

Economic Reforms in India: A Macro-theoretic Study

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By

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Economic Reforms in India: A Macro-Theoretic Study submitted by me for the Doctor of Philosophy in Art in Jadavpur University is based upon my own work carried out under the supervision of Dr. Ambar Nath Ghosh, Professor, Department of Economics, Jadavpur University. And that neither this thesis nor any part of it has been submitted before for any degree or diploma anywhere/elsewhere.

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Chapter 1

Economic Reforms in India: A Macro-Theoretic Study

1. Introduction

The objective of my Ph.D. thesis is to examine the macroeconomic implications of economic reforms in India. The distinguishing feature of this thesis is that it is based on the hypothesis that a capitalist economy is completely under the control of the capitalists. They dictate all the policies and regulate all the macroeconomic phenomena such as the growth rate, the rate of inflation and employment. This is in sharp contrast with the position of mainstream macroeconomics (comprising the neoclassical macroeconomics and the Keynesian macroeconomics), which assumes that a capitalist economy does not have a driver. It is driven by impersonal market forces and the objective of economics is to examine how these forces work and what outcome they produce.

The thesis has three core chapters: Chapters 2, 3 and 4. Using a macro model it develops, Chapter 2 shows how reforms in the financial sector and deregulation of investment and prices benefit the capitalists at the expense of the masses. Using the same model, Chapter 3 shows how the reforms in the monetary policy recommended by the New Economic Policy (NEP) adopted in India in 1991 impoverishes the masses and makes the capitalists richer. Finally, Chapter 4 focuses on the reforms undertaken in the realm of monetary policy, financial sector and fiscal policies and shows how they make it profitable for the capitalists to forcibly take away land from the farmers and sell it to the rich who hold it as an instrument of saving. This leads to a cumulative contraction in the output of food impoverishing the poor. In what follows, we will present in brief the contents of all these three chapters.

1.2 Chapter 2: Economic Reforms and the Common Man in India

India adopted the New Economic Policy (NEP) in 1991 replacing the Nehru-Mahalanobis Strategy (NMS) of economic development. The NEP is being implemented in India since 1991 through a series of Economic Reforms. The objective of the NEP is to privatize all the public sector enterprises and to establish free market by removing all kinds of restrictions and regulations of the NMS era. In other words, the objective of the NEP is to handover all the capital and natural resources of the country to the capitalists (the giant businessmen who control India's corporate sector) and to give them a free hand in running and managing their businesses. We will examine here the implications of some of the Economic Reforms for the capitalists and the common man through their impacts on the organized and the unorganized sectors in India. The question that naturally emerges here is why the Government of India is implementing the NEP and why the political parties in India have accepted the NEP. This is surprising because India is a democratic country. In a democracy, more than one party compete for State Power. Every adult citizen of a democratic country has one vote irrespective of his economic condition. Thus, democracy grants political equality. A general election is held every four or five years. The political party that gets the majority of the votes gets to exercise State Power until the next general election is held. In these circumstances, one would expect every political party to work for the masses who wield more than ninety-nine percent of the votes. If

the political parties work for the masses, the political party in power should confiscate all the wealth of the capitalists and distribute them among the masses. It should nationalize the entire business empire of the capitalists and run it in the interest of the masses so that the masses get all the incomes and benefits from them. Thus, the political equality granted by democracy should eliminate economic inequality and establish an equal society overnight. Therefore, capitalists and capitalism cannot survive democracy. However, this never happens. Democracy does not threaten the capitalists or capitalism in any manner. In fact, the political parties in a democracy behave exactly in the opposite manner. They forcibly take away the land of the poor and give it away to the capitalists free of cost. This is definitely a mystery. Obviously, it is necessary to resolve this mystery in order to gain an understanding of how a capitalist society in general and India in particular work. We try to do it below.

A political party in a capitalist country does not have any source of income of its own. However, to set up and run a political party, an enormous amount of fund is needed. A political party requires a nation-wide network of dedicated workers, access to all kinds of media etc. The larger the amount of fund at the disposal of a political party, the greater is its competitive strength. Accordingly, only the wealthiest of the people can set up and run political parties. Thus, only the capitalists have the resources to set up and run political parties and they do so like their other country-wide or world-wide enterprises and, thereby, usurp State Power. Using the State Power, they keep the masses under control and secure their enormous wealth and business empire from the masses.

In a capitalist country, therefore, just like all the basic necessities of life and justice, the State Power is also an object of purchase and sale and it gets sold-off to the highest bidder.

Democracy is, therefore, a sham and the actual rulers of a capitalist country get themselves hidden behind an elaborate facade of political parties and the government. The capitalists love this camouflage so much that they call their countries not capitalist countries but democracies. Why do the capitalists, the actual rulers of the capitalist countries, get themselves hidden? They do so in order that the anger of the people due to the misery and suffering a capitalist society perpetrates on them get directed not towards the capitalists but towards the leaders of the political party in power, whom the people have themselves chosen as their ruler. Democracy also gives the people a way of giving vent to their anger. They do so by voting out the political party in power and bringing in another political party. The question that emerges is why capitalist societies make people's lives miserable. We will answer this question below.

If the workers have substantial bargaining strength, they can force the capitalists to raise their wage rates to such high levels that the capitalists may even suffer losses. Hence, the capitalists seek to ruin the bargaining strength of the workers by creating large scale unemployment through different means. They invest on a massive scale in R&D to innovate technologies that make the production process more automatic. They continuously incorporate these technologies in the production process to reduce labour requirement of production. They also keep the growth rate of aggregate production on the average at such a low level that the rate of growth of jobs falls short of the rate of growth of the labour force. In these ways, the capitalists create large scale and growing unemployment to destroy the bargaining strength of the workers.

(For details of the view presented above, go through Ghosh and Ghosh (2019^a, 2019^b)). From the above it is clear why all the political parties who come to power in India try to implement the NEP, which seeks to hand over the country to the capitalists at an enormous cost to the masses.

The point to note in this context is that the capitalists who control India are not the Indian capitalists, but the capitalists of Western Europe and the USA, which are the leading capitalist countries of the world and colonized almost the whole of the rest of the world by the time the First World War had begun. The reason we say this is the following. The most important feature of India at the present is that it is completely dependent on the Western European countries and the US for knowledge and technology. Let us illustrate this claim with an example. Think of the case of teaching economics in India. All the text books we refer to are imported from the Western European countries and the US. All the journals we refer to are imported from the Western European countries and the US. All the computers and also all the software we use are bought from the companies of the US or West European origin. This is true of not only economics but also all other subjects. Thus, to set up an educational institute in India, all the knowledge inputs and all the hi-tech inputs have to be imported. This is applicable not only to the educational institutes but also to all the modern production facilities in India. Thus, to set up a bank in India, for example, all the computers, software and high-tech machines have to be imported from the US or Western European countries. India, therefore, has to import on a large scale to sustain its production and investment. However, to import from the Western Europe and the US, India requires currencies of these countries. To earn these currencies, India has to sell its products to these countries. Since India produces its goods and services with imported knowledge and technology, which are never state-of-the-art, India's ability to compete in the world market is virtually nil. Therefore, India cannot get itself going. How does it survive then? The only plausible hypothesis seems to be that the Western capitalists, that is, the capitalists of the US and Western Europe, who have in their control almost all the enterprises and the governments of these countries, get India going by placing export orders with it and by buying India's bonds and stocks on a very large scale (see in this context Chapter 8 of Ghosh and Ghosh (2016) for evidential support) providing India with the requisite amount of foreign currency. Accordingly, India has to abide by the dictates of the Western capitalists at every step. Therefore, India is independent only on paper. It is virtually a colony of the Western capitalists. Since Indian capitalists do not have any independent base of knowledge and technology, they have no competitive strength vis-à-vis the Western capitalists and cannot survive as capitalists on their own. They are; therefore, one may safely presume, merely the representatives of the Western capitalists managing their businesses in India. Thus, the political parties in India are also owned and run by the Western capitalists. Hence, it is the Western capitalists who rule India and run all the large businesses in India. But, at the present, they do so not directly as in the colonial days but indirectly through their Indian representatives. To show how the capitalists rule India, we divide India into two sectors: the organized sector and the unorganized sector. The former consists of the corporate sector, public sector enterprises and large unincorporated private enterprises. The unorganized sector consists of small enterprises including small farming units and cottage and village industries. We will delineate the relevant main features of the two sectors below:

The Organized Sector

Following Keynes(1936), we assume that aggregate output in the organized sector is demand determined and the prices are set by the capitalists and the government. We will not try to explain in this model how capitalists and the government set the prices of their products and simply assume the average price in the organized sector to be given. We will denote the output and the price of the organized sector by Y and P_Y respectively. From the data given in Tables 2.1 and 2.2 in Chapter 2, we find that the share of the organized sector in GDP has grown steadily in the post-reform period. This means that the output of the organized sector has grown at a higher rate than the GDP in the post-reform period. However, even though the organized sector has grown at a high rate in the post-reform period, employment in the organized sector remained more or less fixed. This implies that along with growth in output, there has been taking place continuously labour saving technological and managerial changes enabling the producers to expand their output without generating any employment. Hence, we will assume the employment level in the organized sector to be fixed. We will denote this fixed level of employment in the organized sector by \bar{N} . (However, the recent data on employment, which are, of course, not comparable to the data given in Tables 2.1 and 2.2, show that employment in the organized sector has increased with its output. Even if we make employment in the organized sector an increasing function of its output, all our results will go through.) Given these assumptions, the equilibrium condition of the organized sector may be written as follows:

$$Y = c_c \cdot \left(Y - \frac{W}{P_Y} \bar{N} - \frac{Br_0}{P_Y} \right) + c_w \cdot \alpha \left(\frac{P_X}{P_Y}, R \right) \cdot \left(\frac{W}{P_Y} \bar{N} + \frac{Br_0}{P_Y} \right) + I + a\tilde{X} \quad (2.1)$$

Let us now explain (2.1). The expression on the RHS represents aggregate demand for Y . We have divided the people who take part in the production of Y into two classes: the capitalists and workers. The capitalists earn profit and we have denoted their fixed average and marginal propensities to consume by c_c . W denotes money wage rate. Workers are under the compulsion to save to tide over periods of unemployment, illness and old age. They hold their entire saving, by assumption, in the form of bank deposits. B denotes the stock of bank deposits of the workers outstanding at the beginning of the given period under consideration and r_0 denotes the average interest rate applicable to B and it is, obviously, given in the given period. Br_0 is the interest income of the workers in the given period. Workers' fixed average and marginal propensity to consume is c_w . As workers are much poorer than the capitalists, it is standard to assume that c_w is larger than c_c . However, the workers allocate their consumption spending between the outputs of the organized sector and the unorganized sector. Consumption goods produced by the two sectors are substitutes. Note that the unorganized sector competes with the organized sector almost in every area such as food, clothing, shelter, repair and servicing, education, and healthcare. We assume that the workers spend α fraction of their total consumption spending on Y and α is an increasing function of $\frac{P_X}{P_Y}$, where P_X denotes the price of the output of the unorganized sector. During the Nehru-Mahalanobis era, a number of sectors such as textiles, agriculture, arricultural trade, retail etc, were reserved for the small producers only. However, the NEP through the process of economic reforms is gradually removing these restrictions. We denote the level of these restrictions by R . A fall in R indicates a decline in these restrictions.

Obviously, α is a decreasing function of R . I denotes investment of the organized sector. The standard assumption regarding I in the mainstream economics is that it is a decreasing function of the interest rate. However, as we have argued above, in a capitalist country, the capitalists have in their complete control all the prices and interest rates. In such circumstances, we consider it reasonable to postulate that the capitalists raise I to the maximum possible level so that Y is at its full capacity level, denoted \bar{Y} . This they do to maximize their command and use of produced goods and services so that they can use the maximum possible amount of produced goods and services to set up facilities for producing newer varieties of luxury consumption goods, better varieties of existing consumer goods and for making production less labour intensive. We divide the output of the unorganized sector, which we denote by X , into two parts. One part is produced without using any intermediate input bought from the organized sector. We denote this part of the output by \bar{X} . The other part of its output, which is produced with intermediate inputs bought from the organized sector is denoted by \tilde{X} . Finally, a denotes the requirement of Y per unit of production of \tilde{X} . Since it is not relevant for our purpose at the present, we have not incorporated taxes and government consumption in (2.1). We will incorporate them shortly. Substituting \bar{Y} for Y in (2.1), we rewrite it as follows:

$$\bar{Y} = c_c \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{N} - \frac{Br_0}{P_Y} \right) + c_w \cdot \alpha \left(\frac{P_X}{P_Y}, R \right) \cdot \left(\frac{W}{P_Y} \bar{N} + \frac{Br_0}{P_Y} \right) + I + a\tilde{X} \quad (2.2)$$

The Unorganized Sector

We assume that the producers in the unorganized sector are credit constrained. They need loans to buy the essential intermediate inputs from the organized sector. As they have little collateral to offer, they are able to secure only a small amount of loan, which does not enable them to fully utilize the labour, capital and land they have in their command. They produce the output using only family labour. We denote the given amount of loan they are able to secure by L_X . Hence, the amount of X they are able to produce with the loan is given by $\frac{L_X}{aP_{YX}}$, where P_{YX} is the average price of the intermediate inputs. We also assume that even if the producers fail to secure any credit and buy any input from the organized sector, they are able to produce a given amount of output, which we denote by \bar{X} . If they can secure loan, they can utilize their land and capital more intensively and raise their output above \bar{X} . (For example, farmers can produce some crop in their land using traditional technology and inputs, which they themselves produce. Similarly, weavers and handlooms can produce some clothing without using inputs of the organized sector.) We further assume that the producers of the unorganized sector keep aside β fraction of their output for self-consumption and investment and sell the rest in the market. Denoting the market supply of X by X^S , we get

$$X^S = \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_{YX}} \frac{1}{a} \right) \right) \left[\bar{X} + \frac{L_X}{P_{YX}} \frac{1}{a} \right] \quad (2.3)$$

Let us explain (2.3). Quite a large part of the output of the unorganized sector consists of the basic necessities of life such as food, clothing, shelter etc. Since small and marginal farmers cultivate about 85 percent of India's arable land (see NAABARD (2021)), almost the whole of agriculture is a part of the unorganized sector and it is by far the largest segment of the

unorganized sector. Since producers are heterogeneous in terms of their command over land and capital, we consider it reasonable to assume that the larger the X , the greater is the fraction of the producers who will be able to produce more than their subsistence requirement. Hence, we make β a decreasing function of X . The implication of this assumption is that many producers require loans to produce even the subsistence level of their output and if L_X falls below a certain minimum level, many producers may not be able to pay back their loans and may, thereby, lose their land and capital.

We assume that demand for X in the market comes only from the workers of the organized sector. Denoting it by X^D , we get

$$X^D = c_w \cdot \left(1 - \alpha \left(\frac{P_X}{P_Y}, R \right) \right) \cdot \left[\frac{W \cdot \bar{N} + Br_0}{P_X} \right] \quad (2.4)$$

Therefore, the unorganized sector is in equilibrium when the following equation is satisfied:

$$c_w \cdot \left(1 - \alpha \left(\frac{P_X}{P_Y} \right) \right) \cdot \left[\frac{W \cdot \bar{N} + Br_0}{P_X} \right] = \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_{YX}} \frac{1}{a} \right) \right) \left[\bar{X} + \frac{L_X}{P_{YX}} \frac{1}{a} \right] \quad (2.5)$$

We assume that the producers of the unorganized sector use the sales revenue to pay back their loans along with interest. They save the excess of the sales revenue, if any, over the debt service charges in the form of currency to tide over emergencies such as sudden illness, natural calamities, repairing of implements, treatment of animals etc. Since these producers are semiliterate or illiterate and since the bank branches may be located in far off places, the transaction cost of holding their small savings as bank deposits may be prohibitive. We make this assumption for analytical simplicity. Our results will go through even under more general assumptions. Normally, most of these producers are too poor to make any saving. Hence, it is unlikely to cause much harm, if we ignore their saving.

Regarding investment in the unorganized sector, we make the following observation. Most of the small investments made by the unorganized sector producers are produced in the unorganized sector and are included in the β fraction of output kept aside for self-use. Government supplies the unorganized sector with infrastructure inputs such as water, power, drainage, roads etc.

Our specification of the unorganized sector is complete.

Substituting for X its value in (2.2), we rewrite it as follows:

$$\bar{Y} = c_c \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{N} - \frac{Br_0}{P_Y} \right) + c_w \cdot \alpha \left(\frac{P_X}{P_Y}, R \right) \cdot \left(\frac{W}{P_Y} \bar{N} + \frac{Br_0}{P_Y} \right) + I + \frac{L_X}{P_{YX}} \quad (2.6)$$

We will now delineate the financial sector.

The Financial Sector

The financial sector consists of the RBI and the commercial banks only. We will henceforth refer to the latter as banks. Both the capitalists and the workers of the organized sector hold

their savings as bank deposits. The banks hold a fraction ρ of their deposits as cash reserve and lend out the rest. We make ρ a decreasing function of the interest rate r . However, the monetary policy of the RBI consists in keeping r at a target level \bar{r} . Hence, the supply of new bank loans in the period under consideration, denoted L^S is given by

$$L^S = (1 - \rho(\bar{r})) \cdot \left[(1 - c_c) \cdot \left(Y - \frac{W}{P_Y} \bar{N} - \frac{Br_0}{P_Y} \right) + (1 - c_w) \cdot \left(\frac{W}{P_Y} \bar{N} + \frac{Br_0}{P_Y} \right) \right] \quad (2.7)$$

The capitalists finance their entire investment of the corporate sector with new bank loans. The banks give a given L_X amount of new loans to the producers of the unorganized sector. Therefore, the equilibrium in the financial sector is given by the following equation:

$$(1 - \rho(\bar{r})) \cdot \left[(1 - c_c) \cdot \left(Y - \frac{W}{P_Y} \bar{N} - \frac{Br_0}{P_Y} \right) + (1 - c_w) \cdot \left(\frac{W}{P_Y} \bar{N} + \frac{Br_0}{P_Y} \right) \right] + b = I + \frac{L_X}{P_{YX}} \quad (2.8)$$

In (2.8), b denotes the RBI's new lending to the banks in the period under consideration. It may be positive or negative. If at \bar{r} , there emerges an excess demand for new bank loans, the RBI lends to the banks so that they can meet the excess demand. In this case, b is positive. On the other hand, if there emerges an excess supply at \bar{r} , the banks lend out their excess supply of loans to the RBI. In this case, b is negative. This is how r is kept at \bar{r} by the RBI.

The specification of our model is now complete. It contains three key equations (2.5), (2.6) and (2.8) in three endogenous variables P_X, I and b . We can solve them for the equilibrium values of the three endogenous variables. We can use this simple model to show how the New Economic Policy (NEP), which is being implemented through the process of economic reforms, enables the capitalists to expand their businesses at the expense of the unorganized sector. This is extremely worrying since more than ninety percent of the labour force works in the unorganized sector and the fraction of the labour force engaged in the unorganized sector is also steadily rising. Clearly, therefore, if the organized sector expands at the expense of the unorganized sector, it will increase immensely the poverty and misery of the masses. We will first focus on the implication of financial sector liberalization in this respect.

1.2.1 Financial Sector Liberalization

The NEP came into force in 1991 replacing the Nehru-Mahanobis Strategy (NMS). Under the latter, the ownership and control of the financial sector rested solely with the government. The government administered all the interest rates and directed the financial institutions how much to lend to each of the different sectors so that the plan targets of production and investment were fulfilled. Through this directed credit programme, the government provided the unorganized sector with large amounts of loans at very low interest rates so that the unorganized sector could grow at a fast rate ensuring high rates of growth of both employment and supply of mass consumption goods. The government regarded the unorganized sector as the priority sector and specified the priority sector lending norm which made sure that the producers of the unorganized sector did not suffer any dearth of credit. Under the NMS, the financial institutions were not commercial organizations. They were social organizations and their purpose was to mobilize all the savings of the masses by providing them with completely

safe and remunerative avenues of saving and to utilize this saving in such a manner that the plan targets of production and investment were fulfilled. The NEP, however, seeks to dismantle the directed credit programme, make the financial institutions profit driven and privatize the financial sector so that the market forces determine the allocation of resources. In other words, one of the objectives of the NEP is to transfer the ownership and control of the financial sector from the government to the capitalists enabling the latter to determine the interest rates and allocation of credit across different sectors, firms and individuals. The Government of India (GoI) is seeking to achieve this objective through the process of financial sector reforms. The reforms have already dismantled the directed credit programme diluted the priority sector lending norms substantially and made the financial institutions profit driven commercial organizations and given them the autonomy to set the interest rates and take their lending decisions. The government has also imposed on the banks lending norms that have made them extremely wary of lending to the risky borrowers. Moreover, in banks' parlance, the poorer a borrower the greater is the risk of lending to him. The government has also withdrawn its guarantee of bank deposits, which have made bank deposits unsafe and banks more cautious regarding their lending. We will denote all those factors that make banks more cautious regarding their lending by γ . Using our simple model, we will try to capture the implications of these changes. At the present, the imposition of Basel norms, which put great emphasis on the risk-weighted capital adequacy ratio, has made profit-driven financial institutions extremely cautious about lending to the small producers, who are financially weak. We, therefore, make L_X a decreasing function of γ and the degree of stringency of the Basel norms, which we denote by \emptyset . We also make it a decreasing function of the default rate of the small producers, which we denote by D . The analysis of chapter 2 shows that D is a decreasing function of X and R and an increasing function of r_X , where r_X is the interest rate at which the small producers receive loans. While the reason for D being a decreasing function of r_X is quite self-explanatory, the reasons why it is a decreasing function of X and R is not so. Let us, therefore, explain them briefly. If X goes up, given L_X , on account of a fall in a or P_{YX} or for some other reason, revenue of the small producers is found to go up lowering their default rate. Again, everything else remaining the same, if X rises because of an increase in L_X , the revenue of the small producers is assumed to increase more than the debt service charges. This is said to be the boundary condition of the model. This lowers the default rate of the small producers. Again an increase in R lowers α and it is found to increase the revenue of the small producers lowering their default rate.

