Fragile Foundations: Foreign capital and growth after liberalisation

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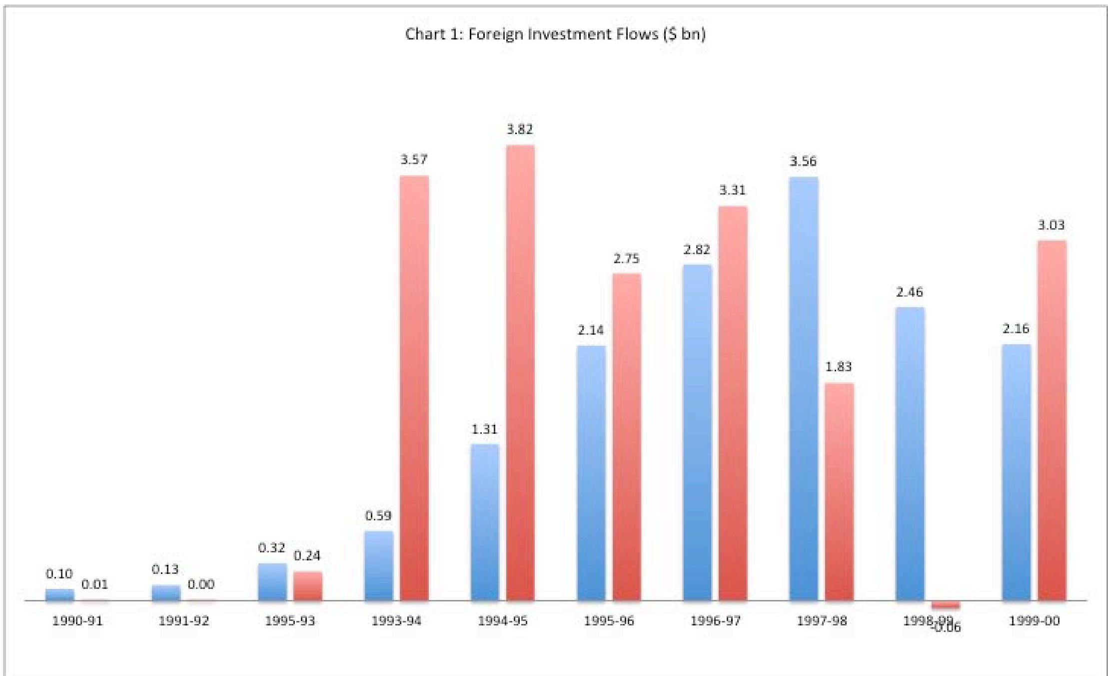
It is now well documented that the balance of payments crisis of 1991, which saw the government turning to the IMF for emergency finance, provided the grounds for a policy shift, marking a new phase in India's relationship with foreign capital. However, as Chart 1 shows[1], while liberalisation did increase inflows into the country, large capital flows, which were substantially in the form of portfolio capital, were a later development. Till 1993-94 total net inflows amounted to less than a billion dollars. Subsequently, foreign investment flows rose sharply to $4.2 billion in 1993-94 and averaged about $6 billion during the second half of the 1990s.

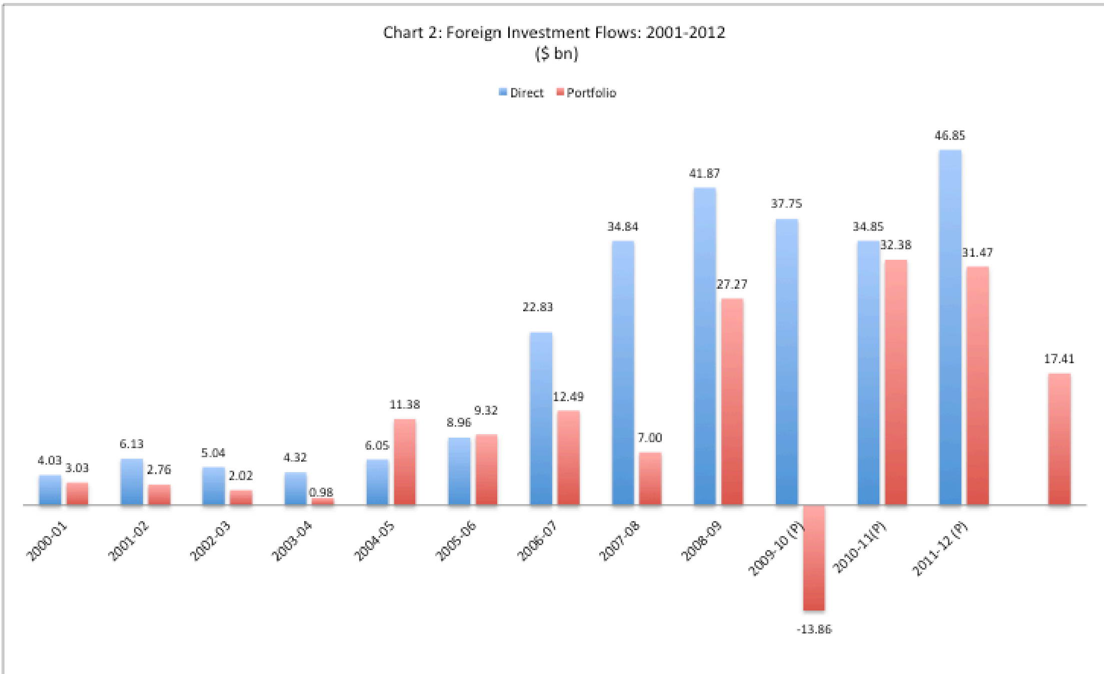


However, there were more significant changes subsequently. During the first decade of this century these inflows rose to $15.7 billion in 2003-04, and then rose to an average of around $65 billion during 2009-12 (Chart 2). This increase would not have been possible without the relaxation of sectoral ceilings on foreign shareholding and the substantial liberalisation of rules governing investments and repatriation of profits and capital from India. But liberalisation began rather early in the 1990s, whereas the boom in foreign investment flows occurred much later. Thus, till 2002-03, the maximum level of net foreign investment inflow was $8.2 billion in 2001-02. This rose to $15.7 billion in 2003-04 and soared thereafter. That change provides the basis for distinguishing between two phases in the post-liberalisation years; one till 2003-04, and the other thereafter.

The other feature that is noteworthy is the change in the nature of capital inflows during the 1990s. After India's own version of the debt crisis in 1991, debt inflows remained more or less stagnant in nominal terms, resulting in a decline in the debt to

[1] All charts and tables are based on data available from the websites of the Central Statistical Organisation or the Reserve Bank of India.

GNI ratio from 33 per cent in 1991 to 21 per cent in 2002. However, as noted above, there was no decline, but an increase, in foreign capital inflows into India after the 1991 crisis. This was because of a significant increase in non-debt inflows, especially portfolio and direct investments. In sum, while the 1991 crisis froze debt inflows into India, liberalisation ensured access to a significant amount of non-debt inflows.



