household financial savings, possibly due to inflation. Could lower interest rates have a negative impact too?

I would believe that personal savings are relatively inelastic to the interest rate in India simply because experiences with stock market and other financial instruments have been very uneven and we don’t have proper pension systems so there is little choice. But on the other hand, there is a question of equity; of justice to pensioners and poor people who are saving in say, post office accounts etc. So maybe you have to think about a structured system where some types of savings are relatively more protected.

The problem with that, some would argue, is that the relatively higher rates on small savings schemes distort the market and impact transmission.

I think banks are completely unjustified in claiming this. I mean where is the evidence that bank are not getting the savings that they can lend out? They are sitting on them and they are investing them in government securities. I believe, in fact I have seen studies that actually suggest that bank margins have been rising. So I’m not convinced by this argument at all.

What then can be done to ensure more effective transmission?

The reason you have nationalised banks and have public sector banks is so that you can tell them what to do! Why do you bother to own a bank if you then tell them to go out there and behave like any old private commercial bank?

And if you can tell them what to do then you shouldn't be complaining about transmission. (Apparently, they can be told what to do when it comes to loans for crony capitalists.) I can understand if Mr. Obama or the EU complains about transmission. But publically owned banks are not supposed to be acting only out of concerns of profitability. And of course if the public sector banks lower rates then private sector banks will be forced to comply so I cannot understand what the fuss is about.

Like you mentioned earlier, representatives of the government have been asking for a rate cut and there have been rumours of a strained relationship. What is your take on the debate over the independence of the RBI, especially in the light of the stress on independence of Central Banks in developed countries?

I believe an independent central bank is an oxymoron – I don't believe they exist and I don't believe they should exist. All the people that tell you that a central bank is independent are basically telling you that it is subservient to financial interests, that is the interest of the financial class, rather than subservient to politics. Joseph Stiglitz made this point at a seminar I was attending that when in fact two senators suggested that a law be passed making the Fed legally independent, Clinton came to him – he was head of the council of economic advisors at the time – and asked him what he thought. Stiglitz said that Clinton should write to the senators saying it should be made an election issue for the upcoming senate elections. But when Clinton wrote that letter these two immediately withdrew their request. In other words, they recognised that if you suggest that the Fed should be reflecting a broader public interest as expressed by elected representatives, it is going to be a political hot potato.

Where should lines be drawn then to reduce the possibility of influence of politics and political business cycles?

You know the funny thing in India is that it's always election time. Have you come across a year when there is not an election? So it's very hard to find a cycle, if you know what I mean. My concern is that there isn't enough influence of politics in public spending. The electorate seems to be saying, we don't like this policy and throwing one government out and the next government comes and does the exact same thing. So the will of the people does not get reflected adequately in macroeconomic choices – both fiscal and monetary policy. It is essentially reflecting the interests of a particular class – like capital, both financial and non-financial.

What would you say should be the priority for the government at this point in time in order to step up and be able to help the economy make use of the rate cut.

I think the real drag on the economy today is the pattern of fiscal policy – of public spending. If they want the economy to revive there needs to be a big push in certain critical areas, which is the opposite of what they are doing. A big push in rural employment guarantee, creation of an urban employment guarantee, increase of social sector spending for health, education and nutrition, actual implementation of the Food Security Act etc. All of this can easily be financed by making the tax administration more efficient. I'm not asking for an increase in taxes. I'm just saying implement your tax laws, properly and seriously.

So what do you make of this push to cut the fiscal deficit?

I think it's obscene. You don't do that In the middle of a deceleration. What's the point? Except for some kudos from some international bankers, who are not actually going to come up and help you to increase investment.

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