Under the NEP, the financial institutions consider it extremely risky to lend to the small producers. Hence, they charge a risk premium, denoted ε , on the loans given to the small producers. While the large producers face \bar{r} , the small ones get loans at

$$r_X = \bar{r} + \varepsilon \quad (2.9)$$

Using (2.3) and (2.9), we get

$$D = D(X, r_X, R) = D\left(\bar{X} + \frac{L_X}{P_Y a}, \bar{r} + \varepsilon, R\right); D_X < 0, D_{r_X} > 0, D_R > 0 \quad (2.10)$$

From the above it follows that

$$L_X = \bar{F} \left(D \left(\bar{X} + \frac{L_X}{P_{YX}} \frac{1}{a}, \bar{r} + \varepsilon \right), \emptyset, \gamma \right) \equiv F(L_X, \bar{X}, P_{YX}, a, R, r_X, \emptyset, \gamma); \frac{\partial F}{\partial L_X} > 0, \frac{\partial F}{\partial a} < 0, \frac{\partial F}{\partial P_{YX}} < 0, \frac{\partial F}{\partial R} > 0, \frac{\partial F}{\partial \gamma} < 0, \frac{\partial F}{\partial \emptyset} < 0 \quad (2.14)$$

We assume that $F(D(\bar{X}, \bar{r} + \varepsilon), \emptyset, \gamma) > 0$ and $0 < F_D D_X X_{L_X} \equiv \frac{\partial F}{\partial L_X} \equiv f < 1$. Under these conditions, we can solve (2.14) for L_X . We show the solution of (2.14) in Figure 2.1 below:

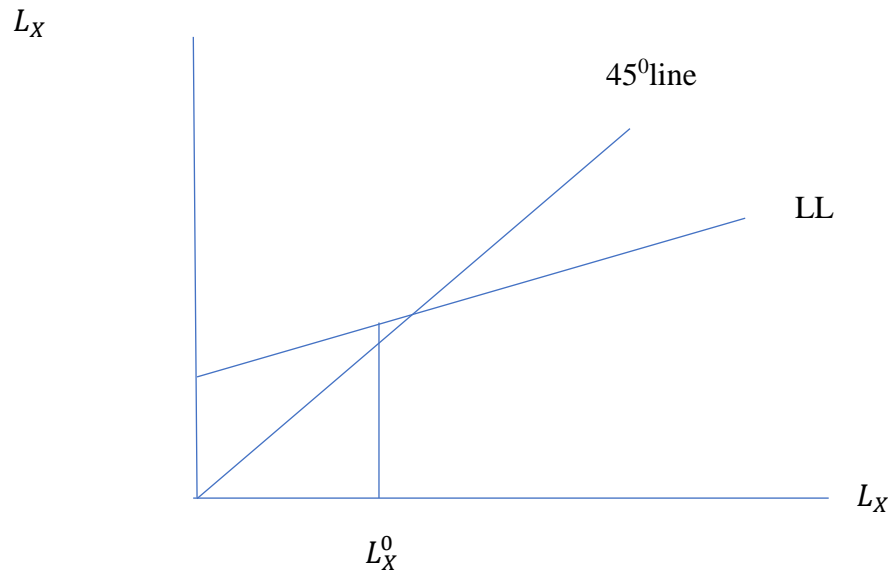


Figure 2.1

In Figure 2.1, LL represents (2.14) and the equilibrium L_X corresponds to the point of intersection of LL and the 45° line. The equilibrium L_X is denoted L_X^0 . Putting this equilibrium value of L_X in (2.3), we get the equilibrium value of X . Putting the equilibrium value of L_X or that of X in (2.5), we can solve it for the equilibrium value of P_X .

Using the model developed above, we have examined how an increase in γ and \emptyset affect X and I . We have also examined how withdrawal of government guarantee of bank deposits, bank fraud, price deregulation and relaxation of control on investment affect X and I . In other words, we have shown here how financial sector reforms, deregulation of investment and prices have benefited the capitalists at the expense of the masses.

Impact of Financial sector Reforms

We have examined first how financial sector reforms are likely to impact the economy. They have made banks profit driven, imposed on the banks lending norms that have made the banks extremely wary of lending to the small borrowers. In other words, these reforms have

substantially raised γ and \emptyset reducing on a large scale the supply of loans to the producers of the unorganized sector. This reduces X creating an excess demand for X at the initial equilibrium P_X . The increase in P_X restores equilibrium in the X market by inducing the workers of the organized sector to switch their spending from X to Y . The consequent decline in the revenue of the producers of X is, by assumption, larger than the fall in their debt service charges. Hence, their bankruptcy rate increases reducing loan supply to them further. Thus, there will take place a cumulative contraction in the output of the X -sector. The fall in demand for Y of the X -sector is likely to enable the capitalists to raise their investment despite the increase in the workers' consumption of Y . We, therefore, get the following proposition:

Proposition 2.1: Financial sector reforms are a weapon at the disposal of the capitalists to increase their market share at the expense of the unorganized sector creating mass unemployment and poverty. These reforms are also likely to allow the capitalists to grab a larger fraction of the GDP for their own use at the expense of the masses.

In order to fully appreciate the implications of the cumulative contraction in the output of the unorganized sector following the financial sector reforms, one has to take into account the following facts. From the data given in Tables 2.1 – 2.4 in Chapter 2, we find that the organized sector employed only 6 percent of the work force in 2004-05. The employment in the organized sector had been virtually stagnant during 1994 – 2014, while the work force had been growing at the rate of more than 2 percent per year during 1999-00 to 2004-05. There is no reason to believe that these trends have reversed since then. However, the recent data on employment, which are not comparable to the data given in the Tables mentioned above, have shown a reversal of the trend. Still, most of the poor people in India derive their livelihood from the unorganized sector at the present. Under these circumstances the cumulative contraction in the output of the unorganized sector due to the financial sector reforms is a cause of major concern. It will lead to a substantial increase in the level of unemployment and poverty threatening the survival of the ordinary Indians.

1.2.2 Deregulation of Prices

During the Nehru-Mahalanobis era, prices of all the essential industrial goods were administered by the government. The government also provided the small producers with inputs at highly subsidized prices. Economic reforms under the New Economic Policy (NEP), however, have done away with price regulation and input subsidy. In the post-reform period, therefore, P_{YX} has gone up steeply. This reduces X creating an excess demand at the initial equilibrium P_X . P_X , therefore, increases lowering M and raising VS until the two become equal at a lower value. The fall in revenue raises the default rate lowering the supply of loans to the small producers. Hence, X falls again. Thus, there takes place a cumulative fall in X enabling the capitalists to grab more of the market of the unorganized sector. The capitalists may also be able to raise their consumption and investment. This yields the following proposition:

Proposition 2.3: P_{YX} is an instrument of exploitation at the disposal of the capitalists. By raising it, they bring about a cumulative contraction in the output of the unorganized sector that produces for the masses and employs in India in all likelihood more than ninety-nine percent of the work force. This leads to a substantial increase in unemployment and poverty. The

capitalists grab more of the market of the unorganized sector and may be able to use the resources released from the production of X to raise their consumption and investment.

1.2.3 Forcible Acquisition of Land of the Small Producers

In the post-reform period, laws have been passed to facilitate forcible acquisition of land of the small producers. This lowers the collateral of the small producers. As a result, supply of loans to them falls leading to, through the process described in the earlier cases a cumulative fall in the output of the unorganized sector. This yields the following proposition:

Proposition 2.4: Forcible acquisition of land of the producers of the unorganized sector will lead to a cumulative decline in the output of the unorganized sector bringing about a substantial increase in unemployment and poverty. This will enable the capitalists to grab more of the market of the unorganized sector and may enable the capitalists to raise their investment on a large scale.

1.2.4 Decline in Public Investment in Infrastructure for the Unorganized Sector

Mishra (2006), Godara et. al. (2014)) show that public investment in agriculture, which is by far the largest segment of the unorganized sector, has declined steadily in the post-reform period. This steady fall in public investment may lead to deterioration in the quality of services provided by the already existing public infrastructure facilities. Hence, quality and quantity of the supply of power, water etc. may deteriorate; drainage and flood control facilities may lose gradually their efficiency. Hence, the producers of the unorganized sector may get less protection from the adverse impacts of drought, water logging, flooding etc. Hence, the productivity of the intermediate inputs they use may fall. In terms of our model, the fall in public investment in the area specified above may bring about an increase in a . This in turn, just as in the earlier cases, will lead to the following proposition:

Proposition 2.5: A decline in public investment in agriculture will bring about a cumulative contraction in the unorganized sector causing cumulative increase in unemployment and poverty. This will enable the capitalists to grab more of the market of the unorganized sector and may enable the capitalists to raise their investment on a large scale.

1.2.5 Conclusion

This study is based on the hypothesis that at the present India is under the complete control of the capitalists. They are making the Government of India undertake a series of Economic Reforms to implement the New Economic Policy (NEP), whose objective is to establish a free market and transfer the ownership of all the capital and natural resources to the capitalists. In sum, the NEP seeks to handover India to the capitalists so that they can run and manage India in whatever way they want. Our study shows that economic reforms in the financial sector and deregulation of prices coupled with forcible acquisition of land from the small producers and decline in public investment in agriculture lead to a large and cumulative shrinkage in the output of the unorganized sector enabling the capitalists to grab the market of the unorganized sector and have in their command a larger part of the aggregate output of goods and services for consumption and investment.

Since most of the ordinary people derive their livelihood from the unorganized sector and the organized sector grows without generating much employment, the shrinkage of the

unorganized sector is a matter of grave concern. If the capitalists, through the process of economic reforms and other means, succeed in obliterating the unorganized sector grabbing its market and resources, most of the ordinary Indians will perish. Thus, in the absence of mass awareness of and strong mass movement against capitalistic exploitation, ordinary people in India might be extinct.

1.3 Chapter 3: Monetary Policy in the Post-Reform Period and the Common Man in India

During the Nehru-Mahalanobis era, monetary policy consisted in a credit policy. The financial sector became the exclusive preserve of the government. The government administered all the interest rates and determined the total volume of credit to be disbursed by the financial institutions and dictated the allocation of the total amount of credit across different sectors and economic agents. The financial institutions had to abide by the dictates of the government. The objective of the credit policy delineated above was to make sure that all the sectoral production and investment targets specified in the Five-Year Plans were fulfilled and no leakage of credit took place in non-planned areas. The financial institutions were social organizations whose objective was not to make profit but to provide the people with fully safe avenues of saving and disburse credit in accordance with plan targets at interest rates administered by the government. The prices of all the non-agricultural essential goods and services were administered by the government. The financial sector and the credit policy were subservient to planning.

The New Economic Policy (NEP) that the Government of India adopted gave up planning and along with it the directed credit programme. It has opened up the financial sector to the private entrepreneurs, made the public financial institutions autonomous commercial organizations that are free to decide whom to lend, how much to lend and at what interest rates. The RBI under the NEP seeks to regulate the interest rates indirectly through policies such as open market operations (OMO), liquidity adjustment facility (LAF) etc. The RBI's monetary policy under the NEP consists in adoption of measures to reduce nominal interest rates to counter recession and to raise nominal interest rates to lower inflation rate when it goes beyond a tolerable level. The objective of this chapter is to subject this monetary policy to close scrutiny to unravel its ulterior motive.

We have used the model developed in the previous chapter for our purpose. We have based our study, as before, on the hypothesis that the capitalists drive a capitalist economy. It is they who create recession and inflation to exploit the masses. We will show here that the monetary policy delineated above instead of countering the recession reinforces them it and, thereby, facilitates the process of exploitation. It is subservient to the objective of the capitalists.

1.3.1 Counter-Recessionary Monetary Policy

As we have already pointed out, the monetary policy of the RBI consists in keeping the interest rate at a target level through policies such as the OMO, LAF etc. In times of recession, it cuts the interest rate to a low level. If that happens, workers' interest income in our model will fall. Hence, their spending on the output of the unorganized sector will fall. This will lower the revenue of the small producers raising their default rate. Loan supply to them will, therefore, fall reducing their output. This will set in motion, for reasons explained in the previous chapter, a cumulative process of decline in the output of the unorganized sector enabling the capitalists to grab the market of the small producers and, in all likelihood, raise their investment. This yields the following proposition:

Proposition 3.1: A cut in the interest rate brings about a cumulative contraction in the output of the unorganized sector and, thereby, deepens recession. It, therefore, brings about a cumulative increase in unemployment and poverty. It enables the capitalists to capture a part of the market of the unorganized sector. It is also highly likely that the capitalists will be able to use a larger part of the output of the organized sector for their own use.

1.3.2 An increase in \emptyset or γ and the Monetary Policy

We will show here how the counter recessionary monetary policy deepens the recession generated by a change made by the capitalists in the value of an instrument of exploitation. Thus, the counter recessionary monetary policy facilitates the capitalists' plan of reducing the unorganized sector. We will establish this claim by considering the example where the capitalists using the State Power bring about an increase in \emptyset . Since \bar{r} is cut to counter recession, it should be a decreasing function of the output gap defined as the excess of the potential real GDP and the actual real GDP. In our perception, the recession remains confined to the unorganized sector. Hence, we will make \bar{r} an increasing function of X , since the potential level of X is given. Thus, following a tightening of Basel norms, as we have shown in the previous chapter, there will take place a cumulative contraction in the output of the unorganized sector widening the output gap. This will induce the RBI to lower the interest rate. This will lead to, as shown above, a further cumulative contraction in X . This process will continue until a new equilibrium is achieved. This yields the following proposition:

Proposition 3.2: A tightening of Basel norms brings about a cumulative contraction in the output of the unorganized sector. This contraction is magnified significantly by the counter recessionary policy of the RBI. The capitalists, through the tightening of Basel norms, grab not only a large part of the market of the unorganized sector but also, in all likelihood, a larger part of the aggregate output of the organized sector for their own use.

The tightening of the Basel norms is just an example to show how the counter recessionary monetary policy deepens the recession in the unorganized sector caused by a change in a policy instrument of the capitalist aimed at reducing the output of the unorganized sector. Thus, a fall in \bar{N} brought about by the capitalists by bringing about more automation in production or a capitalist induced worsening of attitude of the banks towards the unorganized sector will lead to a shrinkage of the unorganized sector and this process of shrinkage will be facilitated greatly by the counter recessionary monetary policy. We will discuss another example where the banks raise r_X .

1.3.3 The Effect of an Increase in r_X

As we have pointed out earlier, we regard r_X as an instrument of the capitalists to exploit the small producers. r_X is independent of \bar{r} , the interest rate at which the capitalists secure loans for financing investment. In fact, in times of recession, r_X often goes up despite the fall in \bar{r} . This happens because in times of recession, banks become more cautious regarding their lending and in their perception the risk of lending to the small producers increases phenomenally. Thus, the risk premium that they charge on loans given to the small producers increases steeply in times of recession. This was in evidence in the USA (see Bernanke (1983), Bernanke, Gertler and Gilchrist (1996) and Mishkin (2009)). The capitalists by exercising State Power in India can make banks raise r_X . We will derive its impact mathematically now. A ceteris paribus increase in r_X should increase the default rate of the small producers inducing the banks to reduce loan supply to the small producers. This, just as in the earlier cases, will lead to a cumulative contraction in the output of the unorganized sector, which will be

aggravated considerably by the counter-recessionary monetary policy and the increase in the risk premium with the deepening of the recession. This yields the following proposition:

Proposition 3.3: An increase in r_x brings about a cumulative contraction in the output of the organized sector. This contraction is magnified significantly by the counter recessionary monetary policy of the RBI. The capitalists, by raising r_x , grab not only a large part of the market of the unorganized sector but also, in all likelihood, a larger part of the aggregate output of the organized sector for their own use.

1.3.4 Conclusion

This paper shows that the counter recessionary monetary policy is a part of the exploitative machinery of the capitalists. It brings about a large and cumulative contraction in the output of the unorganized sector and enables the capitalists to grab a large part of the market of the unorganized sector. The capitalists, in all likelihood, are also able to use a larger part of the output of the organized sector for their own use. The capitalists have many instruments at their disposal to bring about a shrinkage in the unorganized sector. The counter recessionary monetary policy deepens manifold the recession created by these instruments in the unorganized sector.

The scenario is obviously extremely scary in view of the fact that about 99 percent of the workforce derives their livelihood from the unorganized sector. The shrinkage of the unorganized sector raises unemployment and poverty significantly. If the capitalists swallow up the whole of the unorganized sector, the ordinary Indians will perish.

The interest rate is falling steadily since 2015 in India (see Table 3.6 in Chapter 3). The prices on the other hand are rising at an alarming rate (see Table 3.5 in Chapter 3). As a result, the real value of the savings of the workers and that of the interest income yielded by the savings are falling at a high rate benefiting the capitalists, who are net borrowers, and making the lives of the workers precarious. The central banks all across the capitalist world and its satellites such as India are carrying on with this extremely unjust monetary policy in the name of fighting recession, which the capitalists create to reduce the unorganized sector.

Clearly, unless the ordinary people become aware of the real cause of their plight, unless they become united, form their own party and grab the State Power, they are likely to become extinct. However, the spontaneous farmers' movement against the reforms in agriculture keeps the hopes for the ordinary people alive.

1.4 Chapter 4: Monetary Policy, Financial Sector Reform, Fiscal Policy and Land Grab in India

At the present, the monetary policy all across the capitalist world including India consists in pushing down the interest rates to the lowest possible level. Prices on the other hand increase continuously all across the capitalist world including India. As a result, both the principal amount of a loan and the interest income from it fall in real value continuously. This makes loans or financial assets such as bank deposits or bonds unattractive as instruments of saving. Again, the financial sector reforms undertaken in recent years such as the withdrawal of government guarantee of bank deposits and the bank frauds and the bank failures taking place

in the recent years have contributed to the vulnerability of the financial assets. Under these conditions, the savers get induced to divert their savings from the financial assets to real estate. This makes it profitable for the capitalists to appoint land sharks to force the small producers to part with their land. The capitalists sell this land to the savers and, thereby, make a huge profit. The capitalists are able to do so because, as we have explained in Chapters 2 and 3, they own all the political parties and wield the State Power. Obviously, the land lost by the small producers gets locked in unproductive uses, while the output of food and other mass consumption goods falls impoverishing the poor substantially.

The government's fiscal policy these days consists in switching from direct taxes to indirect ones so much so that the fraction of the total tax revenue contributed by the indirect taxes has been rising steadily of late and at the present the major part of the total tax revenue comes from the indirect taxes (see Table 4.1 of Chapter 4). We have shown here that a fall in the direct tax rates will also raise demand for land making it profitable for the capitalists to take away land from the small producers impoverishing the poor. A hike in indirect tax rate will also, as we show here, will bring about a cumulative fall in the small producers' output substantially increasing the poverty of the masses.

The NEP has drastically cut down the direct tax rates. Even though the government has hiked indirect tax rates to make up for the shortfall in revenue, there are limits to such hikes as they produce strong inflationary forces. The NEP has also put stringent restrictions on government's fiscal deficit. As a result, the government has become subject to acute fund shortage and there has taken place drastic fall in public investment in infrastructure that caters to the needs of the small producers and the poor (see in this context Mishra (2006) and Godara et. al.(2014)) . We have shown here how this decline in government expenditure will lead to unproductive real estate development at the cost of the land and output of the small producers substantially impoverishing the poor.

1.5 Conclusion

After gaining independence, India adopted the Soviet model of planned economic development. It modified the strategy a bit and drew up the Nehru-Mahalanobis Strategy of economic development. The objective of this strategy was to establish socialism. With this end in view, the government nationalized all natural resources and financial institutions. All the essential industrial sectors were made exclusive preserves of the government. The government played the major role in developing industry, agriculture and the financial sector of India. The capitalists were not allowed to invest in most sectors. To generate employment, quite a large number of sectors of production and distribution were reserved only for the small producers. All the prices and interest rates were under the control of the government. Through a system of licensing, the government used to regulate production, investment, import and export of the private sector. On the basis of the support received from the Soviet Union, India could adopt and carry on with this strategy of socialist development. However, with the weakening of the Soviet Union since the mid-eighties, the Western capitalists finally succeeded in forcing India to give up the Nehru-Mahalanobis Programme and adopt the NEP in its place in 1991(see Ghosh and Ghosh (2016), (2019^a, 2019^b). The objective of the NEP is to remove all kinds of government restrictions and regulations on economic activities of the capitalists, to sell of all government enterprises and natural resources to the capitalists and to do away with all

restrictions on cross-border trade of goods, services and capital. In other words, the objective of the NEP is to hand over India to the capitalists so that they can run and manage India the way they want to. The NEP is being implemented through a series of economic reforms. This thesis shows how the process of economic reforms is benefiting the capitalists causing immense misery and suffering to the masses.

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Chapter 2

Economic Reforms and the Common Man in India

Abstract

This study is based on the hypothesis that the capitalist countries are fully under the control of the capitalists and so is India. Using this postulate, this study shows that reforms in the financial sector and withdrawal of restrictions on the investments of the capitalists coupled with forcible acquisition of land of the small producers and decline in public investment in agriculture bring about a cumulative shrinkage of the unorganized sector enabling the capitalists to grab the market of the unorganized sector and also a larger part of the GDP for their own consumption and investment. This is a matter of grave concern since most of the ordinary Indians derive their livelihood from the unorganized sector. If the capitalists through these means succeed in obliterating the unorganized sector, most of the Indians will be threatened with extinction.

2.1 Introduction

India adopted the New Economic Policy (NEP) in 1991 replacing the Nehru-Mahalanobis Strategy (NMS) of economic development. The NEP is being implemented in India since 1991 through a series of Economic Reforms. The objective of the NEP is to privatize all the public sector enterprises and to establish free market by removing all kinds of restrictions and regulations of the NMS era. In other words, the objective of the NEP is to handover all the capital and natural resources of the country to the capitalists (the giant businessmen who control India's corporate sector) and to give them a free hand in running and managing their businesses. We will examine here the implications of some of the Economic Reforms for the capitalists and the common man. The question that naturally emerges here is why the Government of India is implementing the NEP and why the political parties in India have accepted the NEP. This is surprising because India is a democratic country. In a democracy, more than one party compete for State Power. Every adult citizen of a democratic country has one vote irrespective of his economic condition. Thus, democracy grants political equality. A general election is held every four or five years. The political party that gets the majority of the votes gets to exercise State Power until the next general election is held. In these circumstances, one would expect every political party to work for the masses who wield more than ninety-nine percent of the votes. If the political parties work for the masses, the political party in power should confiscate all the wealth of the capitalists and distribute them among the masses. It should nationalize the entire business empire of the capitalists and run it in the interest of the masses so that the masses get all the incomes and benefits from them. Thus, the political equality granted by democracy should eliminate economic inequality and establish an equal society overnight. Therefore, capitalists and capitalism cannot survive democracy. However, this never happens. Democracy does not threaten the capitalists or capitalism in any manner. In fact, the political parties in a democracy behave exactly in the opposite manner. They forcibly take away the land of the poor and give it away to the capitalists free of cost. This is definitely a mystery. Obviously, it is necessary to resolve this mystery in order to gain an understanding of how a capitalist society in general and India in particular work. We try to do it below.

A political party in a capitalist country does not have any source of income of its own. However, to set up and run a political party, an enormous amount of fund is needed. A political party requires a nation-wide network of dedicated workers, access to all kinds of media etc. The larger the amount of fund at the disposal of a political party, the greater is its competitive strength. Accordingly, only the wealthiest of the people can set up and run political parties. Thus, only the capitalists have the resources to set up and run political parties and they do so like their other country-wide or world-wide enterprises and, thereby, usurp State Power. Using the State Power, they keep the masses under control and secure their enormous wealth and business empire from the masses.

In a capitalist country, therefore, just like all the basic necessities of life and justice, the State Power is also an object of purchase and sale and it gets sold-off to the highest bidder.

Democracy is, therefore, a sham and the actual rulers of a capitalist country get themselves hidden behind an elaborate facade of political parties and the government. The capitalists love this camouflage so much that they call their countries not capitalist countries but democracies. Why do the capitalists, the actual rulers of the capitalist countries, get themselves hidden? They do so in order that the anger of the people due to the misery and suffering a capitalist society perpetrates on them get directed not towards the capitalists but towards the leaders of the political party in power, whom the people have themselves chosen as their ruler. Democracy also gives the people a way of giving vent to their anger. They do so by voting out the political party in power and bringing in another political party. The question that emerges is why capitalist societies make people's lives miserable. We will answer this question below.