The regime of accumulation

This persistence of access to foreign exchange influenced the regime of accumulation as well. The 1990s were characterised by growth rates similar to that recorded in the 1980s. However, the stimuli driving manufacturing growth were now changing. Though in the course of the crisis and its immediate aftermath industrial growth fell sharply, it soon recovered and India experienced a mini-boom during the period 1994-1997 and a year of reasonable growth towards the end of the decade. A number of factors combined to generate these trends. The first is, of course, public expenditure, which was extremely unstable during the 1990s. That instability was due, *inter alia*, to the following three factors: (i) variations in the government's degree of adherence to its irrational fiscal deficit targets; (ii) a sudden burgeoning of public expenditure towards the end of the 1990s because of the implementation of the Fifth Pay Commission's recommendations; and (iii) the influence of the political business cycle, which results in a ramping up of public expenditures of certain kinds in the run-up to an election. However, on an average, it appears that government spending had ceased to be as much of a stimulus to growth as during the 1980s, with fiscal conservatism leading to an overall deflationary trend in the system. Unstable government expenditure, while contributing to instability in industrial growth, has not been a long run influence in raising the trend rate of growth.

The second factor influencing manufacturing growth during the post-liberalisation years was the increase in the production of domestically assembled or produced import-intensive manufactured goods. This form of industrial growth was stimulated during the mid-1990s by the release of the pent-up demand in the upper income groups for a range of import-intensive consumption goods. Such demand had been limited for long because of restrictions on the imports of both the commodities themselves and of the technology, capital equipment and intermediates needed to produce them domestically. Liberalisation of trade and foreign collaboration rules removed restrictions on the imports of technology, equipment and intermediates while maintaining restrictions on imports of the final product. As a result domestic production of these commodities registered a spurt to cater to the pre-existing demand. This, however, was a once-for-all market. Once the requirements generated by the release of pent up demand was exhausted, the market had to expand if growth had to be sustained. This required the percolation of this demand to new segments of the income spectrum. That did not occur, and so the boom came to an end with fears by the late 1990s that Indian industry was experiencing a recession.

Finally, manufacturing growth was stimulated by a new feature resulting from financial liberalisation, which was a growing role for retail lending in the portfolio of the commercial banks. What followed was an unusual way in which that market for manufactures has been expanded, especially in urban India, during the years of neo-liberal reform: through a boom in housing and consumer credit. One consequence of financial liberalisation and the excess liquidity in the system created by the inflow of foreign financial capital, has been the growing importance of credit provided to individuals for specific purposes such as purchases of property, automobiles and consumer durables of various kinds. This implies a degree of dis-saving on the part of individuals and households. It also implies that financial institutions, which are willing to provide such credit without any collateral, are betting on the inter-temporal income profile of these individuals, since they are seen as being in a position to meet their interest payment and amortisation commitments on the basis of speculative projections of their earnings profiles. These projections are speculative because with banks and other financial institutions competing with each other in the housing and consumer finance markets, the tendency is towards an expansion in the universe of borrowers, with individuals being able to easily take on excess debt from multiple sources, without revealing to any individual creditor their possible over-exposure to debt.

One implication of the expansion of the market for manufactures through these means is that the occurrence and the extent of such expansion depend crucially on the ‘confidence’ of both lenders and borrowers. Lenders need to be confident of the future ability of their clients to meet interest and repayment commitments. Borrowers (excluding those consciously involved in fraud) need to be confident of their ability to meet, in the future, the commitments that they are taking on in the present. This crucial role of the ‘state of confidence’ in triggering this form of demand is what is captured in the oft-used phrase: ‘the feel good factor’. Since there is a strong speculative element involved in lenders providing credit and borrowers increasing their indebtedness, the state of confidence of both parties matters. When such confidence is ‘good’, we can experience growth or even a boom. When such confidence is low among either borrowers or lenders, we can experience recessionary conditions. The exogenous, supply-side influenced surge of capital inflows into India has not merely increased liquidity in the system but bolstered confidence. The result is the growth debt-finance demand. This too played a role in boosting growth during the 1990s.

To summarise, even though the rate of overall and industrial growth during the 1990s was not very different from that in the 1980s, there was evidence of an incipient change in the regime of accumulation. There were two aspects to this change. The first was that, private consumption expenditure on manufactured consumption goods and private investment in housing was beginning to play a more important role (relative to public expenditure) in driving demand and growth. And second, associated with this were signs that debt-financed private consumption expenditure was displacing debt-financed public expenditure as a leading stimulus for growth.

One fall out of these changes was that the growing importance of services in driving GDP growth was enhanced. To start with, the role of government revenue expenditure in driving services growth continued, though to a lesser extent than before. Second, increases in private expenditure, especially of the upper-middle and upper income groups, were directed to a host of new services, contributing to the growth of that sector. Third, with a growing role for non-debt inflows of foreign capital, including FII investments into India's liberalised capital markets, the importance of financial services were increasing. Fourth, with the growing importance of private debt in the growth process, areas like banking were registering rapid growth. And, finally, in the run up to year 2000, the boom in India's IT and IT-enabled services sector had begun, adding to the expansion of services. Put together, this substantially accelerated services growth during the 1990s. Developments mediated substantially by India's changed relationship with foreign capital were beginning to influence the regime of accumulation.

The years since 2003

The year 2003 marked another turning point. As noted earlier this was when foreign capital inflows into India surged. Over the next few years India was receiving far more capital inflows than it needed. To start with, since the beginning of the decade (2000-01), over the 41 quarters till first quarter 2010-11, there were 16 in which India actually recorded a current account surplus. Further, since the beginning of financial year 2003-04, when there has been a capital flow surge into most emerging markets, the inflow of capital has fallen short of the current account deficit only in 7 out of 29 quarters, with the ratio of net capital inflow to the current account deficit being below one (Chart 3: Negative figures are because of a current account surplus or negative deficit).