If the workers have substantial bargaining strength, they can force the capitalists to raise their wage rates to such high levels that the capitalists may even suffer losses. Hence, the capitalists seek to ruin the bargaining strength of the workers by creating large scale unemployment through different means. They continuously incorporate automation in the production process to reduce labour requirement of production. They also keep the growth rate of aggregate production on the average at such a low level that the rate of growth of jobs falls short of the rate of growth of the labour force. In these ways, the capitalists create large scale and growing unemployment to destroy the bargaining strength of the workers. (For details of the view presented above, go through Ghosh and Ghosh (2019^a, 2019^b)). From the above it is clear why all the political parties who come to power in India try to implement the NEP, which seeks to hand over the country to the capitalists at an enormous cost to the masses.

The point to note in this context is that the capitalists who control India are not the Indian capitalists, but the capitalists of Western Europe and the USA, which are the leading capitalist countries of the world and colonized almost the whole of the rest of the world before the First World War had begun. The reason we say this is the following. The most important feature of India at the present is that it is completely dependent on the Western European countries and the US for knowledge and technology. Let us illustrate this claim with an example. Think of the case of teaching economics in India. All the text books we refer to are imported from the Western European countries and the US. All the journals we refer to are imported from the Western European countries and the US. All the computers and also all the software we use are bought from the companies of the US or West European origin. This is true of not only economics but also all other subjects. Thus, to set up an educational institute in India, all the knowledge inputs and all the hi-tech inputs have to be imported. This is applicable not only to the educational institutes but also to all the modern production facilities in India. Thus, to set up a bank in India, for example, all the computers, software and high-tech machines have to be imported from the US or Western European countries. India, therefore, has to import on a large scale to sustain its production and investment. However, to import from the Western Europe and the US, India requires currencies of these countries. To earn these currencies, India has to sell its products to these countries. Since India produces its goods and services with imported knowledge and technology, which are never state-of-the-art, India's ability to compete in the world market is virtually nil. Therefore, India cannot get itself going. How does it survive then? The only plausible hypothesis seems to be that the Western capitalists, that is, the capitalists of

the US and Western Europe, who have in their control almost all the enterprises and the governments of these countries, get India going by placing export orders with it and by buying India's bonds and stocks on a very large scale (see in this context Chapter 8 of Ghosh and Ghosh (2016) for evidential support) providing India with the requisite amount of foreign currency. Accordingly, India has to abide by the dictates of the Western capitalists at every step. Therefore, India is independent only on paper. It is virtually a colony of the Western capitalists. Since Indian capitalists do not have any independent base of knowledge and technology, they have no competitive strength vis-à-vis the Western capitalists and cannot survive as capitalists on their own. They are, therefore, one may safely presume, merely the representatives of the Western capitalists managing their businesses in India. Thus, the political parties in India are also owned and run by the Western capitalists. Hence, it is the Western capitalists who rule India and run all the large businesses in India. But, at the present, they do so not directly as in the colonial days but indirectly through their Indian representatives. To show how the capitalists rule India, we divide India into two sectors: the organized sector and the unorganized sector. The former consists of the corporate sector, public sector enterprises and large non-corporate private enterprises. The unorganized sector consists of small enterprises including small farming units and cottage and village industries. We will delineate the relevant main features of the two sectors below:

2.2 The Model

To show how the capitalists rule India, we divide India into two sectors: the organized sector and the unorganized sector. The former consists of the corporate sector, public sector enterprises and large non-corporate private enterprises. The unorganized sector consists of small enterprises including small farming units and cottage and village industries. We will delineate the relevant main features of the two sectors below:

The Organized Sector

Following Keynes (1936), we assume that aggregate output in the organized sector is demand determined. However, unlike Keynes (1936), here aggregate demand for the organized sector's output is completely under the control of the capitalists. The prices in the organized sector are set by the capitalists. We will not try to explain in this model how capitalists set the prices of their products and simply assume the prices in the organized sector to be given. We will denote the output of the organized sector by Y . From the data given in Tables 2.1 and 2.2, we find that the share of the organized sector in GDP has grown steadily in the post-reform period. This means that the output of the organized sector has grown at a higher rate than the GDP in the post-reform period. However, even though the organized sector has grown at a high rate in the post-reform period, employment in the organized sector remained more or less fixed. This implies that along with growth in output, there has been taking place continuously labour saving technological and managerial changes enabling the producers to expand their output without generating any employment. Hence, we will assume the employment level in the organized sector to be fixed. We will denote this fixed level of employment in the organized sector by \bar{N} . (Note that the recent data on employment, which are, of course, not comparable to the data of the tables mentioned above, have shown employment to be growing in the

organized sector. However, all our results will go through even if we make employment in the organized sector an increasing function of its output.) Given these assumptions, the equilibrium condition of the organized sector may be written as follows:

$$Y = c_c \cdot \left(Y - \frac{W}{P_Y} \bar{N} - \frac{Br_0(\bar{r})}{P_Y} \right) + c_w \cdot \alpha \left(\frac{P_X}{P_Y}, R \right) \cdot \left(\frac{W}{P_Y} \bar{N} + \frac{Br_0(\bar{r})}{P_Y} \right) + I + a\tilde{X} \quad (2.1)$$

Let us now explain (2.1). The expression on the RHS represents aggregate demand for Y . We have divided the people who take part in the production of Y into two classes: the capitalists and workers. The capitalists earn profit and we have denoted their fixed average and marginal propensities to consume by c_c . W denotes money wage rate. Workers are under the compulsion to save to tide over periods of unemployment, illness and old age. They hold their entire saving, by assumption, in the form of bank deposits. B denotes the stock of bank deposits of the workers outstanding at the beginning of the given period under consideration and r_0 denotes the average interest rate applicable to B . Let us now explain how r_0 is determined. The RBI through various means such as open market operations, liquidity adjustment facility etc. keep the interest rate at a target level, which we denote by \bar{r} . Every quarter, RBI revises \bar{r} . Quite a substantial part of the deposits mature within the span of a year. They are renewed and the current interest rates apply to the deposits that are renewed. Thus, r_0 is determined not only by the interest rates that prevailed in the past but also by \bar{r} , the interest rate prevailing in the given period. We make r_0 an increasing function of \bar{r} . $Br_0(\bar{r})$ is the interest income of the workers in the given period. Workers' fixed average and marginal propensity to consume is c_w . As workers are much poorer than the capitalists, it is standard to assume that c_w is larger than c_c . However, the workers allocate their consumption spending between the outputs of the organized sector and the unorganized sector. Consumption goods produced by the two sectors are substitutes. We assume that the workers spend α fraction of their total consumption spending on Y and the rest on the output of the unorganized sector. Note that the two sectors compete with one another in every sphere: food, clothing, shelter, health care, education, retail, repairing and servicing, banking, hotel, transport, entertainment etc. Hence, α should be highly sensitive to and an increasing function of $\frac{P_X}{P_Y}$, where P_X denotes the average price of the output of the unorganized sector, while P_Y denotes the average price of the goods and services produced by the organized sector. It should also be a function of the level of restrictions on the entry of the organized sector into the areas reserved for the unorganized sector. These reservations were made during the Nehru-Mahalanobis era to protect the unorganized sector from the organized sector. We denote the level of these restrictions by R . An increase in R indicates a rise in the level of restrictions and this brings about a fall in α . I denotes investment of the organized sector. The standard assumption regarding I in the mainstream economics is that it is a decreasing function of the interest rate. However, as we have argued above, in a capitalist country, the capitalists have in their complete control all the prices and interest rates. In such circumstances, we consider it reasonable to postulate that the capitalists raise I to the maximum possible level so that Y is at its full capacity level, denoted \bar{Y} . This they do to maximize their command and use of produced goods and services so that they can use the maximum possible amount of produced goods and services to set up facilities for producing newer varieties of luxury consumption goods, better varieties of existing consumer goods and for making production less labour intensive. We

divide the output of the unorganized sector, which we denote by X , into two parts. One part is produced without using any intermediate inputs bought from the organized sector. We denote this part of the output by \bar{X} . \bar{X} denotes that part of output of X , which the producers of the unorganized sector can produce utilizing their lands and capital fully using traditional technology and inputs that they themselves produce. \bar{X} is, therefore, given. To produce more than \bar{X} , the unorganized sector producers have to utilize their land and capital more intensively by using intermediate inputs bought from the organized sector. The part of its output, which is produced with intermediate inputs bought from the organized sector, is denoted by \tilde{X} . The average price of the intermediate inputs bought from the organized sector is denoted by P_{YX} . Finally, a denotes the requirement of Y per unit of production of \tilde{X} . Note that the value of a should depend upon the natural conditions, the quality of infrastructure inputs such as power, water, healthcare service etc. provided by the government. For simplicity, we do not consider these factors explicitly. Since it is not relevant for our purpose at the present, we have not incorporated taxes and government consumption in (2.1). Substituting \bar{Y} for Y in (2.1), we rewrite it as follows:

$$\bar{Y} = c_c \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{N} - \frac{Br_0(\bar{r})}{P_Y} \right) + c_w \cdot \alpha \left(\frac{P_X}{P_Y}, R \right) \cdot \left(\frac{W}{P_Y} \bar{N} + \frac{Br_0(\bar{r})}{P_Y} \right) + I + a\tilde{X} \quad (2.2)$$

The Unorganized Sector

We assume that the producers in the unorganized sector are credit constrained. They need loans to buy the essential intermediate inputs from the organized sector. As they have little collateral to offer, they are able to secure only a small amount of loan, which does not enable them to fully utilize the labour, capital and land they have in their command. They produce the output using only family labour. We denote the given amount of loan they are able to secure by L_X . Hence, the amount of X they are able to produce with the loan is given by $\frac{L_X}{aP_{YX}}$. We also assume that even if the producers fail to secure any credit and buy any input from the organized sector, they are able to produce a given amount of output, which we denote by \bar{X} . If they can secure loan, they can utilize their land and capital more intensively and raise their output above \bar{X} . (For example, farmers can produce some crop in their land using traditional technology and inputs, which they themselves produce. Similarly, weavers and handlooms can produce some clothing without using inputs of the organized sector.) Therefore, the output of the unorganized sector is given by

$$X = \bar{X} + \frac{L_X}{aP_{YX}} \quad (2.3)$$

We further assume that the producers of the unorganized sector keep aside β fraction of their output for self-consumption and investment and sell the rest in the market. Denoting the market supply of X by X^S , we get

$$X^S = \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_{YX} a} \right) \right) \left[\bar{X} + \frac{L_X}{P_{YX} a} \right] \quad (2.4)$$

Let us explain (2.4). Quite a large part of the output of the unorganized sector consists of the basic necessities of life such as food, clothing, shelter etc. Since small and marginal farmers cultivate about 85 percent of India's arable land (see NAABARD (2021)), almost the whole of agriculture is a part of the unorganized sector and it is by far the largest segment of the unorganized sector. Since the producers are heterogeneous in terms of their command over land and capital, we consider it reasonable to assume that the larger the X , the greater is the fraction of the producers who will be able to produce more than their subsistence requirement. Hence, we make β a decreasing function of X . The implication of this assumption is that if L_X falls below a certain minimum level, the producers may not be able to pay back their loans and may, thereby, lose their land and capital. Let us explain this point a little more. We assume here that a small or marginal producer requires a minimum amount of loan to produce his subsistence requirement of his output. If the amount of loan he is able to secure exceeds this minimum amount, he will be able to produce for the market. We assume here that the larger the amount of L_X , the greater is the fraction of producers who are able to secure more than their subsistence loan requirements and produce for the market. It also follows from the above discussion that, given the price of his output and the prices of his inputs prevailing in the market, a small producer requires a minimum amount of loan, which we will refer to as the break even amount of the loan, to earn as much revenue as is needed to pay back his loan along with interest. This break even amount of loan, given the price of X , is larger than the subsistence requirement of loan and it varies from producer to producer since the subsistence requirement of loan does so. Hence, the smaller the amount of L_X , the larger is the number of producers who will fail to secure the break even amount of loan and will, therefore, default on their loans, given the price of X and the prices of inputs prevailing in the market. At the time of securing the loan, however, the producers do not know at what price they will be able to sell their products, what the natural conditions would be, what quality of infrastructure services the government would make available to them, what prices they will have to pay for the inputs etc. and, therefore, they cannot determine what their break even amount of loan is at the time of securing the loans. The points made above will be clearer shortly.

We assume that the demand for X in the market comes only from the workers of the organized sector. Denoting it by X^D , we get

$$X^D = c_w \cdot \left(1 - \alpha \left(\frac{P_X}{P_Y}, R \right) \right) \cdot \left[\frac{W \cdot \bar{N} + B r_0(\bar{r})}{P_X} \right] \quad (2.5)$$

Therefore, the unorganized sector is in equilibrium when the following equation is satisfied:

$$c_w \cdot \left(1 - \alpha \left(\frac{P_X}{P_Y}, R \right) \right) \cdot \left[\frac{W \cdot \bar{N} + B r_0(\bar{r})}{P_X} \right] = \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_{YX}} \frac{1}{a} \right) \right) \left[\bar{X} + \frac{L_X}{P_{YX}} \frac{1}{a} \right] \quad (2.6)$$

We assume that the producers of the unorganized sector use the sales revenue to pay back their loans along with interest. They save the excess of the sales revenue, if any, over the debt service charges in the form of currency to tide over emergencies such as sudden illness, natural calamities, repairing of implements, treatment of animals etc. Since these producers are semiliterate or illiterate and since the bank branches may be located in far off places, the

transaction cost of holding their small savings as bank deposits may be prohibitive. We make this assumption for analytical simplicity. Our results will go through even under more general assumptions. Normally, most of these producers are too poor to make any saving. Hence, it is unlikely to cause much harm, if we ignore their saving.

Regarding investment in the unorganized sector, we make the following observation. Most of the small investments made by the unorganized sector producers are produced in the unorganized sector and are included in the β fraction of output kept aside for self-use. Government supplies the unorganized sector with infrastructure inputs such as water, power, drainage, roads etc.

Our specification of the unorganized sector is complete.

Substituting for \tilde{X} its value in (2), we rewrite it as follows:

$$\bar{Y} = c_c \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{N} - \frac{Br_0(\bar{r})}{P_Y} \right) + c_w \cdot \alpha \left(\frac{P_X}{P_Y}, R \right) \cdot \left(\frac{W}{P_Y} \bar{N} + \frac{Br_0(\bar{r})}{P_Y} \right) + I + \frac{L_X}{P_{YX}} \quad (2.7)$$

We will now delineate the financial sector.

The Financial Sector

The financial sector consists of the RBI and the commercial banks only. We will henceforth refer to the latter as banks. Both the capitalists and the workers of the organized sector hold their savings as bank deposits. The banks hold a fixed fraction ρ of their deposits as cash reserve and lend out the rest. Hence, the supply of new bank loans in the period under consideration, denoted L^S is given by

$$L^S = (1 - \rho) \cdot \left[(1 - c_c) \cdot (P_Y Y - W \bar{N} - Br_0(\bar{r})) + (1 - c_w) \cdot (W \bar{N} + Br_0(\bar{r})) \right] \quad (2.8)$$

The capitalists finance their entire investment of the corporate sector with new bank loans. The banks give a given L_X amount of new loans to the producers of the unorganized sector. Therefore, the equilibrium in the financial sector is given by the following equation:

$$(1 - \rho) \cdot \left[(1 - c_c) \cdot (P_Y Y - W \bar{N} - Br_0(\bar{r})) + (1 - c_w) \cdot (W \bar{N} + Br_0(\bar{r})) \right] + b = P_Y I + L_X \quad (2.9)$$

In (2.9), b denotes the RBI's new lending to the banks in the period under consideration. It may be positive or negative. If at \bar{r} , there emerges an excess demand for new bank loans, the RBI lends to the banks so that they can meet the excess demand. In this case, b is positive. On the other hand, if there emerges an excess supply at \bar{r} , the banks lend out their excess supply of loans to the RBI. In this case, b is negative. This is how r is kept at \bar{r} by the RBI.

The specification of our model is now complete. It contains four key equations (2.3), (2.6), (2.7) and (2.9) in four endogenous variables X , P_X , I and b . We can solve them for the equilibrium values of the four endogenous variables. We can use this simple model to show how the New Economic Policy (NEP), which is being implemented through the process of economic reforms, enables the capitalists to expand their businesses at the expense of the

unorganized sector. This is extremely worrying since more than ninety percent of the labour force works in the unorganized sector and the fraction of the labour force engaged in the unorganized sector is also steadily rising. Clearly, therefore, if the organized sector expands at the expense of the unorganized sector, it will increase immensely the poverty and misery of the masses. We will first focus on the implication of financial sector liberalization in this respect.

2.3 Financial Sector Liberalization

The NEP came into force in 1991 replacing the Nehru-Mahanobis Strategy (NMS). Under the latter, the ownership and control of the financial sector rested solely with the government. The government administered all the interest rates and directed the financial institutions how much to lend to each of the different sectors so that the plan targets of production and investment were fulfilled. Through this directed credit programme, the government provided the unorganized sector with large amounts of loans at very low interest rates so that the unorganized sector could grow at a fast rate ensuring high rates of growth of both employment and supply of mass consumption goods. The government regarded the unorganized sector as the priority sector and specified the priority sector lending norm which made sure that the producers of the unorganized sector did not suffer any dearth of credit. Under the NMS, the financial institutions were not commercial organizations. They were social organizations and their purpose was to mobilize all the savings of the masses by providing them with completely safe and remunerative avenues of saving and to utilize this saving in such a manner that the plan targets of production and investment were fulfilled. The NEP, however, seeks to dismantle the directed credit programme, make the financial institutions profit driven and privatize the financial sector so that the market forces determine the allocation of resources. In other words, one of the objectives of the NEP is to transfer the ownership and control of the financial sector from the government to the capitalists enabling the latter to determine the interest rates and allocation of credit across different sectors, firms and individuals. The Government of India (GoI) is seeking to achieve this objective through the process of financial sector reforms. The reforms have already dismantled the directed credit programme diluted the priority sector lending norms substantially and made the financial institutions profit driven commercial organizations and given them the autonomy to set the interest rates and take their lending decisions. The government has also imposed on the banks lending norms that have made them extremely wary of lending to the risky borrowers. Moreover, in banks' parlance, the poorer a borrower the greater is the risk of lending to him. The government has also withdrawn its guarantee of bank deposits, which have made bank deposits unsafe and banks more cautious regarding their lending. We will denote all those factors that make banks more cautious regarding their lending by γ . Using our simple model, we will try to capture the implications of these changes. At the present, the imposition of Basel norms, which put great emphasis on the risk-weighted capital adequacy ratio, has made profit-driven financial institutions extremely cautious about lending to the small producers, who are financially weak. We, therefore, make L_X a decreasing function of γ and the degree of stringency of the Basel norms, which we denote by \emptyset . We also make it a decreasing function of the default rate of the small producers, which we denote by D . Therefore, we have

$$L_X = \bar{F}(D, \gamma, \emptyset) \tag{2.10}$$

Let us now examine what factors determine D . For this, at first, we have to figure out how revenue earned by the producers of the unorganized sector changes following a decline in X and L_X . For this purpose, we rewrite (2.6) as follows:

Determination of P_X and M

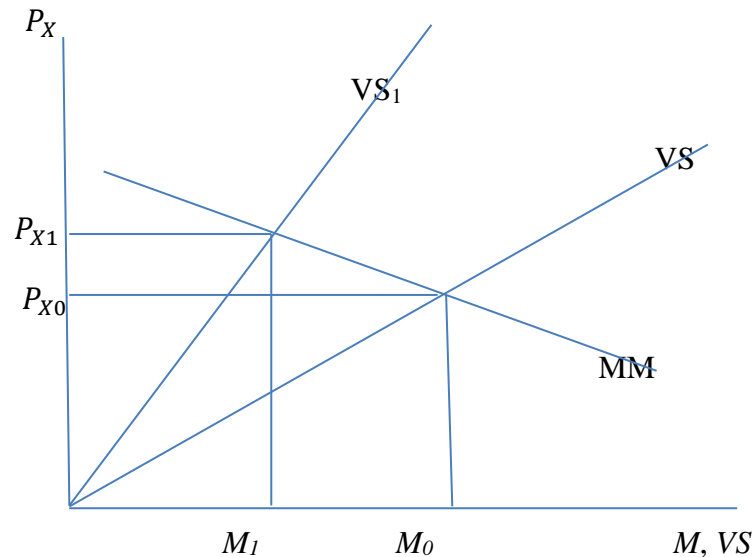


Figure 2.1

$$c_w \cdot \left(1 - \alpha \left(\frac{P_X}{P_Y}, R \right) \right) \cdot [W \cdot \bar{N} + B r_0(\bar{r})] = P_X \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_{YX}} \frac{1}{a} \right) \right) \left[\bar{X} + \frac{L_X}{P_{YX}} \frac{1}{a} \right] \quad (2.11)$$

The LHS of (2.11) gives the revenue of the producers of unorganized sector. We denote it by M . As we have already pointed out, α is an increasing function of $\frac{P_X}{P_Y}$ and it is likely to be highly sensitive to $\frac{P_X}{P_Y}$. This makes M a decreasing function of P_X and the absolute value of $\frac{\partial M}{\partial P_X}$ is likely to be fairly large. We can solve (2.11) for P_X .

The solution is shown in Figure 2.1 where P_X is measured on the vertical axis and M , and the value of the RHS denoted VS are measured on the horizontal axis. The MM schedule gives the value of M corresponding to different values of P_X . This schedule is downward sloping and fairly flat. The VS schedule gives the values of the marketable surplus of X corresponding to different values of P_X . It is a positively sloped ray through the origin.

Equilibrium values of M and P_X correspond to the point of intersection of the VS and MM schedules. The initial equilibrium values of M and P_X are denoted by M_0 and P_{X0} , respectively.

Following a given decrease in L_X , as follows from (2.11), the MM line remains unaffected, while the VS line rotates leftward and the equilibrium value of M falls and that of P_X rises. Solving (2.11), we get the equilibrium value of P_X as a function of L_X , \bar{X} , a , P_{YX} and R , among others. Putting this equilibrium value of P_X in the expression on the RHS of (2.11), we get

$$M = M(L_X, \bar{X}, a, P_{YX}, R); \quad \frac{\partial M}{\partial L_X} > 0, \frac{\partial M}{\partial \bar{X}} > 0, \frac{\partial M}{\partial a} < 0, \frac{\partial M}{\partial P_{YX}} < 0, \frac{\partial M}{\partial R} > 0 \quad (2.12)$$

Determination of L_X

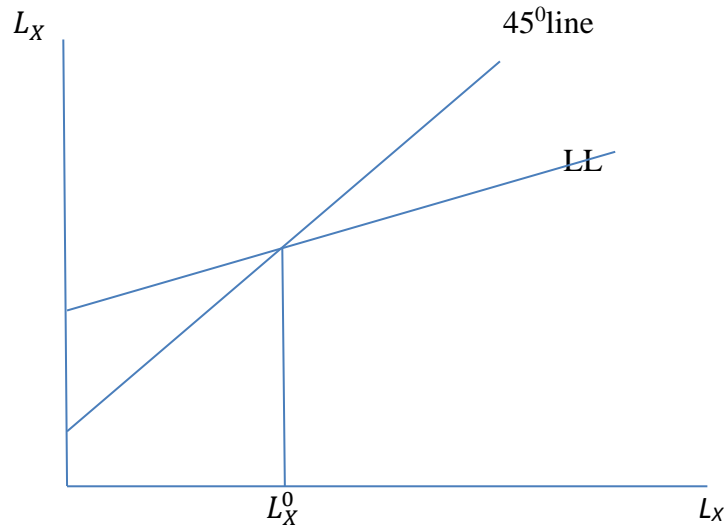


Figure 2.2

We have derived the sign of the first derivative using Figure 2.1. The signs of the other partial derivatives can be similarly derived using Figure 2.1. These signs can also be derived mathematically quite easily.

We make D a decreasing function of M for reasons that will be clear shortly.

$$D = \tilde{D}(M(L_X, \bar{X}, a, P_Y, \bar{N}, R, \bar{r})) \equiv D(L_X, \bar{X}, a, P_Y, \bar{N}, R, \bar{r}); \quad \frac{\partial D}{\partial L_X} < 0, \frac{\partial D}{\partial \bar{X}} < 0, \frac{\partial D}{\partial a} > 0, \frac{\partial D}{\partial P_{YX}} > 0, \frac{\partial D}{\partial R} < 0 \quad (2.13)$$

Let us explain the signs of the partial derivatives of (2.13). Following a given increase in L_X , as we have shown earlier, the amount of revenue (M) increases. We assume here that the increase in revenue per unit increase in L_X exceeds the amount of increase in debt service charges per unit increase in L_X . This is the boundary condition of the model. Obviously, producers of the unorganized sector will not be interested in securing loans if this condition is not satisfied. Thus, as L_X increases, the amount of credit secured exceeds the benchmark level of credit for a larger number of farmers. Hence, the default rate falls. Following an increase in \bar{X} , M rises corresponding to any given L_X . Hence, corresponding to any given level of L_X , the benchmark level of credit falls below the amount of credit secured for a larger number of small producers. Therefore, D falls.

Again, a rise in R raises M corresponding to any given L_X . Hence, corresponding to any given level of L_X , the benchmark level of credit falls below the amount of credit secured for a larger number of small producers. Therefore, D falls.

Similarly, the signs of all other partial derivatives can be explained.

From the above it is clear why it is sensible to make D a decreasing function of M .

Substituting (2.13) into (2.10), we rewrite it as

$$L_X = \bar{F}(D(L_X, \bar{X}, a, P_{YX}, R), \gamma, \emptyset) \equiv F(L_X, \bar{X}, a, P_{YX}, R, \gamma, \emptyset); \frac{\partial F}{\partial \bar{X}} > 0, \frac{\partial F}{\partial a} < 0, \frac{\partial F}{\partial P_{YX}} < 0, \frac{\partial F}{\partial R} > 0, \frac{\partial F}{\partial \gamma} < 0, \frac{\partial F}{\partial \emptyset} < 0 \quad (2.14)$$

We assume that $F(0, \bar{X}, a, P_{YX}, R, \gamma, \emptyset) > 0$ and $0 < \frac{\partial F}{\partial L_X} \equiv f < 1$. Under these conditions, we can solve (2.14) for L_X . We show the solution of (2.14) in Figure 2.2. In Figure 2.2, LL represents (2.14) and the equilibrium L_X corresponds to the point of intersection of LL and the 45° line. The equilibrium L_X is denoted L_X^0 . Putting this equilibrium value of L_X in (2.3), we get the equilibrium value of X . Putting the equilibrium value of L_X or that of X in (2.11), we can solve it for the equilibrium value of P_X . Finally, putting the equilibrium values of P_X and L_X in (2.7), we get the equilibrium value of I .

Using the model developed above, we will examine how an increase in γ and \emptyset affect X and I . Conversion of banks, which were social organizations under the NMS, into commercial entities, withdrawal of government guarantee of bank deposits and bank frauds raise γ , while tightening of Basel norms pushes up \emptyset . Thus, we will show here how financial sector reforms have benefited the capitalists at the expense of the masses.

Effect of an Increase in γ

We have already said that the financial sector reforms have made banks profit driven and extremely cautious about lending to the small producers, who are financially weak. Basel norms are becoming more and more stringent over time. The government is also continuously withdrawing its support to the public sector banks (PSBs) through the withdrawal of guarantee of deposits and the consequent introduction of the Financial Regulation and Deposit Insurance (FRDI) Bill. There has also taken place an alarming increase in bank frauds and defaults on bank loans by large borrowers. According to the RBI's Financial Stability Report 2018 (RBI (2018)), large borrowers accounted for 58.8 percent of gross advances and 85.6 percent of gross non-performing assets of banks. Ironically, however, (for reasons we have already explained), all the factors mentioned above are making the banks more cautious about lending to the small producers. Thus, the process of economic reforms is bringing about a steady increase in γ . We will examine its impact below:

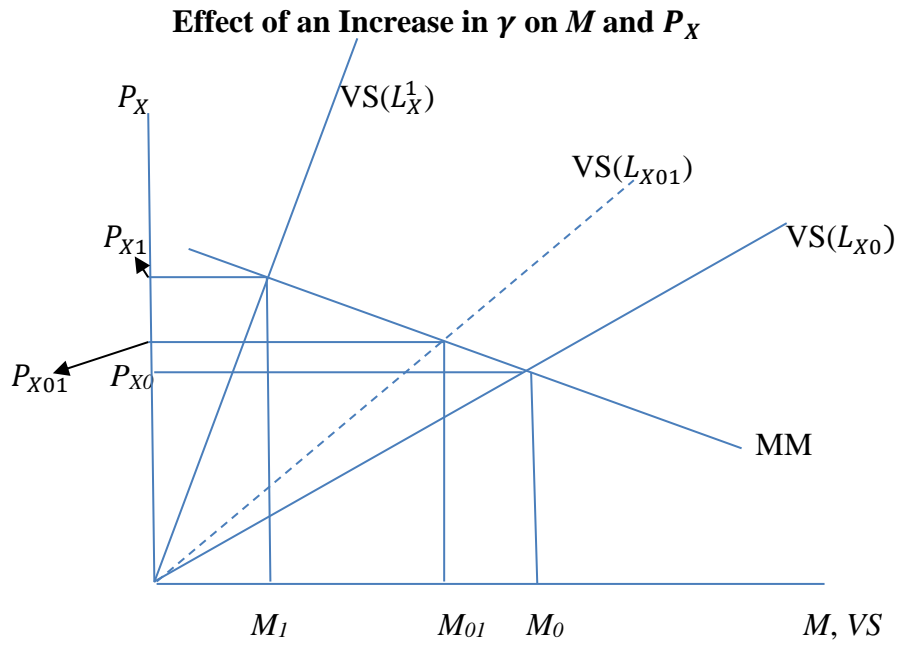


Figure 2.3

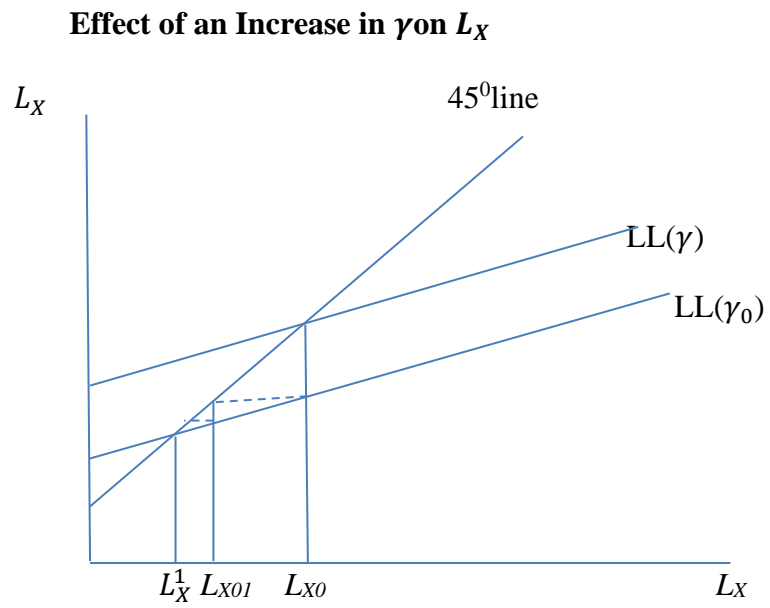


Figure 2.4

Let us first derive the effect using Figures 2.3 and 2.4 where the initial equilibrium levels of P_X , M and L_X are labeled P_{X0} , M_0 and L_{X0} , respectively. Let us first focus on Figure 2.4, where the LL schedule represents (2.14). It follows from (2.14) that, following an increase in γ by $d\gamma$ to γ_0 , there will take place a downward shift in the LL schedule. $LL(\gamma_0)$ represents the new LL schedule. Hence, the equilibrium L_X will fall from L_{X0} to L_X^1 .

Let us now consider Figure 2.3 where the initial equilibrium (M, P_X) labeled (M_0, P_{X0}) corresponds to the point of intersection of MM and $VS(L_{X0})$ schedules. The former represents the LHS of (2.11) and the latter represents the RHS of (2.11), when $L_X = L_{X0}$. Following the increase in γ by $d\gamma$ to γ_0 , as follows from the LHS of (2.11), the MM line remains unaffected. With the fall in L_X from L_{X0} to L_X^1 , the VS line rotates leftward to $VS(L_X^1)$. The new equilibrium (M, P_X) labeled (M_1, P_{X1}) corresponds to the point of intersection of MM and $VS(L_X^1)$ schedules. In the new equilibrium, L_X is less and, as follows from (2.3), X is also less. M is less too.

We will now derive these results mathematically. Taking total differential of (2.14) treating all variables other than L_X and γ as fixed and, then, solving for dL_X , we get

$$dL_X = \frac{F_\gamma d\gamma}{1-f} \quad (2.15)$$

Again, from (2.3) we get

$$dX = \frac{dL_X}{aP_{YX}} \quad (2.16)$$

Taking total differential of (2.11) treating all variables other than γ , L_X and P_X as fixed and, then, solving for dP_X , we get

$$dP_X = -\bar{\theta} dL_X, \quad \text{where } \bar{\theta} \equiv \frac{P_X \theta}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} > 0 \quad ; \quad X^m \equiv \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_{YX} a}\right)\right) \left[\bar{X} + \frac{L_X}{P_{YX} a}\right] > 0; \quad \frac{\partial X^m}{\partial L_X} \equiv \theta \equiv \left[(1 - \beta) + (-\beta') X\right] \frac{1}{aP_{YX}} > 0, \quad p \equiv \frac{P_X}{P_Y}, \quad \bar{W} \equiv W\bar{N} + Br_0(\bar{r}) \quad (2.17)$$

Finally, taking total differential of (2.7) treating all variables other than I , P_X and L_X as fixed and, then, solving for dI , we get

$$dI = -\left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y}\right] dL_X; \quad c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y} < \frac{1}{P_{YX}} \quad (\text{by assumption}) \quad (2.18)$$

Let us now explain the results given by (2.15) – (2.18). Following an increase in γ by $d\gamma$, as follows from (2.14), L_X goes down by $dL_{X1} = F_\gamma d\gamma$. This reduces X by $dX_1 = \frac{dL_{X1}}{aP_{YX}}$. Hence, at the initial equilibrium P_X , value of excess demand in the X market goes up by $P_X \theta dL_{X1}$. P_X , therefore, rises to clear the X market. Per unit increase in P_X , value of excess demand in the X – market falls by $X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}$. Accordingly, P_X goes up by $dP_{X1} = -\bar{\theta} dL_{X1}$. In Figure 2.4, L_X falls from L_{X0} by dL_{X1} to L_{X01} . With the fall in L_X to L_{X01} , the schedule $VS(L_X)$ in Figure 2.3 rotates leftward from $VS(L_{X0})$ to $VS(L_{X01})$. The MM schedule, however, remains unaffected. Hence, P_X rises from its initial equilibrium value by dP_{X1} to P_{X01} in Figure 2.3. Let us now focus on I . The fall in L_X lowers demand for Y of the X sector by $\frac{dL_{X1}}{P_{YX}}$. The fall in L_X by dL_{X1} , however, raises P_X by dP_{X1} . This raises α by $\alpha_p \frac{1}{P_Y} dP_{X1} = -\alpha_p \frac{1}{P_Y} \bar{\theta} dL_{X1}$. Hence, workers' demand for Y rises by $[-c_w \alpha_p \frac{1}{P_Y} \bar{\theta} \bar{W} dL_{X1}]$. In the net, therefore, demand for Y falls by $\left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y}\right] dL_X < 0$ enabling the capitalists to raise I by $dI_1 = -\left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y}\right] dL_{X1}$. This completes the first round changes. The fall in L_X by dL_{X1} in the first round, for reasons we have already explained, will raise the default rate and induce the banks to lower L_X further by $dL_{X2} = f \cdot dL_{X1}$. This will, again, lower X by $dX_2 = \frac{dL_{X2}}{aP_{YX}}$. The fall in L_X and the consequent decline in X will, just as in the first round, will raise P_X by $dP_{X2} =$

$-\bar{\theta}dL_{X2}$. The fall in L_X and the rise in P_X in the second round will, for reasons explained in round 1, will enable the capitalists to raise investment by $dI_2 = -\left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\bar{W}\frac{1}{P_Y}\right]dL_{X2}$. Similarly, in the third round, the changes in L_X , P_X and I are given respectively by $dL_{X3} = f \cdot dL_{X2} = f^2 \cdot dL_{X1}$, $dX_3 = \frac{dL_{X2}}{aP_{YX}}$ and $dI_3 = -\left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\bar{W}\frac{1}{P_Y}\right]dL_{X3}$. The process of contraction in X and increases in P_X and I will continue until the fall in L_X that takes place in each successive round eventually falls to zero. When that happens, the economy achieves the new equilibrium. Thus, the total changes in L_X , X , P_X and I are given respectively by

$$dL_X = dL_{X1} + dL_{X2} + dL_{X3} + \dots = dL_{X1} + f \cdot dL_{X1} + f^2 \cdot dL_{X1} + \dots = \frac{dL_{X1}}{1-f} = \frac{F_Y d\gamma}{1-f} \quad (2.19)$$

$$dX = \frac{dL_{X1}}{aP_{YX}} + \frac{dL_{X2}}{aP_{YX}} + \frac{dL_{X3}}{aP_{YX}} + \dots = \frac{dL_X}{aP_{YX}} \quad (2.20)$$

$$dP_X = -\bar{\theta}dL_{X1} - \bar{\theta}dL_{X2} - \bar{\theta}dL_{X3} - \dots = -\bar{\theta}dL_X \quad (2.21)$$

$$dI = -\left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\bar{W}\frac{1}{P_Y}\right]dL_{X1} - \left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\bar{W}\frac{1}{P_Y}\right]dL_{X2} - \left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\bar{W}\frac{1}{P_Y}\right]dL_{X3} - \dots = -\left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\bar{W}\frac{1}{P_Y}\right]dL_X \quad (2.22)$$

Eqs. (2.19), (2.20), (2.21) and (2.22) tally with (2.15), (2.16), (2.17) and (2.18), respectively, and, thereby, explain them.

The financial sector reforms are making the financial institutions profit driven and inducing them to regard the small producers as extremely risky borrowers even though the large borrowers are responsible in the main for both bank frauds and defaults. The financial sector reforms, therefore, brought about substantial increase in γ . Our analysis shows that an increase in γ will bring about a cumulative contraction in the output of the unorganized sector and a cumulative increase in the level of investment of the capitalists. The financial sector reforms have also brought about continuous tightening of Basel norms indicated by an increase in \emptyset . Following the line of analysis chalked out above, one can easily show that the impact of an increase in \emptyset will be similar to that of an increase in γ .

The above analysis yields the following proposition:

Proposition 2.1: Financial sector reforms are a weapon at the disposal of the capitalists to increase their market share at the expense of the unorganized sector creating mass unemployment and poverty. These reforms also allow the capitalists to grab a larger fraction of the GDP for their own use at the expense of the masses.

In order to fully appreciate the implications of the cumulative contraction in the output of the unorganized sector following the financial sector reforms, one has to take into account the following facts. From the data given in Tables 2.1 –2.4 , we find that the organized sector employed only 6 percent of the work force in 2004-05. The employment in the organized sector had been virtually stagnant during 1994 – 2014, while the labour force had been growing at the rate of more than 2 percent per year during 1999-00 to 2004-05. There is no reason to believe that these trends have reversed since then. However, the recent data on employment, which are, of course, not comparable to the data given in the tables mentioned above, show that the trend has reversed. Still, it may be safe to say that most of the ordinary Indians derive their livelihood from the unorganized sector at the present. Under these circumstances, the cumulative

contraction in the output of the unorganized sector due to the financial sector reforms is a cause of major concern. It will lead to a substantial increase in the level of unemployment and poverty threatening the survival of the ordinary Indians.

Clearly, the capitalists are making the government undertake the financial sector reforms to expand their business empire at the expense of the small producers and the masses.

2.4 Deregulation of Prices

During the Nehru-Mahalanobis era, prices of all the essential industrial goods were administered by the government. The government exercised control even over the prices of essential agricultural items through the Essential Commodities Act. The objective of the government during this period was to keep the prices of all essential goods and services fixed. Under the NEP, sweeping reforms are taking place in this area. The government is withdrawing its control over prices. In 2020, even the Essential Commodities Act has been amended to give the capitalists complete freedom in setting prices. The data given in Table 2.5 show that the inflation rate in the advanced capitalist countries has been positive in every year during the period 2010 – 2019 and the inflation rate in India has been substantially higher than that in the advanced capitalist countries. The question that automatically arises is why prices increase continuously in capitalist countries. The mainstream economics does not seem to have a clue. It has two theories of inflation: the demand pull and cost push. According to the former, the continuous increase in prices should be due to continuous emergences of shortages of goods and services in general at the prevailing set of prices. Why should such shortages arise continuously? The answer that mainstream economics gives is the following. It regards inflation as a monetary phenomenon and argues that if money supply grows at a faster rate than what is warranted by the rate of growth of GDP, shortages of goods and services will arise at the initial set of prices and prices will rise. However, it cannot explain why such a situation will arise continuously in capitalist countries.

Let us now focus on the cost push theory of inflation. It identifies an increase in the average cost of production as the cause of price increase. Let us now examine whether it can explain continuous increase in prices in capitalists countries. Consider all the firms, most of which are owned by the capitalists, all across the world together as a single giant firm. How does it produce goods and services? It hires workers to produce goods and services and pay them wages. It also borrows workers' savings and use them to finance its expenditures. It pays the workers interest on their savings. Therefore, wage payment and interest payment to the workers constitute the cost of production of the giant firm. According to the neoclassical cost-push theory, an increase in either the wage payment or the interest payment or both made by the giant firm per unit of output produced by it raises the unit or average cost of production, which in turn leads to an increase in the price level. This explanation is also untenable. For their survival, the capitalists have to keep the workers under their control and ruin their bargaining strength. They do so, as we have pointed out earlier, by usurping the State Power and by incorporating automation in the production process all the time to create large scale and growing unemployment. They also keep the growth rate at such a low level that the rate of growth of jobs falls short of the rate of growth

Effect of an Increase in P_{YX} on P_X and M

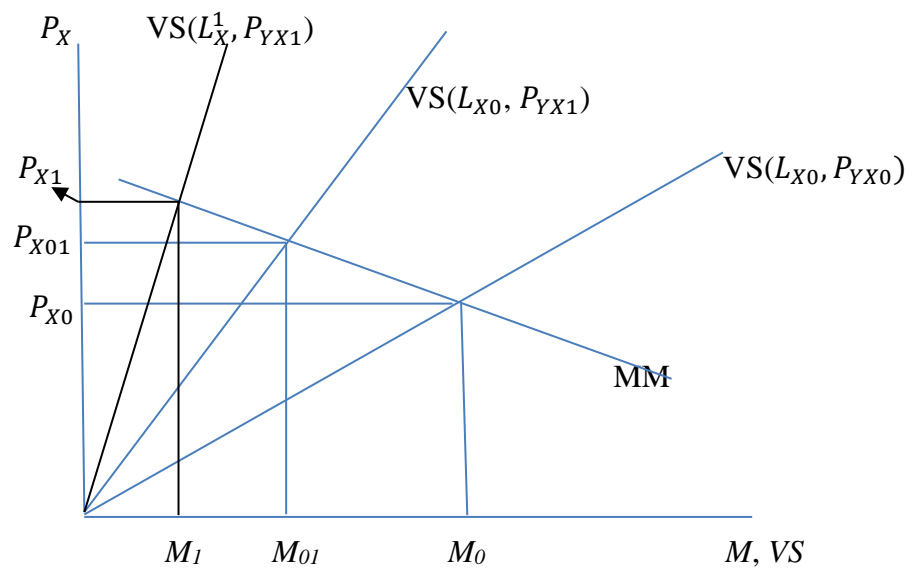


Figure 2.5

Effect of an Increase in P_{YX} on L_X

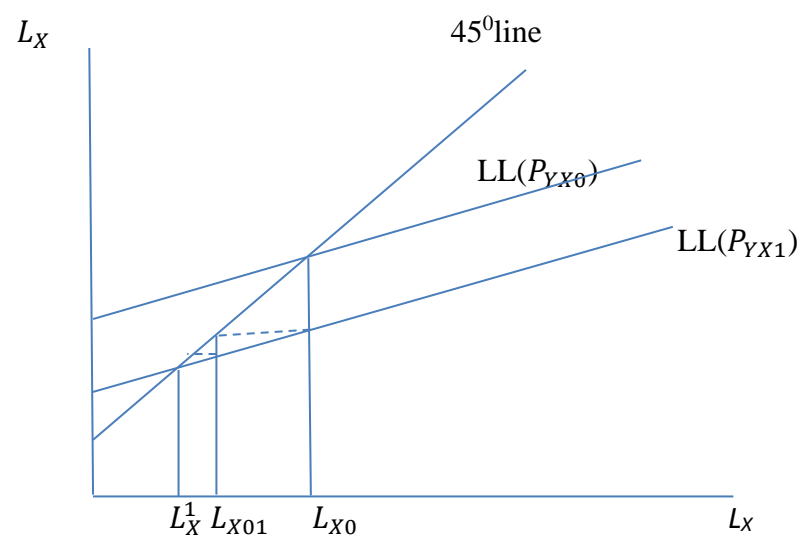


Figure 2.6

of the labour force. Thus, through the exercise of State Power and creation of large scale and growing unemployment, capitalists have ruined completely workers' bargaining strength. Workers have no say in the determination of the wage rate or the interest rate. They have to accept whatever wage rate and interest rate the capitalists offer them. Thus, the capitalists set

the wage rate and interest rate. Obviously, they set them at the lowest possible levels. Moreover, labour requirement per unit of output is falling continuously because of the relentless incorporation of labour saving technological changes in production. As a result, workers' income and, therefore, their saving and lending per unit of output are also falling continuously. Hence, the unit cost of production given by the sum of unit wage and interest costs paid out to the workers is falling continuously in capitalist countries. Neoclassical cost-push theory, therefore, fails to explain the continuous surge in prices in capitalist economies.

In what follows, we will explain why prices rise continuously in capitalist countries. To comprehend it, one should note that the capitalists are a closely knit united small class of people. They set the prices and prices rise continuously because they deliberately raise them continuously. Why do they do it? We will explain it below. We will show that the capitalists use prices as an instrument of exploitation. By raising prices the capitalists grab a larger fraction of the GDP for their own use at the expense of the masses.

We will consider the case where the capitalists raise P_{YX} . For simplicity, we will assume P_Y to remain fixed. During the Nehru-Mahalanobis era, the government used to supply the unorganized sector with inputs at highly subsidized low prices and used to protect this sector from the onerous effect of increase in input prices. Economic reforms have done away with the policy. Now the small producers have to buy all their inputs at their market prices, which the capitalists set.