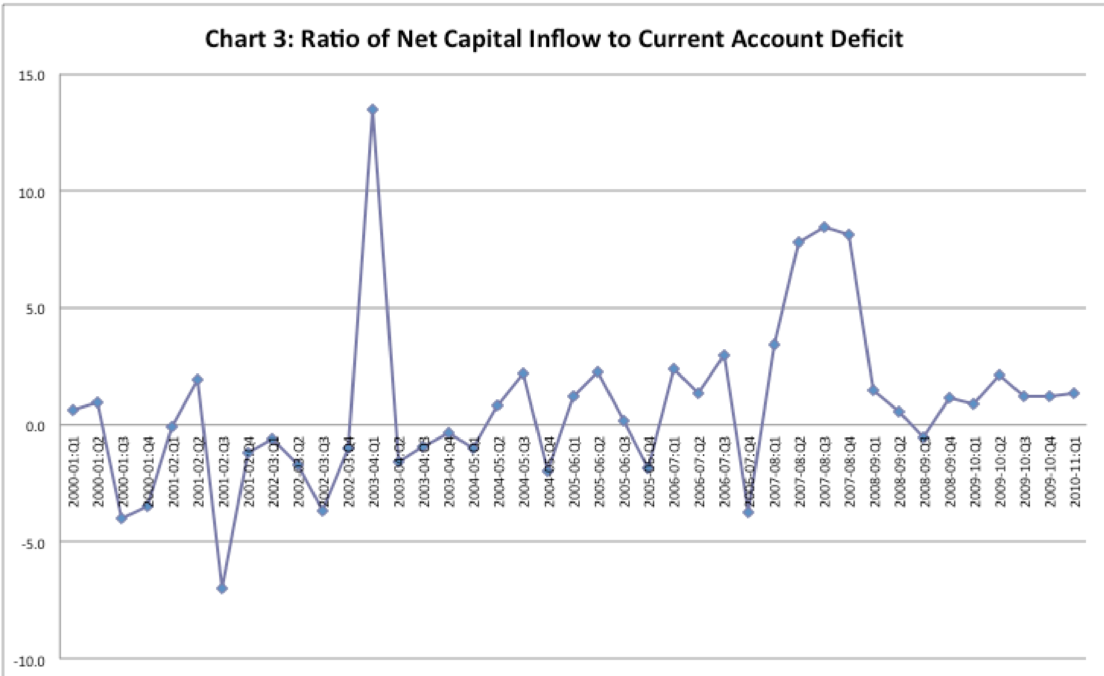


Chart 3: Ratio of Net Capital Inflow to Current Account Deficit

As a result cumulatively there has been a huge excess of capital inflow into the country when compared to its current account financing needs. In fact, if we take the cumulative sum of the excess of the capital inflow relative to the current account deficit, this has increased consistently since the first quarter of 2001-02 to the fourth quarter of 2008-09, and since then has more or less remained near that level despite the exit of capital associated with the global crisis (Chart 4).

There are two reasons why capital inflow has been in excess of India's balance of payments financing requirements. The first is that right through this decade, India had experienced an excess of capital inflows over outflows in all quarters excepting one (3^{rd} quarter 2008). A host of factors have combined to ensure this result. India has been a favoured destination for foreign financial investors. Foreign direct investors turned to India after liberalisation to benefit from the large and growing domestic market. And Indian firms have borrowed heavily abroad given the much lower interest rates in foreign markets and the liberalised conditions relating to external commercial borrowing. The second reason why capital inflows have been in excess of India's balance of payments financing needs is that services exports and remittances from workers providing services on location abroad have substantially covered the country's merchandise trade deficit. As Chart 5 shows, the net inflows on account of Software and Business Services and Remittances have exceeded the merchandise trade deficit during the first half of this decade and more or less equalled it subsequently.

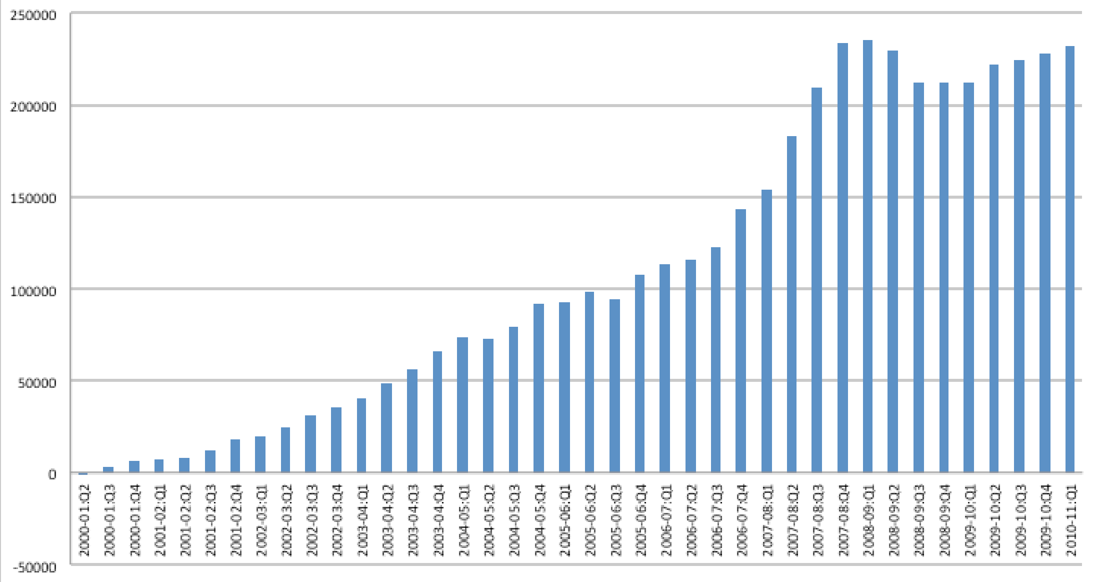


Chart 4: Cumulative Excess of Capital Account Inflow over Current Account Deficit ($ mn)

Given the liberalised exchange rate system that Indian has, the resulting excess supply of foreign exchange creates conditions for an appreciation of the currency. If that appreciation has not occurred it is because of the intervention by the Reserve Bank of India that has resulted in the large reserves that it holds.