We will derive below the impact of an increase in P_{YX} . We will do it first using Figures 2.5 and 2.6, where the initial equilibrium values of P_X , M and L_X are labeled P_{X0} , M_0 and L_{X0} respectively. Let us first focus on Figure 2.6, where the LL schedule represents (2.14). It follows from (2.14) that, following an increase in P_{YX} by dP_{YX} from P_{YX0} to P_{YX1} , there will take place a downward shift in the LL schedule. $LL(P_{YX1})$ represents the new LL schedule. Hence, the equilibrium L_X will fall from L_{X0} to L_X^1 .

Let us now consider Figure 2.5 where the initial equilibrium (M, P_X) labeled (M_0, P_{X0}) corresponds to the point of intersection of MM and $VS(L_{X0}, P_{YX0})$ schedules. The former represents the LHS of (2.11) and the latter represents the RHS of (2.11), when $L_X = L_{X0}$ and $P_{YX} = P_{YX0}$. Following the increase in P_{YX} by dP_{YX} to P_{YX1} , as follows from the LHS of (2.11), the MM line remains unaffected. With the fall in L_X from L_{X0} to L_X^1 , the VS line rotates leftward to $VS(L_X^1, P_{YX1})$. The new equilibrium (M, P_X) labeled (M_1, P_{X1}) corresponds to the point of intersection of MM and $VS(L_X^1, P_{YX1})$ schedules. In the new equilibrium, L_X is less and, as follows from (2.3), X is also less. M is less too.

We will now go into mathematical derivation of the results. Let us first focus on L_X . Taking total differential of (2.14) treating all variables other than L_X and P_{YX} as fixed and, then, solving for dL_X , we get

$$dL_X = \frac{f_{P_{YX}} dP_{YX}}{1-f} \quad (2.23)$$

Again, from (2.3) we get

$$dX = -\frac{L_X}{aP_{YX}^2} dP_{YX} + \frac{dL_X}{aP_{YX}} \quad (2.24)$$

Taking total differential of (2.11) treating all variables other than P_{YX} , L_X and P_X as fixed and, then, solving for dP_X , we get

$$dP_X = -\bar{\theta}dL_X + \mu \frac{L_X}{P_{YX}^2} dP_{YX}, \quad \text{where } \bar{\theta} \equiv \frac{P_X \theta}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} > 0; \quad X^m \equiv \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_Y} \frac{1}{a}\right)\right) \left[\bar{X} + \frac{L_X}{P_Y} \frac{1}{a}\right] > 0, \quad \frac{\partial X^m}{\partial L_X} \equiv \theta \equiv \left[(1 - \beta) + (-\beta')X\right] \frac{1}{a P_{YX}} > 0, \quad p \equiv \frac{P_X}{P_Y}, \quad \bar{W} \equiv W\bar{N} + Br_0(\bar{r}); \quad \mu \equiv \frac{P_X (1 - \beta) \frac{1}{a}}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} > 0 \quad (2.25)$$

Finally, taking total differential of (2.7) treating all variables other than I , P_X and L_X as fixed and, then, solving for dI , we get

$$dI = - \left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y} \right] dL_X + (1 - c_w \alpha_p \mu \bar{W}) \frac{L_X}{P_{YX}^2}; \quad c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y} < \frac{1}{P_{YX}}, \quad (1 - c_w \alpha_p \mu \bar{W}) > 0 \text{ (by assumption)} \quad (2.26)$$

Let us now explain the results given by (2.23) – (2.26). Following an increase in P_{YX} by dP_{YX} , as follows from (2.11), X goes down by $dX_1 = -\frac{L_{X0}}{a P_{YX}^2}$ at the initial equilibrium L_X . At the initial equilibrium P_X , therefore, the RHS of (2.11) denoted VS becomes less than its LHS denoted M . P_X begins to rise raising VS and lowering M until the two become equal at a lower value of M . The increase in P_X is given by $dP_{X1} = \mu \frac{L_{X0}}{P_{YX}^2} dP_{YX}$. The increase in P_{YX} produces two opposite effects on I . On the one hand, X-sector's demand for intermediate inputs falls by $-\frac{L_{X0}}{P_{YX}^2} dP_{YX}$. On the other hand, the increase in P_X by $dP_{X1} = \mu \frac{L_{X0}}{P_{YX}^2} dP_{YX}$ raises workers demand for Y by $c_w \alpha_p \bar{W} dP_{X1} = c_w \alpha_p \mu \bar{W} \frac{L_{X0}}{P_{YX}^2} dP_{YX}$. Under the assumption that $c_w \alpha_p \mu \bar{W} < 1$, capitalists will be able to raise I by $dI_1 = (1 - c_w \alpha_p \mu \bar{W}) \frac{L_X}{P_{YX}^2}$. This is the end of Round 1 changes. The decline in M that takes place in the first round at the initial equilibrium L_X makes larger number of small producers default on their loans. This induces the banks to lower L_X by $dL_{X2} = F_{P_{YX}} dP_{YX}$. This will reduce X further by $dX_2 = \frac{dL_{X1}}{a P_{YX}}$. Hence, at the initial equilibrium P_X , value of excess demand in the X market will go up by $-P_X \theta dL_{X2}$. P_X will, therefore, rise to clear the X market. Per unit increase in P_X , value of excess demand in the X -market falls by $X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}$. Accordingly, P_X will go up by $dP_{X2} = -\bar{\theta} dL_{X2}$. Let us now focus on I . The fall in L_X lowers demand for Y of the X sector by $\frac{dL_{X2}}{P_{YX}}$. The fall in L_X by dL_{X2} , however, raises P_X by dP_{X1} . This raises α by $\alpha_p \frac{1}{P_Y} dP_{X2} = -\alpha_p \frac{1}{P_Y} \bar{\theta} dL_{X1}$. Hence, workers' demand for Y rises by $= -c_w \alpha_p \frac{1}{P_Y} \bar{\theta} \bar{W} dL_{X2}$. In the net, therefore, demand for Y falls by $\left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y} \right] dL_{X2}$ enabling the capitalists to raise I by $dI_2 = - \left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \frac{1}{P_Y} \right] dL_{X2}$. This completes the second round changes. The fall in L_X by dL_{X2} in the second round, for reasons we have already explained, will raise the default rate and induce the banks to lower L_X further by $dL_{X3} = f \cdot dL_{X1}$. This will, again, lower X by $dX_3 = \frac{dL_{X3}}{a P_{YX}}$. The fall in L_X and the consequent decline in X will, just as in the first round, will raise P_X by $dP_{X2} = -\bar{\theta} dL_{X2}$. The fall in L_X and the rise in P_X in the third round will, for reasons explained in Round 2, will enable the capitalists to raise investment by $dI_3 = - \left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y} \right] dL_{X3}$. Similarly, in the fourth round, the changes in L_X , P_X and I are given respectively by $dL_{X4} = f \cdot dL_{X3} = f^2 \cdot dL_{X2}$, $dX_4 = \frac{dL_{X4}}{a P_{YX}}$ and $dI_3 = - \left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y} \right] dL_{X4}$. The process of contraction in X and increases in P_X and I will continue until the fall in L_X that takes place in each successive round eventually falls to

zero. When that happens, the economy achieves the new equilibrium. Thus, the total changes in L_X , X , P_X and I are given respectively by

$$dL_X = dL_{X2} + dL_{X3} + dL_{X4} + \dots = dL_{X2} + f \cdot dL_{X2} + f^2 \cdot dL_{X2} + \dots = \frac{dL_{X2}}{1-f} = \frac{F_{PYX} dPYX}{1-f} \quad (2.27)$$

$$dX = -\frac{L_{X0}}{aP_{YX}^2} + \frac{dL_{X2}}{aP_{YX}} + \frac{dL_{X3}}{aP_{YX}} + \frac{dL_{X4}}{aP_{YX}} + \dots = -\frac{L_{X0}}{aP_{YX}^2} + \frac{dL_X}{aP_{YX}} \quad (2.28)$$

$$dP_X = \mu \frac{L_{X0}}{P_{YX}^2} dP_{YX} - \bar{\theta} dL_{X1} - \bar{\theta} dL_{X2} - \bar{\theta} dL_{X3} - \dots = \mu \frac{L_{X0}}{P_{YX}^2} dP_{YX} - \bar{\theta} dL_X \quad (2.29)$$

$$dI = (1 - c_w \alpha_p \mu \bar{W}) \frac{L_X}{P_{YX}^2} - \left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y} \right] dL_{X1} - \left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y} \right] dL_{X2} - \left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y} \right] dL_{X3} - \dots = (1 - c_w \alpha_p \mu \bar{W}) \frac{L_X}{P_{YX}^2} - \left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y} \right] dL_X \quad (2.30)$$

Eqs. (2.27), (2.28), (2.29) and (2.30) tally with (2.23), (2.24), (2.25) and (2.26), respectively, and, thereby, explain them.

From the above it follows that, following a given increase in P_{YX} , there will take place a cumulative decline in the output of the unorganized sector, a cumulative increase in the prices of the unorganized sector and a cumulative increase in capitalists' investment. This yields the following proposition:

Proposition 2.2: P_{YX} is an instrument of exploitation at the disposal of the capitalists. By raising it, they bring about a cumulative contraction in the output of the unorganized sector that produces for the masses and employs in India about ninety-nine percent of the labour force. This leads to a substantial increase in unemployment and poverty. The capitalists use the resources released to raise their consumption and investment. They also grab the market of the small producers.

The above proposition suggests an explanation of why prices rise continuously in capitalist countries. The neoclassical economics recommends free movement of prices and, thereby, facilitates capitalistic exploitation.

2.5 Forcible Acquisition of Land of the Small Producers

We have already pointed out that close to 99 percent of the Indians at the present derive their livelihood from the unorganized sector. The unorganized sector not only employs close to 99 percent of the workforce, it also produces the basic necessities of life for the masses such as food, clothing, shelter, education, health care, transport etc. Development in a civilized society should mean improvement of the economic condition of the masses. Obviously, to achieve this, the government has to take the major initiative, since the producers of the unorganized sector do not have the resources to develop their sector themselves. The government has to invest heavily in infrastructure to provide the producers of the unorganized sector with assured supply of water, power, transport etc. at low prices. It has to also investment on a large scale in R&D to improve the productivity of land, capital and the organized sector inputs used in the unorganized sector. Since the capitalists are enormously mighty financially and since they have the media completely under their control, the government has to protect the producers of the unorganized sector from competition from the capitalists. It has to prevent the capitalists from producing the goods and services that the unorganized sector produces. To protect the producers of the unorganized sector from capitalistic exploitation, the government should buy the products of the unorganized sector from the producers at remunerative prices and sell them the organized sector inputs at appropriately low prices so that the unorganized sector producers get a satisfactory rate of return on their production. The government should distribute the

produce procured among the masses at appropriately low prices through a public distribution system. Backed by the Soviet Union, the Government of India during the Nehru-Mahalanobis era followed such policies. However, with the disintegration of the Soviet Union in 1991, the capitalists conquered the political parties and the government again. At the present, the government under the New Economic Policy (NEP) is gradually and relentlessly withdrawing all the protection that the government gave to the unorganized sector during the Nehru-Mahalanobis era. Moreover, the government now-a-days is forcibly taking away land from the unorganized sector and is giving it away free of cost to the capitalists. Clearly, the scenario is extremely scary. If the capitalists, through their hold over the State Power, succeed in swallowing up the unorganized sector and produce all the goods and services employing just a minuscule section of the labour force, most of the people in India will perish. We will examine here how forcible acquisition of land from the producers of the organized sector will affect the rich and the poor in India.

Note that we can use \bar{X} as the index of the amount of land in the possession of the unorganized sector producers. \bar{X} denotes the amount of X they can produce utilizing fully the amount of land in their possession using traditional technology that does not require the use of intermediate inputs of the organized sector. We should make L_X an increasing function of the amount of land the producers of the unorganized sector can offer as collateral. We should, therefore, rewrite (2.14) as

$$L_X = \bar{F}(D(L_X, \bar{X}, a, P_{YX}, R), \gamma, \phi, \bar{X}) \equiv F(L_X, \bar{X}, a, P_{YX}, R, \gamma, \phi); \quad \frac{\partial F}{\partial \bar{X}} > 0, \quad \frac{\partial F}{\partial a} < 0, \quad \frac{\partial F}{\partial P_{YX}} < 0, \quad \frac{\partial F}{\partial R} < 0, \quad \frac{\partial F}{\partial \gamma} < 0, \quad \frac{\partial F}{\partial \phi} < 0 \quad (2.31)$$

We will now go into the mathematical derivation of the results. Let us first focus on L_X . Taking total differential of (2.31) treating all variables other than L_X and \bar{X} as fixed and, then, solving for dL_X , we get

$$dL_X = \frac{F_{\bar{X}} d\bar{X}}{1-f}; \quad F_{\bar{X}} \equiv (F_D D_{\bar{X}} + F_{\bar{X}}) < 0, \quad \text{when } d\bar{X} < 0 \quad (2.32)$$

Again, from (2.3) we get

$$dX = d\bar{X} + \frac{dL_X}{aP_{YX}} \quad (2.33)$$

Taking total differential of (2.11) treating all variables other than \bar{X} , L_X and P_X as fixed and, then, solving for dP_X , we get

$$dP_X = -\bar{\theta} dL_X + \bar{\mu} d\bar{X}, \quad \text{where } \bar{\theta} \equiv \frac{P_X \theta}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} > 0; \quad X^m \equiv \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_Y} \frac{1}{a}\right)\right) \left[\bar{X} + \frac{L_X}{P_Y} \frac{1}{a}\right] > 0, \quad \frac{\partial X^m}{\partial L_X} \equiv \theta \equiv [(1 - \beta) + (-\beta') X] \frac{1}{a P_{YX}} > 0, \quad p \equiv \frac{P_X}{P_Y}, \quad \bar{W} \equiv W\bar{N} + Br_0(\bar{r}); \quad \bar{\mu} \equiv -\frac{P_X [(1-\beta) + (-\beta')]}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} < 0 \quad (2.34)$$

Finally, taking total differential of (2.7) treating all variables other than I , P_X and L_X as fixed and, then, solving for dI , we get

$$dI = -\left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y}\right] dL_X - c_w \alpha_p \bar{\mu} \bar{W} d\bar{X}; \quad c_w \alpha_p \bar{\theta} \bar{W} \frac{1}{P_Y} < \frac{1}{P_{YX}}, \quad (\text{by assumption}) \quad (2.35)$$

Let us now explain the results given by (2.32) – (2.35). Following a decrease in \bar{X} by $d\bar{X}$, as follows from (2.11), X goes down by $dX_1 = d\bar{X}$ at the initial equilibrium L_X . At the initial

equilibrium P_X , therefore, the RHS of (2.11) denoted VS becomes less than its LHS denoted M . P_X begins to rise raising VS and lowering M until the two become equal at a lower value of M . The increase in P_X is given by $dP_{X1} = \bar{\mu}d\bar{X}$. This increase in P_X will raise workers' demand for Y by $c_w\bar{W}\alpha_p\bar{\mu}d\bar{X}$ lowering I by $dI_1 = c_w\bar{W}\alpha_p\bar{\mu}d\bar{X}$. This is the end of Round 1 changes. The decline in M that takes place in the first round at the initial equilibrium L_X makes larger number of small producers default on their loans. The fall in \bar{X} also reduces the collateral of the small producers. For both these reasons, the banks will lower L_X by $dL_{X2} = F_{\bar{X}}d\bar{X}$. This will reduce X further by $dX_2 = \frac{dL_{X2}}{aP_{YX}}$. Hence, at the initial equilibrium P_X , the value of excess demand in the X market will go up by $P_X\theta dL_{X2}$. P_X will, therefore, rise to clear the X market. Per unit increase in P_X , value of excess demand in the X -market falls by $X^m + c_w\bar{W}\alpha_p\frac{1}{P_Y}$. Accordingly, P_X will go up by $dP_{X2} = -\bar{\theta}dL_{X2}$. Let us now focus on I . The fall in L_X lowers demand for Y of the X sector by $\frac{dL_{X2}}{P_{YX}}$. The fall in L_X by dL_{X2} , however, raises P_X by dP_{X2} . This raises α by $\alpha_p\frac{1}{P_Y}dP_{X2} = -\alpha_p\frac{1}{P_Y}\bar{\theta}dL_{X2}$. Hence, workers' demand for Y rises by $= -c_w\bar{W}\alpha_p\frac{1}{P_Y}\bar{\theta}dL_{X2}$. In the net, therefore, demand for Y falls by $\left[\frac{1}{P_{YX}} - c_w\bar{W}\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X2}$ enabling the capitalists to raise I by $dI_2 = -\left[\frac{1}{P_{YX}} - c_w\bar{W}\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X2}$. This completes the second round of changes. The fall in L_X by dL_{X2} in the second round, for reasons we have already explained, will raise the default rate and induce the banks to lower L_X further by $dL_{X3} = f.dL_{X2}$ (see (2.14)). This will, again, lower X by $dX_3 = \frac{dL_{X3}}{aP_{YX}}$. The fall in L_X and the consequent decline in X will, just as in the second round, will raise P_X by $dP_{X3} = -\bar{\theta}dL_{X3}$. The fall in L_X and the rise in P_X in the third round will, for reasons explained in Round 2, will enable the capitalists to raise investment by $dI_3 = -\left[\frac{1}{P_{YX}} - c_w\bar{W}\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X3}$. Similarly, in the fourth round, the changes in L_X , P_X and I are given respectively by $dL_{X4} = f.dL_{X3} = f^2.dL_{X2}$, $dX_4 = \frac{dL_{X4}}{aP_{YX}}$ and $dI_3 = -\left[\frac{1}{P_{YX}} - c_w\bar{W}\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X4}$. The process of contraction in X and increases in P_X and I will continue until the fall in L_X that takes place in each successive round eventually falls to zero. When that happens, the economy achieves the new equilibrium. Thus, the total changes in L_X , X , P_X and I are given respectively by

$$dL_X = dL_{X2} + dL_{X3} + dL_{X4} + \dots = dL_{X2} + f.dL_{X2} + f^2.dL_{X2} + \dots = \frac{dL_{X2}}{1-f} = \frac{F_{\bar{X}}d\bar{X}}{1-f} \quad (2.36)$$

$$dX = d\bar{X} + \frac{dL_{X2}}{aP_{YX}} + \frac{dL_{X3}}{aP_{YX}} + \frac{dL_{X4}}{aP_{YX}} + \dots = d\bar{X} + \frac{dL_X}{aP_{YX}} \quad (2.37)$$

$$dP_X = \bar{\mu}d\bar{X} - \bar{\theta}dL_{X1} - \bar{\theta}dL_{X2} - \bar{\theta}dL_{X3} - \dots = \bar{\mu}d\bar{X} - \bar{\theta}dL_X \quad (2.38)$$

$$dI = -c_w\alpha_p\bar{\mu}d\bar{X} - \left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X1} - \left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X2} - \left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X3} - \dots = -c_w\alpha_p\bar{\mu}d\bar{X} - \left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_X \quad (2.39)$$

Eqs. (2.36), (2.37), (2.38) and (2.39) tally with (2.32), (2.33), (2.34) and (2.35), respectively, and, thereby, explain them.

From the above it follows that, following a given decrease in \bar{X} , there will take place a cumulative decline in the output of the unorganized sector, a cumulative increase in the prices of the unorganized sector and a cumulative increase in the market share of the organized sector. It is also highly likely that there will take place a cumulative increase in capitalists' investment. This yields the following proposition:

Proposition 2.3: Forcible acquisition of land of the producers of the unorganized sector will lead to a cumulative decline in the output of the unorganized sector bringing about a substantial increase in unemployment and poverty. This will enable the capitalists to grab a large part of the market of the unorganized sector. It is also quite likely that they will also be able to raise their investment on a large scale.

Besides the forcible acquisition of land from the producers of the unorganized sector, the government is also rendering production in the unorganized sector unprofitable by continuously reducing investment in infrastructure and R&D that caters to the unorganized sector. We will discuss its implications below:

2.6 Decline in Public Investment in Infrastructure for the Unorganized Sector

Mishra (2006), Godara et. al.(2014)) shows that public investment in agriculture, which is by far the largest segment of the unorganized sector, has declined steadily in the post-reform period. This steady fall in public investment may lead to deterioration in the quality of services provided by the already existing public infrastructure facilities. Hence, quality and quantity of the supply of power, water etc. may deteriorate, drainage and flood control facilities may lose gradually their efficiency. Hence, the producers of the unorganized sector may get less protection from the adverse impacts of drought, waterlogging, flooding etc. Hence, the productivity of the intermediate inputs they use may fall. In terms of our model, the fall in public investment in the area specified above may bring about an increase in a . We will derive below its effects on L_X , X , P_X and I .