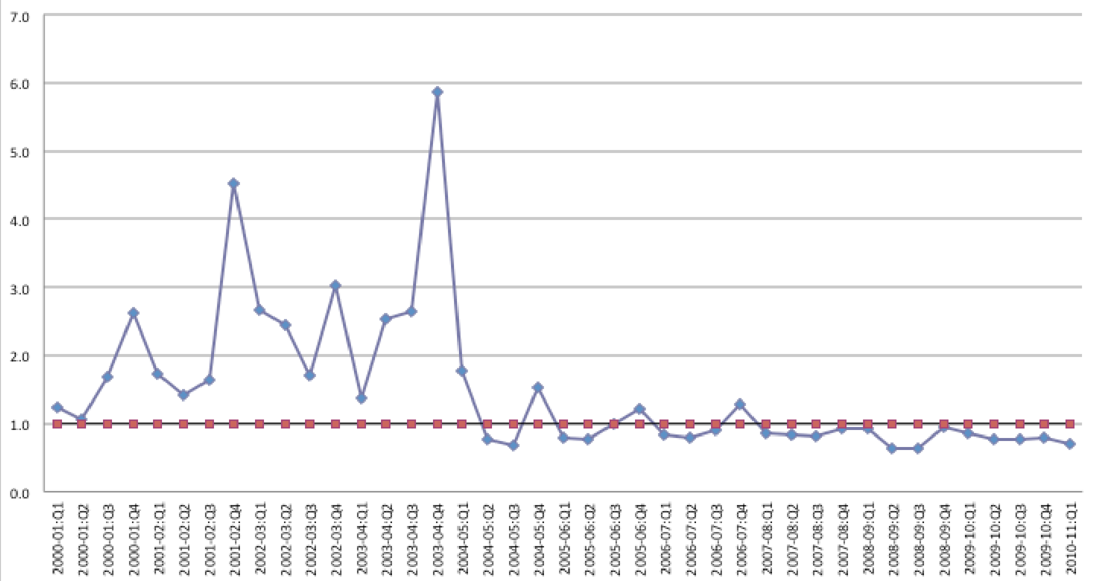
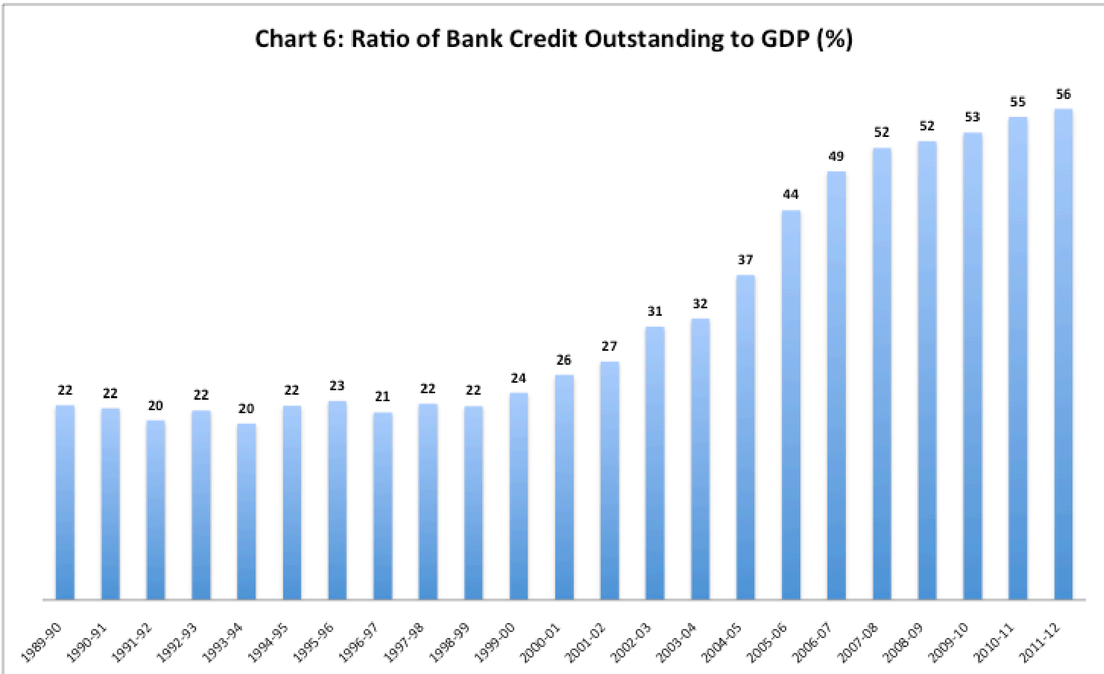


Chart 5: Ratio of Net Inflows from Software and Business Services and Remittances to Merchandise Trade Deficit

There is, however, one important implication of these trends. It is that, capital inflows rather than current account surpluses explain India's comfortable reserve position. In the muted celebration to mark the completion of two decades of reform, one statistic often referred to was the size of India's foreign exchange reserves. But we must not forget that these reserves have income and capital payment commitments in foreign exchange associated with them. They are borrowed and not earned.

Impact on growth



Enhanced capital inflows during the last decade have, as before, had important implications for the regime of accumulation. The inflow of foreign exchange had as its counterpart an increase in the overhang of liquidity in the domestic economy. Based on that overhang, a liberalised banking system has been creating new credit assets at a rapid rate. The ratio of bank credit outstanding to GDP had remained at around 22 per cent for a decade starting 1989-90. However, this figure began to rise after 1999-2000, doubled (to 44.4 per cent) by 2005-06 and then rose further to 56 per cent by 2011-12 (Chart 6).

There were also significant changes in the sectoral distribution of credit. Overall there were two sets of sectors that gained in share. The first comprised of the so-called “sensitive sectors”, consisting of the stock market, commercial real estate and commodity trading. The exposure of banks to the stock market occurs in three forms. First, it takes the form of direct investment in shares, in which case, the impact of stock price fluctuations directly impinge on the value of the banks’ assets. Second, it takes the form of advances against shares, to both individuals and stockbrokers. Any fall in stock market indices reduces, in the first instance, the value of the collateral. It could also undermine the ability of the borrower to clear his dues. To cover the risk involved in such activity banks stipulate a margin, between the value of the collateral and the amounts advanced, set largely according to their discretion. Third, it takes the form of “non-fund based” facilities, particularly guarantees to brokers, which renders the bank liable in case the broking entity does not fulfil its obligation.

The effects of this on bank fragility become clear from the role of banks in the periodic scams in the stock market since the early 1990s, the crisis in the cooperative banking sector and the enforced closure-cum-merger of banks such as Nedungadi Bank and Global Trust Bank. However, this evidence only begins to reveal what even the RBI has described as “the unethical nexus” emerging between some inter-connected stock broking entities and promoters/managers of banks. The problem clearly runs deep and has been generated in part by the inter-connectedness, the thirst for quick and high profits and the inadequately stringent and laxly implemented regulation that financial liberalization breeds.

The second area that gained from the change in the sectoral distribution of credit, was retail advances. The share of personal loans increased from slightly more than 9 per cent of total outstanding commercial bank credit at the end of March 1996 to more than 22 per cent by end-March 2007 (Table 1).

Table 1:

Personal loans as per cent of total outstanding credit of commercial banks			
	1996	2000	2007
State Bank of India and associates	9.5	10.7	22.0
Other nationalised Banks	9.1	10.9	15.8
Foreign banks	8.8	17.1	24.8
Regional Rural Banks	10.5	18.8	20.5
Private sector banks	9.7	7.9	37.3
All Scheduled Commercial Banks	9.3	11.2	22.3

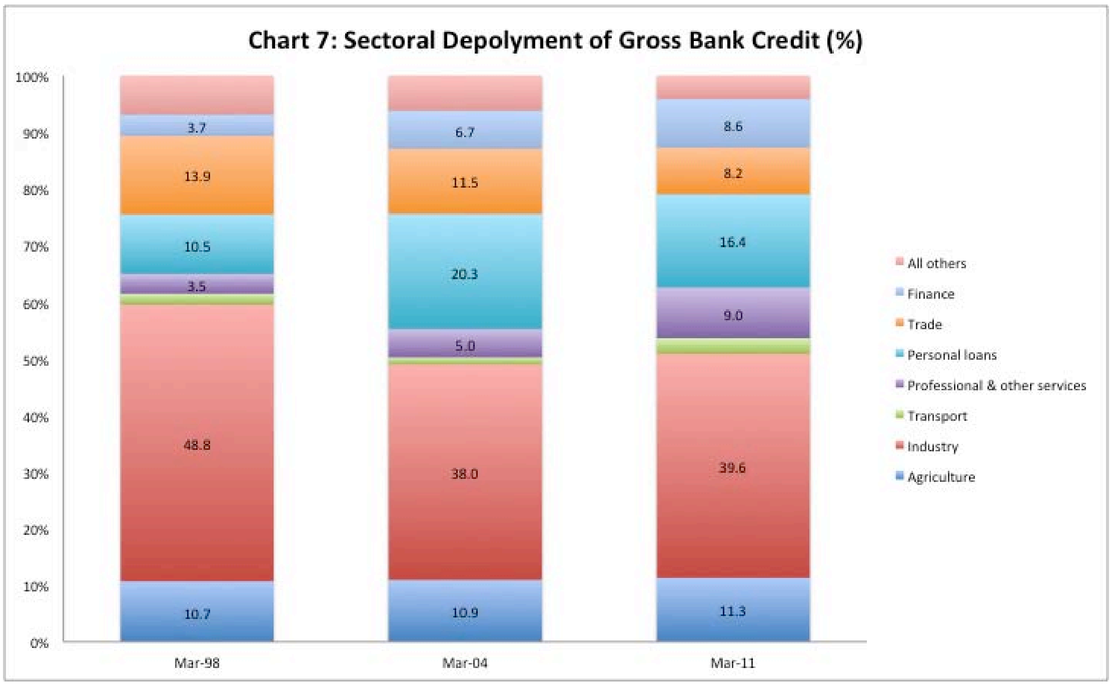
Of the components of retail credit, the growth in housing loans was the highest in most years. The rate of growth of housing loans gathered momentum at the end of 1990s and remained at extremely high levels right up to 2006-07. As a result the share of housing finance in total credit rose from 5 per cent in 2001-02 to 12 per cent in 2006-07. The increase is often attributed to the low level of penetration of the mortgage market in India, standing at 7 per cent in 2006, as compare to 12 per cent in China, 17 per cent in Thailand, 26 per cent in Korea, 29 per cent in Malaysia and a huge 80 and 86 per cent respectively in the US and UK respectively. But these differential penetration rates have to be seen in the light of differentials in per capita income and the degree of income inequality, both of which do not favour a significantly large mortgage market in India.

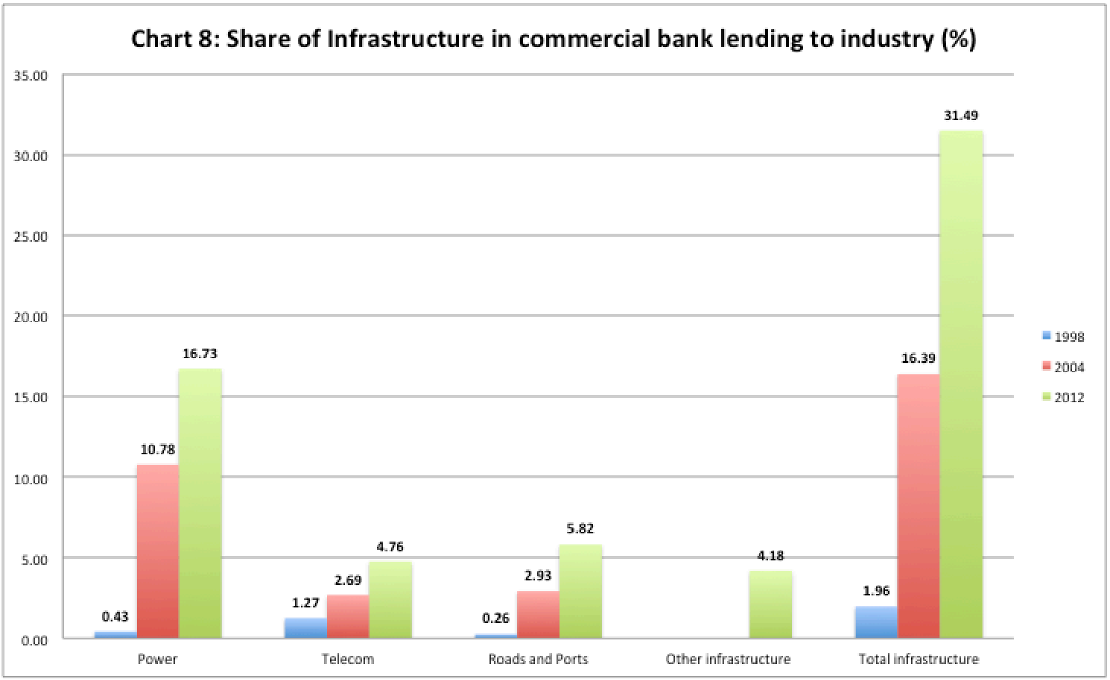
This has resulted in the accumulation of loans of doubtful quality in the portfolio of banks. Addressing a seminar on risk management in October 2007, when the subprime crisis had just about unfolded in the US, veteran central banker and former chair of two committees on capital account convertibility, S.S. Tarapore, warned that India may be heading towards its own home-grown sub-prime crisis. Even though the suggestion was dismissed as alarmist by many, there is reason to believe that the evidence warranted those words of caution at that time, and are of relevance even today. Besides the lessons to be drawn from developments in the US mortgage market, there were three trends in the domestic credit market that seemed to have prompted Tarapore's comment.

The increase in retail exposure was also reform related. Financial liberalisation expanded the range of investment options open to savers and through liberalisation of controls on deposit rates increased the competition among banks to attract deposits by offering higher returns. The resulting increase in the cost of resources meant that banks had to diversify in favour of more profitable lending options, especially given the emphasis on profits even in the case of public sector banks. The resulting search for volumes and returns encouraged diversification in favour of higher risk retail credit. Since credit card outstandings tend to get rolled over and the collateral for housing, auto and consumer durable loans consists essentially of the assets whose purchase was financed with the loan concerned, risks are indeed high. If defaults begin, the US mortgage crisis made clear, the value of the collateral would decline, resulting in potential losses. Tarapore's assessment clearly was and possibly remains that an increase in default was a possibility because a substantial proportion of such credit was sub-prime in the sense of being provided to borrowers with lower than warranted creditworthiness. Even if the reported incomes of borrowers do not warrant this conclusion, the expansion of the universe of borrowers brings in a large number with insecure jobs. A client with a reasonable income today may not earn the same income when circumstances change.

These factors notwithstanding the expansion in retail credit served as a form of autonomous demand for manufactured goods. Credit served as a stimulus to industrial demand in three ways. First, it financed a boom in investment in housing and real estate and spurred the growth in demand for construction materials. Second, it financed purchases of automobiles and triggered an automobile boom. Finally, it contributed to the expansion in demand for consumer durables. This infusion of autonomous demand, though unsustainable in the medium term, was an important factor explaining the revival of industrial growth during the mid-2000s.

But this was not the only role that credit expansion played. As Chart 7 illustrates the growing important of these sectors has resulted in a stagnation in the share of credit going to agriculture (at around 11 per cent) between 1998 and 2011, and a decline in the shares of trade (from 14 per cent to 8 per cent) and industry (from 49 to 40 per cent). However, what is interesting is the distribution of the credit going to industry, which at 40 per cent of total bank credit outstanding was still substantial. The share of infrastructural lending in the *total advances of scheduled commercial banks to the industrial sector* rose sharply, from less than 2 per cent at the end of March 1998 to 16.4 per cent at the end of March 2004 and as much as 31.5 per cent at the end of March 2012 (Chart 8). That is, while the share (though not volume) of lending to industry in the total advances of the banking system has fallen, the importance of lending to infrastructure within industry has increased hugely. Four sectors have been the most important here: power, roads and ports, and telecommunications, and more recently a residual 'other' category, reflecting in all probability the lending to civil aviation.