We will now go into mathematical derivation of the results. Let us first focus on L_X . Taking total differential of (2.14) treating all variables other than L_X and a as fixed and, then, solving for dL_X , we get

$$dL_X = \frac{F_a}{1-f} da \quad (2.40)$$

Again, from (2.3) we get

$$dX = -\frac{L_X}{a^2 P_{YX}} da + \frac{dL_X}{a P_{YX}} \quad (2.41)$$

Taking total differential of (2.11) treating all variables other than a , L_X and P_X as fixed and, then, solving for dP_X , we get

$$dP_X = -\bar{\theta} dL_X + \sigma \frac{L_X}{a^2 P_{YX}} da, \quad \text{where } \bar{\theta} \equiv \frac{P_X \theta}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} > 0; \quad X^m \equiv \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_Y} \frac{1}{a}\right)\right) \left[\bar{X} + \frac{L_X}{P_Y} \frac{1}{a}\right] > 0, \quad \frac{\partial X^m}{\partial L_X} \equiv \theta \equiv [(1 - \beta) + (-\beta')X] \frac{1}{a P_{YX}} > 0, \quad p \equiv \frac{P_X}{P_Y}, \quad \bar{W} \equiv W\bar{N} + Br_0(\bar{r}); \quad \sigma \equiv \frac{P_X[(1-\beta)+X(-\beta')]}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} > 0 \quad (2.42)$$

Finally, taking total differential of (2.7) treating all variables other than I , P_X , a and L_X as fixed and, then, solving for dI , we get

$$dI = -\left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \frac{1}{P_Y}\right] dL_X - c_w \alpha_p \sigma \frac{L_X}{a^2 P_{YX}} da; \quad c_w \alpha_p \bar{\theta} \frac{1}{P_Y} < \frac{1}{P_{YX}} \text{ and } (1 - c_w \alpha_p \sigma) > 0 \quad (\text{by assumption}) \quad (2.43)$$

Let us now explain the results given by (2.40) – (2.43). Following a given increase in a by da , as follows from (2.11), X goes down by $dX_1 = -\frac{L_X}{a^2 P_{YX}} da$ at the initial equilibrium L_X . At the initial equilibrium P_X , therefore, the RHS of (2.11) denoted VS becomes less than its LHS denoted M . P_X begins to rise raising VS and lowering M until the two become equal at a lower value of M . The increase in P_X is given by $dP_{X1} = \sigma \frac{L_X}{a^2 P_{YX}} da$. This increase in P_X will raise workers' demand for Y by $c_w \bar{W} \alpha_p \sigma \frac{L_X}{a^2 P_{YX}} da$ lowering I by $dI_1 = -c_w \bar{W} \alpha_p \sigma \frac{L_X}{a^2 P_{YX}} da$. This is the end of Round 1 changes. The decline in M that takes place in the first round at the initial equilibrium L_X makes larger number of small producers default on their loans. The banks will, therefore lower L_X by $dL_{X2} = F_a da$. This will reduce X further by $dX_2 = \frac{dL_{X2}}{a P_{YX}}$. Hence, at the initial equilibrium P_X , the value of excess demand in the X market will go up by $-P_X \theta dL_{X2}$. P_X will, therefore, rise to clear the X market. Per unit increase in P_X , value of excess demand in the X -market falls by $X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}$. Accordingly, P_X will go up by $dP_{X2} = -\bar{\theta} dL_{X2}$. Let us now focus on I . The fall in L_X lowers demand for Y of the X sector by $\frac{dL_{X2}}{P_{YX}}$. The fall in L_X by dL_{X2} , however, raises P_X by dP_{X2} . This raises α by $\alpha_p \frac{1}{P_Y} dP_{X2} = -\alpha_p \frac{1}{P_Y} \bar{\theta} dL_{X2}$. Hence, workers' demand for Y rises by $[-c_w \bar{W} \alpha_p \frac{1}{P_Y} \bar{\theta} dL_{X2}]$. In the net, therefore, demand for Y falls by $\left[\frac{1}{P_{YX}} - c_w \bar{W} \alpha_p \bar{\theta} \frac{1}{P_Y} \right] dL_{X2}$ enabling the capitalists to raise I by $dI_2 = -\left[\frac{1}{P_{YX}} - c_w \bar{W} \alpha_p \bar{\theta} \frac{1}{P_Y} \right] dL_{X2}$. This completes the second round changes. The fall in L_X by dL_{X2} in the second round, for reasons we have already explained, will raise the default rate and induce the banks to lower L_X further by $dL_{X3} = f \cdot dL_{X2}$. This will, again, lower X by $dX_3 = \frac{dL_{X3}}{a P_{YX}}$. The fall in L_X and the consequent decline in X will, just as in the second round, raise P_X by $dP_{X3} = -\bar{\theta} dL_{X3}$. The fall in L_X and the rise in P_X in the third round will, for reasons explained in Round 2, will enable the capitalists to raise investment by $dI_3 = -\left[\frac{1}{P_{YX}} - c_w \bar{W} \alpha_p \bar{\theta} \frac{1}{P_Y} \right] dL_{X3}$. Similarly, in the fourth round, the changes in L_X , P_X and I are given respectively by $dL_{X4} = f \cdot dL_{X3} = f^2 \cdot dL_{X2}$, $dX_4 = \frac{dL_{X4}}{a P_{YX}}$ and $dI_4 = -\left[\frac{1}{P_{YX}} - c_w \bar{W} \alpha_p \bar{\theta} \frac{1}{P_Y} \right] dL_{X4}$. The process of contraction in X and increases in P_X and I will continue until the fall in L_X that takes place in each successive round eventually falls to zero. When that happens, the economy achieves the new equilibrium. Thus, the total changes in L_X , X , P_X and I are given respectively by

$$dL_X = dL_{X2} + dL_{X3} + dL_{X4} + \dots = dL_{X2} + f \cdot dL_{X2} + f^2 \cdot dL_{X2} + \dots = \frac{dL_{X2}}{1-f} = \frac{F_a da}{1-f} \quad (2.44)$$

$$dX = -\frac{L_X}{a^2 P_{YX}} + \frac{dL_{X2}}{a P_{YX}} + \frac{dL_{X3}}{a P_{YX}} + \frac{dL_{X4}}{a P_{YX}} + \dots = -\frac{L_X}{a^2 P_{YX}} + \frac{dL_X}{a P_{YX}} \quad (2.45)$$

$$dP_X = \sigma \frac{L_X}{a^2 P_{YX}} da - \bar{\theta} dL_{X1} - \bar{\theta} dL_{X2} - \bar{\theta} dL_{X3} - \dots = \sigma \frac{L_X}{a^2 P_{YX}} da - \bar{\theta} dL_X \quad (2.46)$$

$$dI = -c_w \alpha_p \sigma \frac{L_X}{a^2 P_{YX}} da - \left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \frac{1}{P_Y} \right] dL_{X1} - \left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \frac{1}{P_Y} \right] dL_{X2} - \left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \frac{1}{P_Y} \right] dL_{X3} - \dots = -c_w \alpha_p \sigma \frac{L_X}{a^2 P_{YX}} da - \left[\frac{1}{P_{YX}} - c_w \alpha_p \bar{\theta} \frac{1}{P_Y} \right] dL_X \quad (2.47)$$

Eqs. (2.44), (2.45), (2.46) and (2.47) tally with (2.40), (2.41), (2.42) and (2.43), respectively and, thereby, explain them.

From the above it follows that, following a given increase in a , there will take place a cumulative decline in the output of the unorganized sector, a cumulative increase in the prices of the unorganized sector and a cumulative increase in the market size of the organized sector.

It is also highly likely that there will take place a cumulative increase in capitalists' investment. This yields the following proposition:

Proposition 2.4: A decline in public investment in agriculture will bring about a cumulative contraction in the unorganized sector causing cumulative increase in unemployment and poverty. The capitalists will be able to grab a large part of the market of the unorganized sector. There may also take place also a cumulative increase in their investment.

2.7 Removal of Restrictions on Investments of the Capitalists

Since the organized sector is highly capital intensive and since most of the workers derive their livelihood from the unorganized sector, the planners during the Nehru-Mahalanobis era reserved certain sectors of production such as the textiles industry, retail trade, agricultural trade etc. exclusively for the small producers. The capitalists were not allowed to invest in these areas. Under the New Economic Policy, however, these restrictions are being withdrawn. In terms of our model, the economic reforms are continuously reducing R . We can examine the impact of a fall in R . We will derive this impact mathematically below.

Let us first focus on L_X . Taking total differential of (2.14) treating all variables other than L_X and R as fixed and, then, solving for dL_X , we get

$$dL_X = \frac{F_R}{1-f} dR < 0, \text{ when } dR < 0 \quad (2.48)$$

Again, from (2.3) we get

$$dX = \frac{dL_X}{aP_{YX}} \quad (2.49)$$

Taking total differential of (11) treating all variables other than R , L_X and P_X as fixed and, then, solving for dP_X , we get

$$dP_X = -\bar{\theta} dL_X + \rho \cdot dR, \quad \text{where } \bar{\theta} \equiv \frac{P_X \theta}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} > 0 \quad ; \quad X^m \equiv \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_Y a}\right)\right) \left[\bar{X} + \frac{L_X}{P_Y a}\right] > 0, \quad \frac{\partial X^m}{\partial L_X} \equiv \theta \equiv [(1 - \beta) + (-\beta')X] \frac{1}{aP_{YX}} > 0, \quad p \equiv \frac{P_X}{P_Y}, \quad \bar{W} \equiv W\bar{N} + Br_0(\bar{r}); \quad \rho \equiv \frac{-c_w \alpha_R \bar{W}}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} > 0 \quad (2.50)$$

Finally, taking total differential of (2.7) treating all variables other than I , P_X , R and L_X as fixed and, then, solving for dI , we get

$$dI = -\left[\frac{1}{P_{YX}} - c_w \bar{W} \alpha_p \bar{\theta} \frac{1}{P_Y}\right] dL_X - \left[-c_w \alpha_p \frac{1}{P_Y} \rho - c_w \alpha_R\right] \bar{W} \cdot (-dR); \quad c_w \bar{W} \alpha_p \bar{\theta} \frac{1}{P_Y} < \frac{1}{P_{YX}} \quad (\text{by assumption}) \quad (2.51)$$

Let us now explain the results derived above. Following a given decrease in R by dR , α rises by $-\alpha_R dR$. It produces two effects. First, workers' demand for Y will rise by $c_w \alpha_R \bar{W} dR$ lowering I by the same amount. Second, workers' demand for X falls by $c_w \alpha_R \bar{W} dR$ reducing the LHS of (2.11) denoted M by the same amount, while the RHS of (2.11) denoted VS remains unchanged. Hence, there emerges excess supply in the X -market at the initial equilibrium P_X . P_X begins to fall raising M and lowering VS until the two become equal at a lower value of M . The decrease in P_X is given by $dP_{X1} = \rho \cdot dR < 0$. This decrease in P_X will lower workers' demand for Y by $c_w \alpha_p \bar{W} \cdot \frac{1}{P_Y} \cdot \rho \cdot dR$ raising I by the same amount. However, it is clear from (2.11) that in the new equilibrium α must be less, that is, $-\alpha_p \cdot \frac{1}{P_Y} \cdot \rho \cdot dR < \alpha_R dR$. Hence, in

the net, I must fall by $dI_1 = -\left[c_w\alpha_R\bar{W}.dR - \left\{-c_w\alpha_p\frac{1}{P_Y}\rho\bar{W}.dR\right\}\right]$. This is the end of Round 1 changes. The decline in M that takes place in the first round at the initial equilibrium L_X makes larger number of small producers default on their loans. The banks will, therefore lower L_X by $dL_{X2} = F_R dR$. This will reduce X by $dX_2 = \frac{dL_{X2}}{aP_{YX}}$. Hence, at the initial equilibrium P_X , the value of excess demand in the X market will go up by $P_X\theta dL_{X2}$. Therefore, P_X will rise to clear the X market. Per unit increase in P_X , value of excess demand in the X -market falls by $X^m + c_w\bar{W}\alpha_p\frac{1}{P_Y}$. Accordingly, P_X will go up by $dP_{X2} = -\bar{\theta}dL_{X2}$. Let us now focus on I . The fall in L_X lowers demand for Y of the X sector by $\frac{dL_{X2}}{P_{YX}}$. The fall in L_X by dL_{X2} , however, raises P_X by dP_{X2} . This raises α by $\alpha_p\frac{1}{P_Y}dP_{X2} = -\alpha_p\frac{1}{P_Y}\bar{\theta}dL_{X2}$. Hence, workers' demand for Y rises by $= -c_w\bar{W}\alpha_p\frac{1}{P_Y}\bar{\theta}dL_{X2}$. In the net, therefore, demand for Y falls by $\left[\frac{1}{P_{YX}} - c_w\bar{W}\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X2}$ enabling the capitalists to raise I by $dI_2 = -\left[\frac{1}{P_{YX}} - c_w\bar{W}\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X2}$. This completes the second round of changes. The fall in L_X by dL_{X2} in the second round, for reasons we have already explained, will raise the default rate and induce the banks to lower L_X further by $dL_{X3} = f.dL_{X2}$. This will, again, lower X by $dX_3 = \frac{dL_{X3}}{aP_{YX}}$. The fall in L_X and the consequent decline in X will, just as in the first round, will raise P_X by $dP_{X3} = -\bar{\theta}dL_{X3}$. The fall in L_X and the rise in P_X in the third round will, for reasons explained in Round 2, will enable the capitalists to raise investment by $dI_3 = -\left[\frac{1}{P_{YX}} - c_w\bar{W}\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X3}$. Similarly, in the fourth round, the changes in L_X, X, P_X and I are given respectively by $dL_{X4} = f.dL_{X3} = f^2.dL_{X2}$, $dX_4 = \frac{dL_{X4}}{aP_{YX}}$ and $dI_3 = -\left[\frac{1}{P_{YX}} - c_w\bar{W}\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X4}$. The process of contraction in X and increases in P_X and I will continue until the fall in L_X that takes place in each successive round eventually falls to zero. When that happens, the economy achieves the new equilibrium. Thus, the total changes in L_X, X, P_X and I are given respectively by

$$dL_X = dL_{X2} + dL_{X3} + dL_{X4} + \dots = dL_{X2} + f.dL_{X2} + f^2.dL_{X2} + \dots = \frac{dL_{X2}}{1-f} = \frac{F_R dR}{1-f} < 0 \quad (2.52)$$

$$dX = \frac{dL_{X2}}{aP_{YX}} + \frac{dL_{X3}}{aP_{YX}} + \frac{dL_{X4}}{aP_{YX}} + \dots = \frac{dL_X}{aP_{YX}} < 0 \quad (2.53)$$

$$dP_X = \rho.dR - \bar{\theta}dL_{X1} - \bar{\theta}dL_{X2} - \bar{\theta}dL_{X3} - \dots = \rho.dR - \bar{\theta}dL_X \quad (2.54)$$

$$dI = -\left[c_w\alpha_R - c_w\alpha_p\frac{1}{P_Y}\rho\right]\bar{W}.dR - \left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X1} - \left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X2} - \left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_{X3} - \dots = -\left[c_w\alpha_R - c_w\alpha_p\frac{1}{P_Y}\rho\right]\bar{W}.dR - \left[\frac{1}{P_{YX}} - c_w\alpha_p\bar{\theta}\frac{1}{P_Y}\right]dL_X \quad (2.55)$$

Eqs. (2.52), (2.53), (2.54) and (2.55) tally with (2.48), (2.49), (2.50) and (2.51), respectively and, thereby, explain them.

From the above it follows that, following a given decrease in R , there will take place a cumulative decline in the output of the unorganized sector, a cumulative increase in the prices of the unorganized sector and a highly likely cumulative increase in capitalists' investment. This yields the following proposition:

Proposition 2.5: A decline in the level of restrictions on capitalists' investment in the areas reserved for the unorganized sector will bring about a cumulative contraction in the unorganized sector causing cumulative increase in unemployment and poverty. The capitalists

will grab a sizable part of the market of the unorganized sector. It is also highly likely that the capitalists will be able to bring about a cumulative increase in their investment.

2.8 Conclusion

This study is based on the hypothesis that at the present India is under the complete control of the capitalists. They are making the Government of India undertake a series of Economic Reforms to implement the New Economic Policy (NEP), whose objective is to establish free market and transfer the ownership of all the capital and natural resources to the capitalists. In sum, the NEP seeks to handover India to the capitalists so that they can run and manage India in whatever way they want. Our study shows that economic reforms in the financial sector, deregulation of prices, relaxation of restrictions on corporate investment in the areas reserved for the small producers coupled with forcible acquisition of land from the small producers and decline in public investment in agriculture lead to a large and cumulative shrinkage in the output of the unorganized sector enabling the capitalists to grab the market of the unorganized sector and have in their command a larger part of the aggregate output of goods and services for consumption and investment.

Since about 99 percent of the people derive their livelihood from the unorganized sector and the organized sector grows without generating any employment, the shrinkage of the unorganized sector is a matter of grave concern. If the capitalists, through the process of economic reforms and other means, succeed in obliterating the unorganized sector grabbing its market and resources, most of the ordinary Indians will perish. Thus, in the absence of mass awareness of and strong mass movement against capitalistic exploitation, ordinary people in India might be extinct.

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Table 2.1

Contributions of the Organized Sector and the Unorganized Sector to the Value added of Major Sectors of Production and NDP

Industry	1993-94		2003-04		2010-2011	
	Organized	Unorganized	Organized	Unorganized	Organized	Unorganized
Agriculture, Forestry and Fishing	3.5	96.5	4.1	95.9	5.8	94.2
Mining, manufacturing and Services	64.2	35.8	60.5	39.5	64.5	35.5
Electricity, construction and services	47.1	58.9	53.1	46.9	42.2	51.8
NDP	36.8	63.2	43.3	56.7	45.1	54.9

Source: CSO (2005): National Accounts Statistics 2005, Government of India and National Accounts Statistics 2012, Government of India

Table 2.2

Employment in the Organized sector (in million)

Year	Growth Rate Of GDP At Constant (2004-05) Prices	Number of Workers Employed
1994-95	6.4	27.53
2000-01	5.3	27.79
2001-02	5.5	27.20
2003-04	8.1	26.45
2004-05	7.0	26.46
2005-06	9.5	26.96
2006-07	9.6	27.24
2007-08	9.6	27.55
2008-09	6.7	28.18
2009-10	8.4	29.00
2010-11	8.4	29
2011-12	5.3	29.65

Source: RBI

Table 2.3

Sectoral Shares in Work Force (2004-05)

	Organised Sector	Unorganized sector
Percentage of Workforce Employed 2004-05	6	94

Source: NSSO 61st Round

Table 2.4**Labour Force, Work force and Unemployment (in million)**

	1993-94	1999-00	2004-05	1999-00 to 2004-05 Point to point annualised Growth rate
Labour Force	387.94	406.05	469.06	2.93
Work Force	374.45	397.00	457.82	2.89
Number of Unemployed	7.49	9.05	17.24	

Source: NSSO and Report of the Task Force on Employment Opportunities (planning Commission)

Table 2.5**Rate of Consumer Price Inflation (Annual %)**

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
France	1.5	2.1	1.9	0.8	0.5	0.04	0.2	1.03	1.9	1.1
Germany	1.1	2.1	2.0	1.5	0.9	0.5	0.5	1.5	1.7	1.4
UK	2.5	3.9	2.6	2.3	1.4	0.4	1.0	2.5	2.3	1.7
USA	1.6	3.1	2.0	1.5	1.6	0.1	1.3	2.1	2.4	1.8
HIC¹	2.0	3.4	2.7	1.5	1.0	0.32	0.4	1.5	1.8	1.6
India	11.1	8.9	9.3	10.9	6.4	5.9	4.1	2.5	4.9	7.7

(Source: International Monetary Fund)

Chapter 3

Monetary Policy in India: A Cruel Instrument of Exploitation

Abstract

The objective of this chapter is to show that monetary policy is an essential ingredient in the exploitative machinery of the capitalists. To accomplish this, it divides the Indian economy into two sectors: the organized sector and the unorganized sector. The former consists of the corporate sector, public sector and large private producers. The latter consists of the production units of the small producers. This chapter shows that counter-recessionary monetary policy of rate cut creates recession in the unorganized sector alone and enables the capitalists to grab a large part of the market of the unorganized sector. In all likelihood, it also enables the capitalists to utilize a larger part of the output of the organized sector for their own use. There are many other instruments by means of which the capitalists can bring about shrinkage of the unorganized sector. This study shows that the counter-recessionary monetary policy deepens significantly the recession in the unorganized sector created by these instruments and, thereby, facilitates the capitalists' plan of gradually obliterating the unorganized sector.

3.1 Introduction

In the pre-reform period in India, the monetary policy consisted in a credit policy. The government at that time administered all the interest rates and also determined the allocation of credit across all sectors and economic agents. The objective was to get all the plan targets of production and investment fulfilled. The financial institutions at that time were social organizations. Their purpose was to mobilize all the surplus fund of the people by providing them with a fully safe avenue of saving and disburse the savings thus mobilized in accordance with the directives of the government at the administered interest rates. The Economic Reforms have done away with planning and the directed credit programme. The financial institutions are now commercial organization. They are now free to set their interest rates and decide on the allocation of credit without any interference from the government. Their objective now is to maximize profit. The government does not give any guarantee to the deposits even of public sector banks. The monetary policy of the RBI at the present, just as in all the advanced capitalist countries, consists in keeping the interest rates at target levels indirectly through open market operations and other policies. The central banks in all the advanced capitalist countries have reduced the interest rates to as close to zero as possible giving the excuse of recession. Thus, for example, Japan went into a recession in 1992 and the Bank of Japan took measures to lowers interest rates to the minimum possible level. Japan is still in recession and the interest rates are still as close to zero as possible. The US went into the ‘Great Recession’ following the financial meltdown in 2007. The Fed in response undertook programmes that reduced interest rates to the minimum possible level. This is the scenario in Europe also since 2008. However, prices are continuously rising in all the advanced capitalist countries (see Table 3.5). In India also, the RBI, through its policies such as the open market operations, Liquidity Adjustment Facility etc. has been reducing interest rates steadily since 2015 (see Table 3.2). The prices on the other hand are spiraling upward at a high rate (see Table 3.1). The scenario is obviously extremely unjust for the lenders. Their nominal interest income is falling steadily and along with it the real value of the interest income and the principal amounts of their loans is declining rapidly. Clearly, the lenders’ loss is getting into the hands of the borrowers as gain. Is it possible to justify this redistribution in any manner? To this, we will now turn.

In all capitalist countries including India, workers are under the compulsion to save. They have to save as much as possible of their income to tide over periods of old age, illness, unemployment etc. Even though, they borrow to finance their purchase of houses and consumer durables, in the net, they are savers and lenders. The capitalists on the other hand borrow workers’ savings via the financial institutions where the workers park their savings. Since workers constitute more than ninety-nine percent of the people and since they are much poorer than the capitalists, the redistribution of income brought about by the fall in interest rates and rise in prices is unjust to the extreme. Let us now examine whether this can be justified as a counter recessionary measure going by the theories in mainstream macroeconomics. Since workers are much poorer than the capitalists, workers’ marginal propensity to consume is much higher than that of the capitalists. Therefore, a redistribution of income from the workers to the capitalists will substantially reduce aggregate consumption demand. However, a cut in interest rate, according to mainstream macroeconomics gives a boost to investment spending.

However, the large fall in consumption demand is likely to make a large dent in the morale or the animal spirits of the investors. Hence, investment, a la Keynesian economics, is also likely to fall. Thus, even if we go by the precepts of the mainstream macroeconomics, the redistribution of income from the lenders to the borrowers cannot be justified as a counter recessionary measure as well.

The redistribution of income discussed above is cruel to the extreme. The workers are unable to accumulate a comfortable amount of wealth through their saving to fall back on in their old age or in times of need. The plight of the retired workers also knows no bound. Their accumulated savings parked in the financial institutions and the interest income that they yield rapidly lose their purchasing power through the fall in the nominal interest rate and the secular increase in the price level at a high rate. Thus, a worker comfortably off at the time of retirement finds it difficult to make his two ends meet just after a few years. Mainstream economists and the political parties turn a blind eye to the suffering the monetary policy causes to the workers.

Despite the points made above, the central banks in all the advanced capitalist countries and their satellites such as India follow the monetary policy noted above. The question is why. We have already answered this question in Chapter 2 where we have argued that every capitalist country and their satellites like India are completely under the control of the Western capitalists and they own and run all the political parties and wield State Power. Accordingly, the Western capitalists dictate all the policies including the monetary policy. We will show here that the monetary policy the Government of India is following at the present is a cruel instrument of exploitation. It enables the capitalists to grab a larger share of aggregate production at the expense of the masses. We will use the model developed in Chapter 2 for our purpose.

3.2 The Model

The model of chapter 2 divides the real sector of the economy into two sub-sectors: the organized sector and the unorganized sector. The equilibrium condition of the organized sector is given by (2.7) of Chapter 2. It is presented below:

$$\bar{Y} = c_c \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{N} - \frac{B r_0(\bar{r})}{P_Y} \right) + c_w \cdot \alpha \left(\frac{P_X}{P_Y}, R \right) \cdot \left(\frac{W}{P_Y} \bar{N} + \frac{B r_0(\bar{r})}{P_Y} \right) + I + \frac{L_X}{P_{YX}} \quad (2.7)$$

Note that in (2.7) B denotes the stock of bank deposits of the workers outstanding at the beginning of the given period under consideration and r_0 denotes the average interest rate applicable to B . Let us now explain how r_0 is determined. The RBI through various means such as open market operations, liquidity adjustment facility etc. keep the interest rate at a target level, which we denote by \bar{r} . Every quarter, RBI revises \bar{r} . Quite a substantial part of the deposits mature within the span of a year. They are renewed and the current interest rates apply to the deposits that are renewed. Thus, r_0 is determined not only by the interest rates that prevailed in the past but also by \bar{r} , the

Determination of L_X

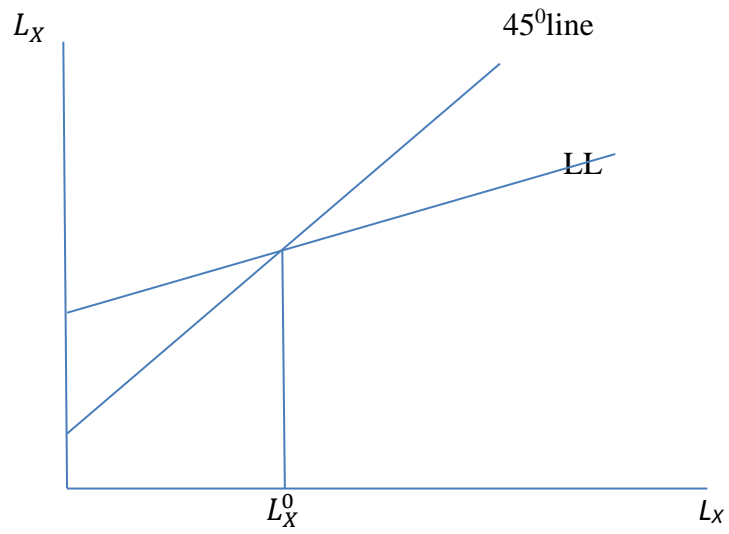


Figure 2.2

Determination of P_X and M

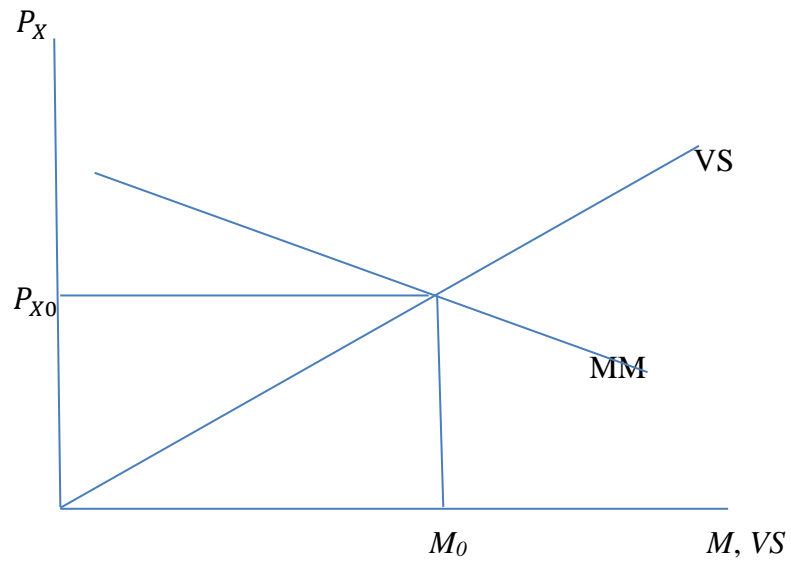


Figure 2.1

interest rate prevailing in the given period. We make r_0 an increasing function of \bar{r} . $Br_0(\bar{r})$ is the interest income of the workers in the given period.

The output of the unorganized sector is denoted by X . Its value is given by (2.3) of Chapter 2:

$$X = \bar{X} + \frac{L_X}{aP_{YX}} \quad (2.3)$$

The equilibrium condition of the unorganized sector is given by (2.6) of Chapter 2. We reproduce it below:

$$c_w \cdot \left(1 - \alpha \left(\frac{P_X}{P_Y}, R \right) \right) \cdot \left[\frac{W\bar{N} + Br_0(\bar{r})}{P_X} \right] = \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_{YX} a} \right) \right) \left[\bar{X} + \frac{L_X}{P_{YX} a} \right] \quad (2.6)$$

Equilibrium condition of the financial sector is given by (2.9) of Chapter 2. It is given below:

$$(1 - \rho) \cdot \left[(1 - c_c) \cdot (P_Y \bar{Y} - W\bar{N} - Br_0(\bar{r})) + (1 - c_w) \cdot (W\bar{N} + Br_0(\bar{r})) \right] + b = P_Y I + L_X \quad (2.9)$$

Finally, L_X in Chapter 2 is given by

$$L_X = \bar{F}(D(L_X, \bar{X}, a, P_{YX}, R), \gamma, \emptyset) \equiv F(L_X, \bar{X}, a, P_{YX}, R, \gamma, \emptyset); \quad \frac{\partial F}{\partial \bar{X}} > 0, \frac{\partial F}{\partial a} < 0, \frac{\partial F}{\partial P_{YX}} < 0, \frac{\partial F}{\partial R} > 0, \frac{\partial F}{\partial \gamma} < 0, \frac{\partial F}{\partial \emptyset} < 0 \quad (2.14)$$

Eqs. (2.3), (2.6), (2.7), (2.9) and (2.14) constitute a system of five equations in five endogenous variables: X , P_X , I , b and L_X . We solve then as follows: We assume that $F(0, \bar{X}, a, P_{YX}, R, \gamma, \emptyset) > 0$ and $0 < \frac{\partial F}{\partial L_X} \equiv f < 1$. Under these conditions, we can solve (2.14) for L_X .

We show the solution of (2.14) in Figure 2.2. In Figure 2.2, LL represents (2.14) and the equilibrium L_X corresponds to the point of intersection of LL and the 45° line. The equilibrium L_X is denoted L_X^0 . Putting this equilibrium value of L_X in (2.3), we get the equilibrium value of X . Putting the equilibrium value of L_X or that of X in (2.11), we can solve it for the equilibrium value of P_X . Putting the equilibrium values of P_X and L_X in (2.7), we get the equilibrium value of I . Finally, putting the values of I and L_X in (2.14), we get the equilibrium value of b .

With L_X fixed at its equilibrium value, we can solve (2.11) for P_X . The LHS of (2.11) gives the revenue of the producers of unorganized sector. We denote it by M . As we have already pointed out in Chapter 2, α is an increasing function of $\frac{P_X}{P_Y}$ and it is likely to be highly sensitive to $\frac{P_X}{P_Y}$. This makes M a decreasing function of P_X and the absolute value of $\frac{\partial M}{\partial P_X}$ is likely to be fairly large. The solution of P_X is shown in Figure 2.1 where P_X is measured on the vertical axis and, M and the value of the RHS denoted VS are measured on the horizontal axis. The MM schedule gives the value of M corresponding to different values of P_X . This schedule is downward sloping and fairly flat. The VS schedule gives the values of the marketable surplus of X corresponding to different values of P_X . It is a positively sloped ray through the origin.

Equilibrium values of M and P_X correspond to the point of intersection of the VS and MM schedules. The equilibrium values of M and P_X are denoted by M_0 and P_{X0} , respectively.

We are now in a position to use the model to examine how counter-recessionary monetary policy is likely to affect India.

3.3 Counter-Recessionary Monetary Policy

The monetary policy under the NEP consists in reducing \bar{r} to counter recession. The RBI is continuously lowering \bar{r} since 2015 to revive the economy (see Table 3.2). We will use this simple model to show how a cut in \bar{r} deepens recession by bringing about a shrinkage in the output of the unorganized sector and, thereby, enables the capitalists to expand their businesses at the expense of the unorganized sector. This is extremely worrying since about ninety-nine percent of the work force works in the unorganized sector and the fraction of the labour force engaged in the unorganized sector is also steadily rising. Clearly, therefore, if the organized sector expands at the expense of the unorganized sector, it will increase immensely the poverty and misery of the masses.

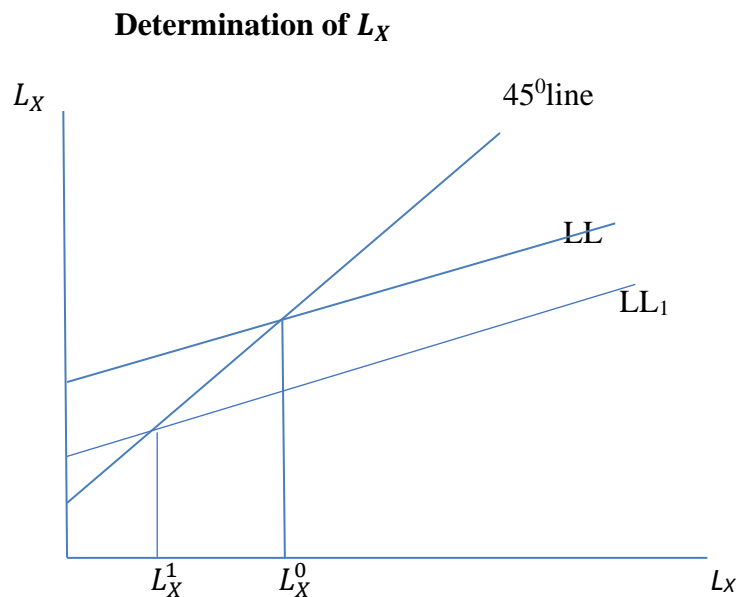


Figure 3.1

Determination of P_X and M

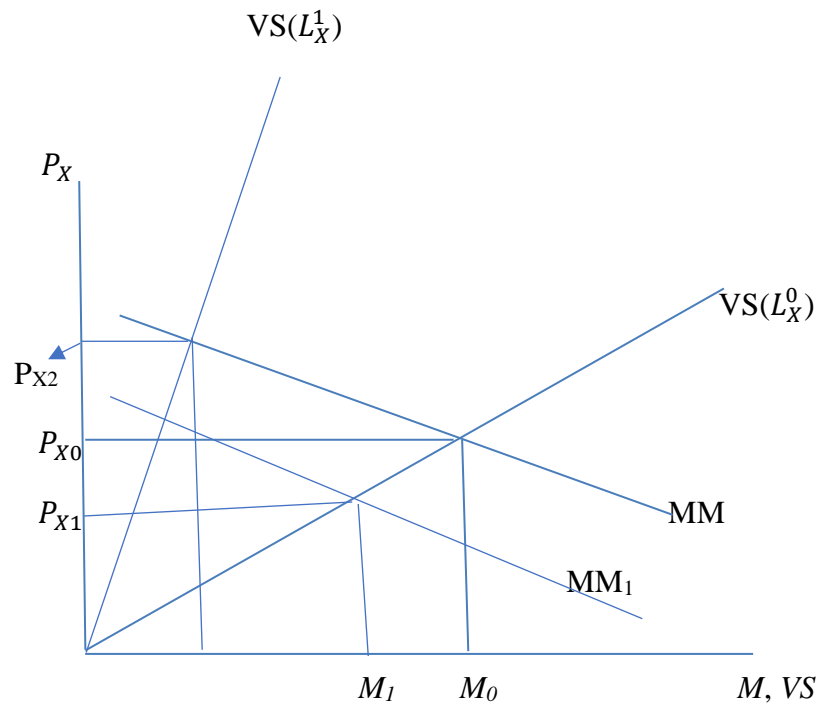


Figure 3.2

Let us first derive the effect of a cut in \bar{r} using Figures 3.1 and 3.2 where the initial equilibrium levels of P_X, M and L_X are labeled P_{X0}, M_0 and L_{X0} , respectively. Let us first focus on Figure 3.2, where the MM and $VS(L_X^0)$ schedules represent the LHS and RHS of (2.11), respectively, when L_X is fixed at L_X^0 . It follows from (2.11) that a cut in \bar{r} by $d\bar{r}$ to \bar{r}_0 will bring about a leftward shift in the MM schedule. The new MM is labeled MM_1 . The $VS(L_X^0)$ schedule, as follows from the RHS of (2.11), remains unaffected. Hence, both M and P_X go down to M_1 and P_{X1} , respectively. With L_X fixed at L_X^0 , the fall in M will make more small producers default on their loans. The result will hold not only for L_{X0} but also for any given level of L_X . Therefore, in (2.14), L_X should be an increasing function of \bar{r} . Thus, following a cut in \bar{r} , the LL schedule in Figure 3.1 should shift downward. The new LL schedule is labeled LL_1 . The L_X in the new equilibrium, therefore, falls from L_X^0 to L_X^1 . Accordingly, in the new equilibrium, as follows from (2.3), X will be less.

Let us now consider Figure 3.2 again, where the initial equilibrium (M, P_X) labeled (M_0, P_{X0}) corresponds to the point of intersection of MM and $VS(L_{X0})$. The former represents the LHS of (2.11) when the RBI has kept the current interest rate at \bar{r} and the latter represents the RHS of (2.11), when $L_X = L_{X0}$. Following the cut in r from \bar{r} to \bar{r}_0 , as follows from the LHS of (2.11), the MM line shifts leftward to MM_1 . With the fall in L_X from L_X^0 to L_X^1 , the VS line rotate leftward to $VS(L_X^1)$. The new equilibrium (M, P_X) labeled (M_1, P_{X1}) corresponds to the point of intersection of $MM(\bar{r}_0)$ and $VS(L_X^1)$. In the new equilibrium, therefore, along with L_X and X , M is less too.

We will now derive these results mathematically. Incorporating \bar{r} into (2.14) and, then, taking total differential of (2.14) treating all variables other than L_X and \bar{r} as fixed and, then, solving for dL_X , we get

$$dL_X = \frac{F_{\bar{r}}}{1-f} d\bar{r} \quad (3.1)$$

Again, from (2.3) we get

$$dX = \frac{dL_X}{aP_{YX}} \quad (3.2)$$

Taking total differential of (2.11) treating all variables other than \bar{r} , L_X and P_X as fixed and, then, solving for dP_X , we get

$$dP_X = -\bar{\theta}dL_X + \tilde{\theta}d\bar{r}, \text{ where } \bar{\theta} \equiv \frac{P_X\theta}{X^m+c_w\bar{W}\alpha_p\frac{1}{P_Y}} > 0 ; X^m \equiv \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_Y a}\right)\right) \left[\bar{X} + \frac{L_X}{P_Y a}\right] > 0; \frac{\partial X^m}{\partial L_X} \equiv \theta \equiv \left[(1 - \beta) + (-\beta')X\right] \frac{1}{aP_Y} > 0, p \equiv \frac{P_X}{P_Y}, \bar{W} \equiv W\bar{N} + Br_0(\bar{r}); \tilde{\theta} \equiv \frac{c_w(1-\alpha)Br_0'}{X^m+c_w\bar{W}\alpha_p\frac{1}{P_Y}} > 0$$

(3.3)

Finally, taking total differential of (2.7) treating all variables other than I , P_X and L_X as fixed and, then, solving for dI , we get

$$dI = (c_w\alpha - c_c) \frac{B}{P_Y} r_0'(-d\bar{r}) - \left[1 - c_w\alpha_p\bar{W}\bar{\theta}\right] \frac{1}{P_Y} dL_X + c_w\bar{W}\alpha_p \frac{1}{P_Y} \tilde{\theta}(-d\bar{r}); \quad c_w\alpha_p\bar{W}\bar{\theta} < 1$$

(by assumption) (3.4)

Let us now explain the results given by (3.1) – (3.4). Following a cut in \bar{r} by $d\bar{r}$, as follows from (2.11), M goes down but the value of the market supply of X (denoted VS) remains unaffected at the initial equilibrium P_X . Hence, P_X will start falling. With the decline in P_X , M will rise through the fall in α and VS will fall and, thus, through the fall in P_X , the two will be equal at lower values of M and VS. P_X falls by $dP_{X1} = \tilde{\theta}d\bar{r}$. The fall in M corresponding to the initial equilibrium L_X , L_{X0} , will raise the default rate of the producers of X . This will induce the banks to lower L_X by $dL_{X1} = F_{\bar{r}}d\bar{r}$. The fall in \bar{r} will redistribute income from the workers to the capitalists and this will lower aggregate consumption demand for Y by $(c_w\alpha - c_c) \frac{B}{P_Y} r_0' d\bar{r}$ under the standard assumption that $(c_w\alpha - c_c) > 0$. The fall in P_X will lower α and, thereby, reduce workers' demand for Y by $c_w\bar{W}\alpha_p \frac{1}{P_Y} \tilde{\theta}d\bar{r}$. The fall in L_X will also lower demand for Y by $\frac{dL_{X1}}{aP_{YX}}$. Thus, I in the first round will increase by $dI_1 = -(c_w\alpha - c_c) \frac{B}{P_Y} r_0' d\bar{r} - c_w\alpha_p \frac{1}{P_Y} \tilde{\theta}d\bar{r} - \frac{dL_{X1}}{P_Y}$. This is where the Round 1 changes are complete.

The fall in L_X in the first round reduces X in the second round by $dX_2 = \frac{dL_{X1}}{aP_{YX}} = \frac{F_{\bar{r}}d\bar{r}}{aP_Y}$. At the given P_X , as follows from (2.11), VS will become less than M creating an excess demand for X . Hence, P_X will rise by $P_{X2} = -\bar{\theta}dL_{X1}$. Through the rise in P_X , VS will rise and M will fall and become equal at a smaller M . The fall in L_X in the first round and the consequent decline in M will, for reasons we have already explained in Chapter 2, raise the default rate and, thereby, reduce L_X further by $dL_{X2} = f dL_{X1}$. The rise in P_X in the second round raises α and this increases workers' demand for Y by $c_w\bar{W}\alpha_p \bar{\theta} dL_{X1}$. The fall in L_X in the second round lowers demand for Y by $\frac{dL_{X2}}{aP_{YX}}$. This will enable the capitalists to raise I in the second round by $dI_2 = -\left(\frac{dL_{X2}}{aP_Y} + c_w\bar{W}\alpha_p \bar{\theta} \frac{1}{P_Y} dL_{X1}\right)$. Similarly, the fall in L_X in the second round will reduce X in the third round by $dX_3 = f \frac{dL_{X1}}{aP_Y}$. This will raise P_X by $dP_{X3} = -\bar{\theta}dL_{X2}$. This will reduce L_X further by $dL_{X3} = f dL_{X2} = f^2 dL_{X1}$. Finally, I will go up by $dI_3 = -\left(\frac{dL_{X3}}{aP_Y} + c_w\alpha_p\bar{W}\bar{\theta} \frac{1}{P_Y} dL_{X2}\right)$. The process of contraction in X and the increase in I will continue until the fall in L_X that takes place in each successive round eventually falls to zero. When that happens,

the economy achieves the new equilibrium. Thus, the total changes in L_X , X , P_X and I are given by the following equations:

$$dL_X = dL_{X1} + f \cdot dL_{X1} + f^2 dL_{X1} + \dots = \frac{F_{\bar{r}} d\bar{r}}{1-f} \quad (3.5)$$

$$dX = \frac{dL_{X1}}{aP_Y} + \frac{dL_{X2}}{aP_Y} + \frac{dL_{X3}}{aP_Y} + \dots = \frac{dL_X}{aP_Y} \quad (3.6)$$

$$dP_X = \tilde{\theta} d\bar{r} + -\bar{\theta} dL_{X1} - \bar{\theta} dL_{X2} - \dots = \tilde{\theta} d\bar{r} - \bar{\theta} dL_X \quad (3.7)$$

$$\begin{aligned} dI = & - \left[(c_w \alpha - c_c) \frac{B}{P_Y} r'_0 + c_w \bar{W} \alpha_p \frac{1}{P_Y} \tilde{\theta} \right] d\bar{r} - (1 - c_w \bar{W} \alpha_p \bar{\theta}) \frac{1}{P_Y} dL_{X1} - (1 - \\ & c_w \bar{W} \alpha_p \bar{\theta}) \frac{1}{P_Y} dL_{X2} - (1 - c_w \bar{W} \alpha_p \bar{\theta}) \frac{1}{P_Y} dL_{X3} = - \left[(c_w \alpha - c_c) \frac{B}{P_Y} r'_0 + c_w \alpha_p \frac{1}{P_Y} \tilde{\theta} \right] d\bar{r} - \\ & (1 - c_w \bar{W} \alpha_p \bar{\theta}) \frac{1}{P_Y} dL_X \end{aligned} \quad (3.8)$$

Note that (3.1), (3.2), (3.3) and (3.4) tally with (3.5), (3.6), (3.7) and (3.8), respectively and, thereby, explain them. Our analysis yields the following proposition:

Proposition 3.1: A cut in the interest rate brings about a cumulative contraction in the output of the unorganized sector and, thereby, deepens recession. It, therefore, brings about a cumulative increase in unemployment and poverty. It enables the capitalists to capture a part of the market of the unorganized sector. It is also highly likely that the capitalists will be able to use a larger part of the output of the organized sector for their own use.

3.4 An increase in \emptyset or γ and the Monetary Policy

We will show here how the counter recessionary monetary policy deepens the recession generated by a change made by the capitalists in the value of an instrument of exploitation. Thus, the counter recessionary monetary policy facilitates the capitalists' plan of reducing the unorganized sector. We will establish this claim by considering the example where the capitalists using the State Power bring about an increase in \emptyset . Since \bar{r} is cut to counter recession, it should be a decreasing function of the output gap defined as the excess of the potential real GDP and the actual real GDP. In our perception, the recession remains confined to the unorganized sector. Hence, we will make \bar{r} an increasing function of X , since the potential level of X is given. We also make it dependent on the capitalists' policy captured by a parameter, ε . We assume that \bar{r} is a decreasing function of ε . Thus,

$$\bar{r} = \bar{r}(X, \varepsilon); \bar{r}_X > 0, \bar{r}_\varepsilon < 0 \quad (3.9)$$

We are now in a position to derive the impact of an increase in \emptyset . We will do it mathematically. Taking total differential of (2.14) treating all variables other than L_X and \bar{r} as fixed and, then, solving for dL_X , we get (using (3.9))

$$\begin{aligned} dL_X = f dL_X + F_{\bar{r}} d\bar{r} + F_{\emptyset} d\emptyset = f dL_X + F_{\bar{r}} \bar{r}_X \frac{1}{aP_{YX}} dL_X + F_{\emptyset} d\emptyset \text{ or, } dL_X = \frac{F_{\emptyset}}{1-(f+F_{\bar{r}} \bar{r}_X \frac{1}{aP_{YX}})} d\emptyset; \bar{f} \equiv \\ F_{\bar{r}} \bar{r}_X \frac{1}{aP_{YX}}; \bar{r}_X \equiv \frac{\partial \bar{r}}{\partial X} \end{aligned} \quad (3.10)$$

We assume that $(f + \bar{f}) < 1$.