The government was clearly using the banking system as an instrument to further an aspect of its larger liberalisation agenda, which was the entry of the private sector into core infrastructural areas involving lumpy capital intensive investments in power, telecommunications, roads and ports and sectors like civil aviation. Under normal circumstances banks are not expected to lend much to these areas as it involves a significant maturity and liquidity mismatch: banks draw deposits from savers in small volumes with the implicit promise of low income and capital risk and high liquidity. Infrastructural investments require large volumes of credit and do involve significant income and capital risk, besides substantial liquidity risk. So what is required for supporting infrastructural investment is increased equity flows from corporate or high net worth investors and the expansion of sources of long-term credit like a bond market.

Neither of these, especially the latter, occurred in adequate measure. Rather, the development financial institutions with special access to lower cost financial resources, which were created as providers of long term-finance, had been shut down as part of liberalisation. Hence, besides recourse to external commercial borrowing, many infrastructural projects had to turn to the banking system. As is to be expected, private banks have been unwilling to commit much to this risky business. So it is the public banking system (besides a couple of private banks) that has moved into this area, possibly under government pressure.

However, as the exposure of the banks to these sectors has increased, the folly of "dragging" the private sector into infrastructure with concessions and cheap credit is becoming clear. The shake out has begun in civil aviation with possibly only one airline able to show profit after many years of liberalisation. But there are other sectors like power generation, power distribution and ports and roads where returns have been below expectations or negative.

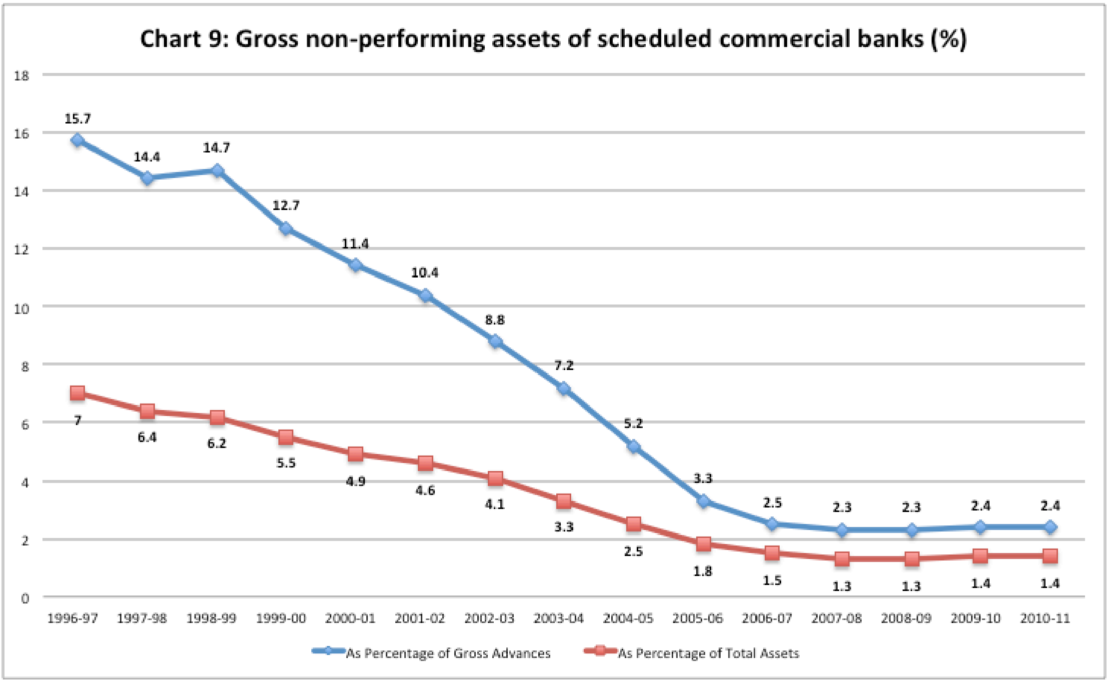
The result is the prospect of default on loans provided to these ventures by the banks. This has presented banks with a serious problem. If they press for payments, they invite default of the large volume of debt they have already provided. The impact on their balance sheets can be damaging. So they are under pressure to restructure debt, offer better terms, extend repayment periods, *and* provide more credit to keep the unit afloat. But they are doing so with the knowledge that unless the government uses taxpayers' money in some form to bail out the unit, this is merely sending good money after bad.

Thus, for example, in 2010 the banks had got together and under the Corporate Debt Restructuring (CDR) scheme of the RBI, restructured debt to the tune of Rs. 77 .2 billion owed by Kingfisher Airlines. By 2012, with the debt of the airline having increased by another Rs. 10 billion or so, it had been forced to suspend operations with no hope of repaying the banks unless the impossible happens.

Table 2: Trends in Restructuring

	Mar-09	Mar-10	Mar-11	Mar-12
Gross Advances (Rs. Crore)	27,53,365	32,27,287	39,82,954	46,55,271
Restructured Standard Advances (Rs. Crore)	75,304	1,36,426	1,37,602	2,18,068
Restructured Standard to Gross Advances Ratio (%)	2.73	4.23	3.45	4.68
Gross NPAs as a % of Gross Advances	2.44	2.5	2.35	2.9

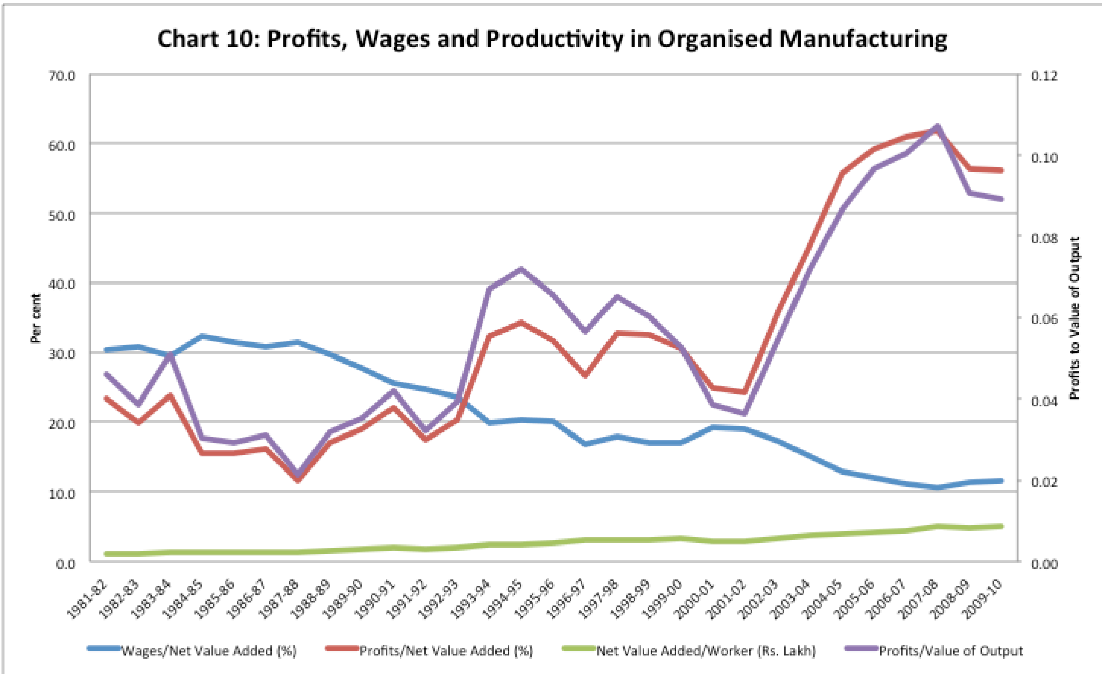
The implication of this comes through from Chart 9 and Table 2. While the government has been priding itself that the non-performing assets of the commercial banking system have come down quite significantly post-reform (Chart 9), this has been accompanied by a significant increase in the ratio of restructured assets that are treated as standard assets to gross advances. While the ratio of gross NPAs to gross advances by banks has increased only marginally over the three years ending March 2011 from its confortable low level, the ratio of restructured (and, therefore, still "standard") advances to gross advances has risen from 2.7 per cent to 4.7 per cent. Expectations are that with a rush of borrowers to the CDR cell, this figure is likely to rise sharply. Thus, while sustaining and intensifying the credit-financed boom in household investment and consumption and private corporate investment in infrastructure, the banking system is being rendered increasingly fragile.



It must be noted that the period between 2003-04 and 2007-08 was also one in which the government finally implemented its self-imposed resolve to substantially reduce its fiscal deficit. This implied that the high growth era was one in which the stimulus offered by debt-financed public expenditure was on the decline. What seems to have been occurring was a substitution of this stimulus provided by debt-financed private investment and consumption. Though there are signs that this process cannot be sustained, it does seemed to have contributed (along with the continued, self-reinforcing growth of services) to the short-term realisation of a high growth trajectory. Thus, associated with the recent phase of India's post-Independence engagement with foreign capital, was a surge in inflows of debt and non-debt forms of foreign capital that triggered in turn a whole new regime of accumulation.

Capital under the new regime

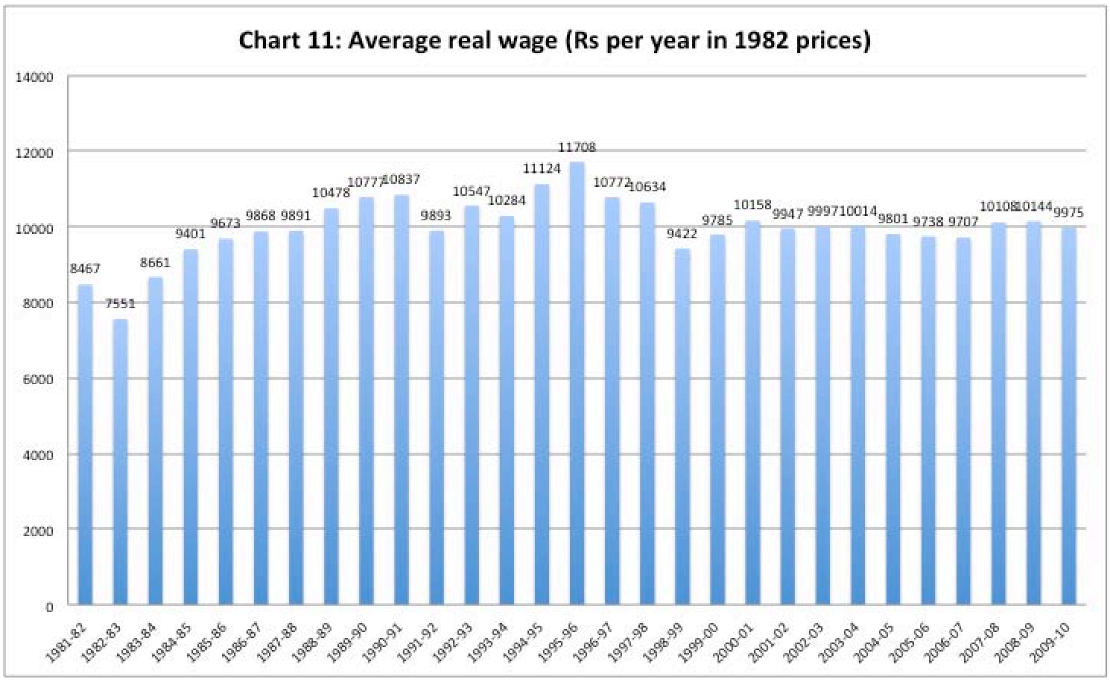
One question that remains is the factors that endowed lenders and borrowers with the confidence that sustained this regime of accumulation through the 2000s. The answer lies possibly in the fact that the period was special also because investment was fuelled by a mechanism that had profit inflation at its core. The sectors that were growing (in both manufacturing and services) were ones characterised by a sharp increase in valued added per worker—influenced by technology in the case of organised manufacturing and by the nature of the activity in the case of modern services. The result was an increase in the private sector's ability to garner higher profits.



Consider trends emerging from the official Annual Survey of Industries relating to the organised manufacturing sector depicted in Chart 10. To start with, since the early 1990s, when liberalisation opened the doors to investment and permitted much freer import of technology and equipment from abroad, productivity in organised manufacturing has been almost continuously rising. Net value added (or the excess of output values over input costs and depreciation) per employed worker measured in constant 2004-05 prices, rose from a little over Rs. 1 lakh to more than Rs. 5 lakh. That is, productivity as measured by net product per worker adjusted for inflation registered a close to five-fold increase over the 30-year period beginning 1981-82. And more than three-fourths of that increase came after the early 1990s.

Unfortunately for labour, and fortunately for capital, the benefit of that productivity increase did not accrue to workers. The average real wage paid per worker employed in the organised sector, calculated by adjusting for inflation as measured by the Consumer Price Index for Industrial Workers [CPI(IW) with 1982 as base], rose from Rs. 8467 a year in 1981-82 to Rs. 10777 in 1989-90 and then fluctuated around that level till 2009-10 (Chart 11). The net result of this stagnancy in real wages after liberalisation is that the share of the wage bill in net value added or net product (Chart 10), which stood at more than 30 per cent through the 1980s, declined subsequently and fell to 11.6 per cent or close to a third of its 1980s level by 2009-10.

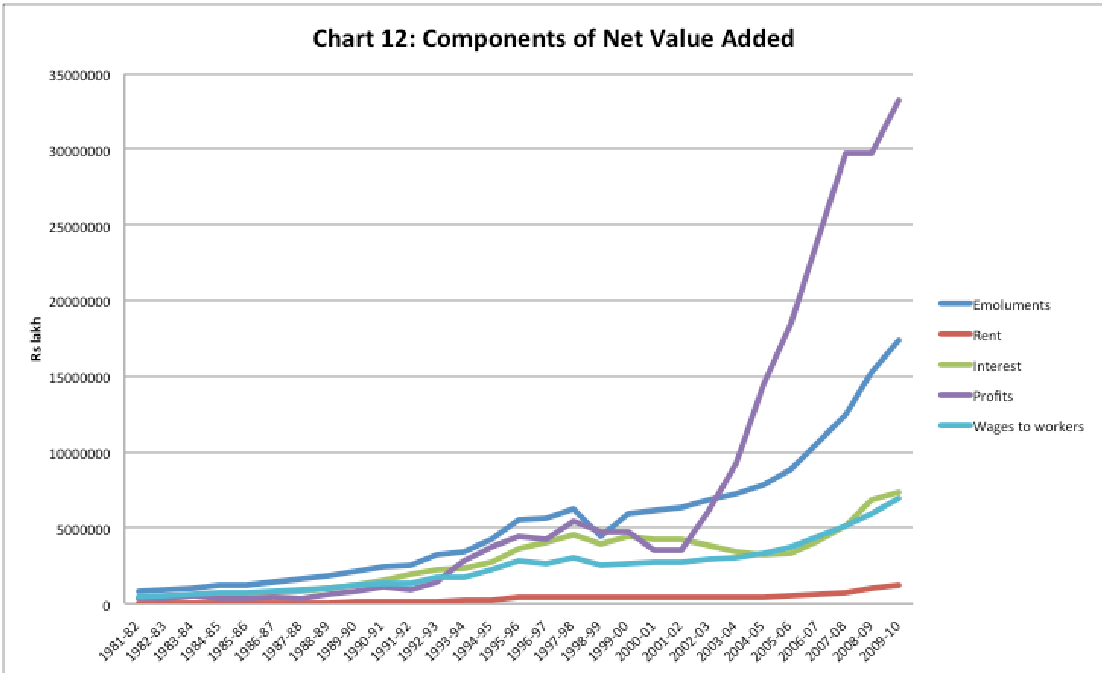
A corollary of the decline in the share of wages in net value added was of course a rise in the share of profits. However, the trend in the share of profits is far less regular than that of the other components in net value added. Between 1981-82 and 1992-93, the ratio of profits to net value added fluctuated between 11.6 per cent and 23.4 per cent. During much of the next decade (1992-93 to 2002-03) it remained at a significantly higher level, fluctuating between 20.4 per cent and 34.3 per cent, but showed clear signs of falling during the recession years 1998-99 to 2001-02.



However, the years after 2001-02 saw the ratio of profit to net value added soar, from just 24.2 per cent to a peak of 61.8 per cent in 2007-08. Unfortunately for manufacturing capital, the good days seem to be at an end. There are signs of the profit boom tapering off and even declining between 2006-07 and 2009-10. But this latter period being short, we need to wait for more recent ASI figures to arrive at any firm conclusions.

As of now, what needs explaining is the remarkable boom in profits at the expense of all other components of net value added. An interesting feature that emerges from the chart is that the ratio of profits to value of output, or the margin on sales, tracks closely the irregular trend in the share of profits in value added described above. Increases in profit shares have clearly been the result of a rise in the mark up represented by the profit margin to sales ratio, or the ability of capital to extract more profit from every unit of output.

Interestingly, the periods in which the ratio of profits to the value of output has risen, leading to sharp increases in profit shares, were also the years when the two post-liberalisation booms in manufacturing occurred. The first of those was the mini-boom of the mid-1990s, starting in 1993-94 and going on to 1997-98, which was fuelled by the pent-up demand in the upper income groups for a range of goods that had remained unsatisfied prior to the liberalisation of imports and foreign investment rules. The second was the stronger and more prolonged boom after 2002-03, led by new sources of demand. That boom lasted till the global financial crisis in 2008-09. The coincidence of the rise in profit margins and profit shares and the output booms suggests that, in periods of rising demand, the organised manufacturing sector in India has been able to exploit liberalisation in three ways. First, it has been able to expand and modernise using imported technologies, raising labour productivity significantly in the process. Secondly, it has been able to ensure that the benefit of that productivity increase accrues almost solely to profit earners, because of the conditions created by the "reformed" economic environment. As a result, the mark up rose significantly or sharply in these periods and delivered a profit boom. Third, to ensure this to the dramatic extent depicted, it has obviously used a range of concessions from the state to inflate profits. Through means varying from tax concessions to access to cheap or near-free assets and resources, the state has virtually transferred income and wealth to the private sector to boost private profitability.



An interesting feature is the way in which this process feeds on itself. As Chart 12 depicting trends in the different components of net value added shows, while the nominal value of rent, interest and wages rose only marginally over a long period, the increase in emoluments, which include managerial salaries was substantial. Profits of course soared as noted earlier. The increase in non-wage salaries and incomes not only directly drives manufacturing demand, but also provides the basis for the expansion of credit-financed investment and consumption expenditure. Thus the boom creates conditions that also help prolong that boom.

Seen in this light, there are reasons to believe that certain recent developments could be constraining growth in the manufacturing sector. The first is the fear of a reduction and even reversal in foreign capital inflows into the country as a result of both global and domestic uncertainty. This is putting pressure on the government to reduce its fiscal deficit and the level of public debt, which has a deflationary impact. Secondly, the large credit overhang and the uncertainty arising from increase debt defaults in the retail and infrastructural lending markets is reducing the volume of credit and hence the volume of debt-financed investment and consumption.

Finally, there has been an increase in allegations of large scale corruption. The instances to which such allegations relate are many, varying from the sale of 2G spectrum and the mobilisation and/or disposal of land and mining resources to purchases made as part of large and concentrated public expenditures (as in the case of the Commonwealth Games). What this has done is increase the reticence and limit the ability of the government to openly favour private capital with concessions that deliver high and rising profit margins.

When the effects of such developments combine they could restrict demand and dampen investment considerably leading to a reduction in the rate of growth of manufacturing. They are also possibly reducing profit margins and profitability so that we may well be at the end of the period of profit-inflation led growth.

The issue of sustainability aside, the import of the above argument is that as India's relationship with foreign capital has shifted from muted hostility to one of attracting and winning its confidence, the nature of the regime of accumulation has changed as well. These changes had indeed taken India onto a higher growth trajectory by activating mechanisms that were very different in the 1980s, 1990s and 2000s. The long period of relatively high growth created the impression that these three phases were in fact only one, and that the high growth was now irreversible. The argument above seeks to establish these were not only three different phases but that each was in its own way unsustainable. Thus the regimes of accumulation themselves were fragile, besides the fact that growth driven by dependence on financial flows is vulnerable because of the possibility that such inflows can stop and capital outflow could occur, including for reasons unrelated to circumstances in the host country.

*** This article was originally published in the Social-Scientist dated Jan-Feb 2013.**