Again, from (2.3) we get

$$dX = \frac{dL_X}{aP_{YX}} \quad (3.11)$$

Taking total differential of (3.9) treating ε as fixed, we get

$$d\bar{r} = \bar{r}_X dX = \bar{r}_X \frac{dL_X}{aP_{YX}} \quad (3.12)$$

Taking total differential of (3.11) treating all variables other than \bar{r} , L_X and P_X as fixed and, then, solving for dP_X , we get

$$dP_X = -\tau dL_X, \quad \text{where} \quad \tau \equiv \frac{P_X \theta - c_w \alpha B r_0' \bar{r}_X \frac{1}{aP_Y}}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} < \bar{\theta} \equiv \frac{P_X \theta}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} > 0; X^m \equiv \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_{YX}} \frac{1}{a}\right)\right) \left[\bar{X} + \frac{L_X}{P_{YX}} \frac{1}{a}\right] > 0; \frac{\partial X^m}{\partial L_X} \equiv \theta \equiv [(1 - \beta) + (-\beta')X] \frac{1}{aP_{YX}} > 0, p \equiv \frac{P_X}{P_Y}, \bar{W} \equiv W\bar{N} + Br_0(\bar{r}) \quad (3.13)$$

(3.13)

Finally, taking total differential of (2.7) treating all variables other than I , P_X and L_X as fixed and, then, solving for dI , we get

$$dI = -(c_w \alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_{YX}} dL_X - c_w \alpha_p \bar{W} \bar{\tau} dL_X - [1 - c_w \alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} dL_X; \quad c_w \alpha_p \bar{W} \bar{\theta} < 1 \quad (\text{by assumption}) \text{ and } \bar{\tau} \equiv \frac{c_w \alpha B r_0' \bar{r}_X \frac{1}{P_Y}}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} > 0 \quad (3.14)$$

Let us now explain the results given by (3.10) – (3.14). Following an increase in \emptyset by $d\emptyset$, as follows from (2.14), L_X goes down by $dL_{X1} = F_\emptyset d\emptyset$. This lowers X by $dX_1 = \frac{dL_{X1}}{aP_{YX}}$ creating excess demand in the X-market at the initial equilibrium P_X . Hence, P_X will rise raising VS (the RHS of (2.11)) and lowering M (the LHS of (2.11)) and the two will be equal at a lower value of M . P_X will go up by $\bar{\theta} dL_{X1}$. However, the fall in X will lower \bar{r} by $d\bar{r}_1 = \bar{r}_X \frac{1}{aP_{YX}} dL_{X1}$. This will lower M by $c_w \alpha B r_0' \bar{r}_X \frac{1}{P_Y} dL_{X1}$ engendering an excess supply in the X-market. P_X will accordingly fall by $\frac{c_w \alpha B r_0' \bar{r}_X \frac{1}{P_Y} dL_{X1}}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} \equiv \bar{\tau} dL_{X1}$. P_X , in the net, may, therefore, either fall or rise.

We assume, without any loss of generality, that it rises. In the first round, therefore, P_X increases by $dP_{X1} = -\tau dL_{X1}$. Let us now focus on I . The decline in L_X lowers demand for Y of the X-sector by $\frac{1}{P_{YX}} dL_X$. However, the increase P_X that it brings about at the initial \bar{r} raises workers' demand for Y by $c_w \alpha_p \bar{W} \bar{\theta} \frac{1}{P_Y} dL_{X1}$. In the net, demand for Y , by assumption, falls enabling the capitalists to raise I by $[1 - c_w \alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} dL_{X1}$. The fall in L_X and the consequent reduction in X , as we have pointed out above, induces the RBI to lower \bar{r} by $d\bar{r}_1$. This reduces demand for Y in two ways: First, there takes place a redistribution of income from the workers to the capitalists and this lowers demand for Y by $(c_w \alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_Y} dL_{X1}$. Second, as derived above, it lowers P_X by $\bar{\tau} dL_{X1}$ and, thereby, reduces workers' demand for Y by $c_w \alpha_p \bar{W} \bar{\tau} dL_{X1}$. Hence, capitalists are able to raise I in the first round by $dI_1 = -(c_w \alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_{YX}} dL_{X1} - c_w \alpha_p \bar{W} \bar{\tau} dL_{X1} - [1 - c_w \alpha_p \bar{W} \bar{\theta}] \frac{1}{P_Y} dL_{X1}$.

The fall in L_X and \bar{r} in the first round raises the default rate for reasons explained earlier. L_X in the second round will, therefore, fall by $dL_{X2} = f dL_{X1} + F_{\bar{r}} d\bar{r}_1 = f dL_{X1} + F_{\bar{r}} \bar{r}_X \frac{1}{aP_Y} dL_{X1} = (f + \bar{f}) dL_{X1}$. As a result, X will fall by $dX_2 = \frac{dL_{X2}}{aP_{YX}}$. Consequently, \bar{r} goes down by $d\bar{r}_2 =$

$\bar{r}_X \frac{1}{aP_{YX}} dL_{X2}$. For reasons explained in the first round, P_X will go up by $dP_{X2} = -\tau dL_{X2}$ and I will increase by $dI_2 = -(c_w\alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_{YX}} dL_{X2} - c_w\alpha_p \bar{W} \bar{\tau} dL_{X2} - [1 - c_w\alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} dL_{X2}$.

Similarly, in the third round, the changes in L_X , X , \bar{r} , P_X and I are given, respectively, by $dL_{X3} = (f + \bar{f}) dL_{X2} = (f + \bar{f})^2 dL_{X1}$, $dX_3 = \frac{dL_{X3}}{aP_{YX}}$, $d\bar{r}_3 = \bar{r}_X \frac{1}{aP_{YX}} dL_{X3}$ and $dI_3 = -(c_w\alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_{YX}} dL_{X3} - c_w\alpha_p \bar{W} \bar{\tau} dL_{X3} - [1 - c_w\alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} dL_{X3}$. This process of contraction in X will continue until the fall in X that takes place in each successive round eventually falls to zero. When that happens, the economy achieves the new equilibrium. Thus, the total changes in L_X , X , \bar{r} , P_X and I are given, respectively, by

$$dL_X = dL_{X1} + (f + \bar{f}) dL_{X1} + (f + \bar{f})^2 dL_{X1} + \dots = \frac{dL_{X1}}{1 - (f + \bar{f})} = \frac{F_\emptyset}{1 - (f + \bar{f})} d\emptyset \quad (3.15)$$

$$dX = \frac{dL_{X1}}{aP_{YX}} + \frac{dL_{X2}}{aP_{YX}} + \frac{dL_{X3}}{aP_{YX}} + \dots = \frac{dL_X}{aP_{YX}} \quad (3.16)$$

$$d\bar{r} = \bar{r}_X \frac{1}{aP_{YX}} dL_{X1} + \bar{r}_X \frac{1}{aP_{YX}} dL_{X2} + \bar{r}_X \frac{1}{aP_{YX}} dL_{X3} + \dots = \bar{r}_X \frac{1}{aP_{YX}} dL_X \quad (3.17)$$

$$dP_X = -\tau dL_{X1} - \tau dL_{X2} - \tau dL_{X3} - \dots = \tau dL_X \quad (3.18)$$

And

$$\begin{aligned} dI &= - \left\{ (c_w\alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_Y} + c_w\alpha_p \bar{W} \bar{\tau} + [1 - c_w\alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} \right\} dL_{X1} \\ &\quad - \left\{ (c_w\alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_Y} + c_w\alpha_p \bar{W} \bar{\tau} + [1 - c_w\alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} \right\} dL_{X2} \\ &\quad - \left\{ (c_w\alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_Y} + c_w\alpha_p \bar{W} \bar{\tau} + [1 - c_w\alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} \right\} dL_{X3} \\ &= - \left\{ (c_w\alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_Y} + c_w\alpha_p \bar{W} \bar{\tau} + [1 - c_w\alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} \right\} dL_X \end{aligned} \quad (3.19)$$

Note that eqs.(3.10) – (3.14) tally with (3.15) – (3.19) and, thereby, explain them. From the above it follows that a tightening of Basel norms brings about a large and cumulative contraction in the output of the unorganized sector and this contraction gets magnified manifold by the counter-recessionary monetary policy of the RBI. This yields the following proposition:

Proposition 3.2: A tightening of Basel norms brings about a cumulative contraction in the output of the unorganized sector. This contraction is magnified significantly by the counter recessionary policy of the RBI. The capitalists, through the tightening of Basel norms, grab not only a large part of the market of the unorganized sector but also, in all likelihood, a larger part of the aggregate output of the organized sector for their own use.

The tightening of the Basel norms is just an example to show how the counter recessionary monetary policy deepens the recession in the unorganized sector caused by a change in a policy instrument of the capitalist aimed at reducing the output of the unorganized sector. Thus, a fall in \bar{N} brought about by the capitalists by bringing about more automation in production or a capitalist induced worsening of attitude of the banks towards the unorganized sector will lead to a shrinkage of the unorganized sector and this process of shrinkage will be facilitated greatly

by the counter recessionary monetary policy. We will discuss another example where the banks raise r_X , which denotes the interest rate at which the small producers get loans.

3.5 The Effect of an Increase in r_X

As we have pointed out earlier, we regard r_X as an instrument of the capitalists to exploit the small producers. r_X is independent of \bar{r} , the interest rate at which the capitalists secure loans for financing investment. In fact, in times of recession, r_X often goes up despite the fall in \bar{r} . This happens because in times of recession, banks become more cautious regarding their lending and in their perception the risk of lending to the small producers increases phenomenally. Thus, the risk premium that they charge on loans given to the small producers increases steeply in times of recession. This was in evidence in the USA (see Bernanke (1983), Bernanke, Gertler and Gilchrist (1996) and Mishkin (2009)). The capitalists by exercising State Power in India can make banks raise r_X . We will derive its impact mathematically now.

A ceteris paribus increase in r_X should increase the default rate of the small producers inducing the banks to reduce loan supply to the small producers. Hence, in (2.14) L_X should be a decreasing function of r_X . Incorporating r_X into (2.14) and, then, taking total differential of (2.14) treating all variables other than L_X and r_X as fixed and, then, solving for dL_X , we get (using (3.9) and (3.10))

$$dL_X = f dL_X + F_{\bar{r}} d\bar{r} + F_{r_X} dr_X = f dL_X + F_{\bar{r}} \bar{r}_X \frac{1}{aP_{YX}} dL_X + F_{r_X} dr_X, \text{ i. e., } dL_X = \frac{F_{r_X}}{1-(f+\bar{f})} dr_X; \bar{f} \equiv F_{\bar{r}} \bar{r}_X \frac{1}{aP_{YX}}; \bar{r}_X \equiv \frac{\partial \bar{r}}{\partial X} \quad (3.20)$$

We assume that $(f + \bar{f}) < 1$.

Again, from (2.3) we get

$$dX = \frac{dL_X}{aP_Y} \quad (3.21)$$

Taking total differential of (3.9) treating ε as fixed, we get

$$d\bar{r} = \bar{r}_X dX = \bar{r}_X \frac{dL_X}{aP_{YX}} \quad (3.22)$$

Taking total differential of (2.11) treating all variables other than L_X and P_X as fixed and, then, solving for dP_X , we get

$$dP_X = -\tau dL_X, \text{ where } \tau \equiv \frac{P_X \theta - c_w \alpha B r_0' \bar{r}_X \frac{1}{P_{YX}}}{X^m + c_w \bar{W} \alpha p \frac{1}{P_Y}} < \bar{\theta} \equiv \frac{P_X \theta}{X^m + c_w \bar{W} \alpha p \frac{1}{P_Y}} > 0; X^m \equiv \left(1 - \beta \left(\bar{X} + \frac{L_X}{P_{YX} a} \right) \right) \left[\bar{X} + \frac{L_X}{P_{YX} a} \right] > 0; \frac{\partial X^m}{\partial L_X} \equiv \theta \equiv [(1 - \beta) + (-\beta') X] \frac{1}{aP_{YX}} > 0, \quad p \equiv \frac{P_X}{P_Y}, \quad \bar{W} \equiv W \bar{N} + B r_0(\bar{r}) \quad (3.23)$$

Finally, taking total differential of (2.7) treating all variables other than I , P_X and L_X as fixed and, then, solving for dI , we get

$$dI = - \left\{ (c_w \alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_Y} + c_w \alpha_p \bar{W} \bar{r} + [1 - c_w \alpha_p \bar{W} \bar{\theta}] \frac{1}{P_Y} \right\} dL_X; \quad c_w \alpha_p \bar{W} \bar{\theta} < 1 \text{ (by assumption)} \quad (3.24)$$

Let us now explain the results given by (3.20) – (3.24). Following an increase in r_X by dr_X , at the initial equilibrium L_X and P_X , default rate of the small producers increases inducing the banks to lower L_X . As follows from (2.14) (with r_X incorporated into it), L_X goes down by $dL_{X1} = F_{r_X} dr_X$. This lowers X by $dX_1 = \frac{dL_{X1}}{aP_{YX}}$ creating excess demand at the initial equilibrium

P_X . Hence, P_X will rise raising VS (the RHS of (2.11)) and lowering M (the LHS of (2.11)) and the two will be equal at a lower value of M . P_X will go up by $\bar{\theta}dL_{X1}$. However, the fall in X will lower \bar{r} by $d\bar{r}_1 = \bar{r}_X \frac{1}{aP_{YX}} dL_{X1}$. This will lower M by $c_w \alpha B r_0' \bar{r}_X \frac{1}{aP_{YX}} dL_{X1}$ engendering an

excess supply in the X-market. P_X will accordingly fall by $\frac{c_w \alpha B r_0' \bar{r}_X \frac{1}{aP_{YX}} dL_{X1}}{X^m + c_w \bar{W} \alpha_p \frac{1}{P_Y}} \equiv \bar{\tau} dL_{X1}$. P_X may,

therefore, either fall or rise. We assume, without any loss of generality, that it rises. In the first round, therefore, P_X increases by $dP_{X1} = -\tau dL_{X1}$. Let us now focus on I . The decline in L_X lowers demand for Y of the X-sector by $\frac{1}{P_{YX}} dL_X$. However, the increase P_X that it brings about

at the initial \bar{r} raises workers' demand for Y by $c_w \alpha_p \bar{W} \bar{\theta} \frac{1}{P_{YX}} dL_{X1}$. In the net, demand for Y falls by assumption enabling the capitalists to raise I by $dI_1 = [1 - c_w \alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} dL_{X1}$. The

fall in L_X and the consequent reduction in X , as we have pointed out above, induces the RBI to lower \bar{r} by $d\bar{r}_1$. This reduces demand for Y in two ways: First, there takes place a redistribution

of income from the workers to the capitalists and this lowers demand for Y by $(c_w \alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_{YX}} dL_{X1}$. Second, as derived above, it lowers P_X by $\bar{\tau} dL_{X1}$ and, thereby,

reduces workers' demand for Y by $c_w \alpha_p \bar{W} \bar{\tau} dL_{X1}$. Hence, capitalists are able to raise I in the first round by $dI_1 = -(c_w \alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_{YX}} dL_{X1} - c_w \alpha_p \bar{W} \bar{\tau} dL_{X1} - [1 - c_w \alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} dL_{X1}$.

The fall in L_X and \bar{r} in the first round raises the default rate for reasons explained earlier. L_X in the second round will, therefore, fall by $dL_{X2} = f dL_{X1} + F_{\bar{r}} d\bar{r}_1 = f dL_{X1} + F_{\bar{r}} \bar{r}_X \frac{1}{aP_{YX}} dL_{X1} = (f + \bar{f}) dL_{X1}$. As a result, X will fall by $dX_2 = \frac{dL_{X2}}{aP_{YX}}$. Consequently, \bar{r} goes down by $d\bar{r}_2 =$

$\bar{r}_X \frac{1}{aP_{YX}} dL_{X2}$. For reasons explained in the first round, P_X will go up by $dP_{X2} = -\tau dL_{X2}$ and I will increase by $dI_2 = -(c_w \alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_{YX}} dL_{X2} - c_w \alpha_p \bar{W} \bar{\tau} dL_{X2} - [1 - c_w \alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} dL_{X2}$.

Similarly, in the third round, the changes in L_X , X , \bar{r} , P_X and I are given, respectively, by $dL_{X3} = (f + \bar{f}) dL_{X2} = (f + \bar{f})^2 dL_{X1}$, $dX_3 = \frac{dL_{X3}}{aP_{YX}}$, $d\bar{r}_3 = \bar{r}_X \frac{1}{aP_{YX}} dL_{X3}$ and $dI_3 = -(c_w \alpha - c_c) \frac{B}{P_Y} r_0' \bar{r}_X \frac{1}{aP_{YX}} dL_{X3} - c_w \alpha_p \bar{W} \bar{\tau} dL_{X3} - [1 - c_w \alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} dL_{X3}$. This process of

contraction in X will continue until the fall in X that takes place in each successive round eventually falls to zero. When that happens, the economy achieves the new equilibrium. Thus, the total changes in L_X , X , \bar{r} , P_X and I are given, respectively, by

$$dL_X = dL_{X1} + (f + \bar{f}) dL_{X1} + (f + \bar{f})^2 dL_{X1} + \dots = \frac{dL_{X1}}{1 - (f + \bar{f})} = \frac{F_{r_X}}{1 - (f + \bar{f})} dr_X \quad (3.25)$$

$$dX = \frac{dL_{X1}}{aP_{YX}} + \frac{dL_{X2}}{aP_{YX}} + \frac{dL_{X3}}{aP_{YX}} + \dots = \frac{dL_X}{aP_{YX}} \quad (3.26)$$

$$d\bar{r} = \bar{r}_X \frac{1}{aP_{YX}} dL_{X1} + \bar{r}_X \frac{1}{aP_{YX}} dL_{X2} + \bar{r}_X \frac{1}{aP_{YX}} dL_{X3} + \dots = \bar{r}_X \frac{1}{aP_{YX}} dL_X \quad (3.27)$$

$$dP_X = -\tau dL_{X1} - \tau dL_{X2} - \tau dL_{X3} - \dots = -\tau dL_X \quad (3.28)$$

And

$$\begin{aligned}
dI &= - \left\{ (c_w \alpha - c_c) \frac{B}{P_Y} r'_0 \bar{r}_X \frac{1}{a P_{YX}} + c_w \alpha_p \bar{W} \bar{\tau} + [1 - c_w \alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} \right\} dL_{X1} \\
&\quad - \left\{ (c_w \alpha - c_c) \frac{B}{P_Y} r'_0 \bar{r}_X \frac{1}{a P_{YX}} + c_w \alpha_p \bar{W} \bar{\tau} + [1 - c_w \alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} \right\} dL_{X2} \\
&\quad - \left\{ (c_w \alpha - c_c) \frac{B}{P_Y} r'_0 \bar{r}_X \frac{1}{a P_{YX}} + c_w \alpha_p \bar{W} \bar{\tau} + [1 - c_w \alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} \right\} dL_{X3} \\
&= - \left\{ (c_w \alpha - c_c) \frac{B}{P_Y} r'_0 \bar{r}_X \frac{1}{a P_{YX}} + c_w \alpha_p \bar{W} \bar{\tau} + [1 - c_w \alpha_p \bar{W} \bar{\theta}] \frac{1}{P_{YX}} \right\} dL_X
\end{aligned}$$

(3.29)

Note that eqs.(3.20) – (3.24) tally with (3.25) – (3.29) and, thereby, explain them. From the above it follows that an increase in r_X brings about a large and cumulative contraction in the output of the unorganized sector and this contraction gets magnified manifold by the counter-recessionary monetary policy of the RBI. This yields the following proposition:

Proposition 3.3: An increase in r_X brings about a cumulative contraction in the output of the unorganized sector. This contraction is magnified significantly by the counter recessionary policy of the RBI. The capitalists, by raising r_X , grab not only a large part of the market of the unorganized sector but also, in all likelihood, a larger part of the aggregate output of the organized sector for their own use.

3.6 Conclusion

This chapter shows that the counter recessionary monetary policy is a part of the exploitative machinery of the capitalists. It brings about a large and cumulative contraction in the output of the unorganized sector and enables the capitalists to grab a large part of the market of the unorganized sector. The capitalists, in all likelihood, are also able to use a larger part of the output of the organized sector for their own use. The capitalists have many instruments at their disposal to bring about a shrinkage in the unorganized sector. The counter recessionary monetary policy deepens manifold the recession created by these instruments in the unorganized sector.

The scenario is obviously extremely scary in view of the fact that about 99 percent of the workforce derives their livelihood from the unorganized sector. The shrinkage of the unorganized sector raises unemployment and poverty significantly. If the capitalists swallow up the whole of the unorganized sector, the ordinary Indians will perish.

The interest rate is falling steadily since 2015 in India (see Table 3.2). The prices on the other hand are rising at an alarming rate (see Table 3.1). As a result, the real value of the savings of the workers and that of the interest income yielded by the savings are falling at a high rate benefitting the capitalists, who are net borrowers, and making the lives of the workers precarious. The central banks all across the capitalist world and its satellites such as India are carrying on with this extremely unjust monetary policy in the name of fighting recession, which the capitalists create to reduce the unorganized sector.

Clearly, unless the ordinary people become aware of the real cause of their plight, unless they become united, form their own party and grab the State Power, they are likely to become extinct. However, the spontaneous farmers' movement against the reforms in agriculture keeps the hopes for the ordinary people alive.

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Table 3.1**Rate of Consumer Price Inflation (Annual %)**

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
France	1.5	2.1	1.9	0.8	0.5	0.04	0.2	1.03	1.9	1.1
Germany	1.1	2.1	2.0	1.5	0.9	0.5	0.5	1.5	1.7	1.4
UK	2.5	3.9	2.6	2.3	1.4	0.4	1.0	2.5	2.3	1.7
USA	1.6	3.1	2.0	1.5	1.6	0.1	1.3	2.1	2.4	1.8
HIC¹	2.0	3.4	2.7	1.5	1.0	0.32	0.4	1.5	1.8	1.6
India	11.1	8.9	9.3	10.9	6.4	5.9	4.1	2.5	4.9	7.7

Source: International Monetary Fund

Table 3.2**Interest Rates (%) on Long Term Deposits (up to 10 years) of the State Bank of India**

2008	09	10	11	12	13	14	15	16	17	18	19	20
8.5	7.5	8.75	9.25	8.5	9.0	8.25	7.00	6.5	6.0	6.85	6.25	5.4

Source: State Bank of India

Chapter 4

Monetary Policy, Financial Sector Reform, Fiscal Policy and Land Grab in India

Abstract

The objective of the study carried out in this chapter is to show how the changes that have taken place in the areas of monetary policy, financial sector and fiscal policy under the New Economic Policy (NEP) in India have impacted the real estate sector and the poor. The study shows that all these changes make it profitable for the capitalists to forcibly take away land from the small producers and use it for completely unproductive real estate development. On the other hand, the small producers not only lose their land, they also suffer a cumulative fall in their output. Both these losses bring about a substantial deterioration in the economic condition of the small producers and low-skilled workers who constitute the class of the poor.

4.1 Introduction

At the present, the monetary policy all across the capitalist world including India consists in pushing down the interest rates to the lowest possible level. Prices on the other hand increase continuously all across the capitalist world including India. As a result, both the principal amount of a loan and the interest income from it fall in real value continuously. This makes loans or financial assets such as bank deposits or bonds unattractive as instruments of saving. Again, the financial sector reforms undertaken in recent years such as the withdrawal of government guarantee of bank deposits and the introduction of the Financial Regulation and Deposit Insurance (FRDI) Bill that allows a distressed bank to take over the deposits of the depositors to tide over its troubles have contributed to the vulnerability of the financial assets. Under these conditions, the savers get induced to divert their savings from the financial assets to real estate. This makes it profitable for the capitalists to appoint land sharks to force the small producers to part with their land. The capitalists sell this land to the savers and, thereby, make a huge profit. The capitalists are able to do so because, as we have explained in Chapters 2 and 3, they own all the political parties and wield the State Power. Obviously, the land lost by the small producers gets locked in unproductive uses, while the output of food and other mass consumption goods falls impoverishing the poor substantially.

The government's fiscal policy these days consists in switching from direct taxes to indirect ones so much so that the fraction of the total tax revenue contributed by the indirect taxes has been rising steadily of late and at the present the major part of the total tax revenue comes from the indirect taxes (see Table 4.1). We have shown here that a fall in the direct tax rates will also raise demand for land making it profitable for the capitalists to take away more land from the small producers impoverishing the poor. A hike in indirect tax rate will also, as we show here, will bring about a cumulative fall in the small producers' output substantially increasing the poverty of the masses.

The NEP has drastically cut down the direct tax rates. Even though the government has hiked indirect tax rates to make up for the shortfall in revenue, there are limits to such hikes as they produce strong inflationary forces. The NEP has also put stringent restrictions on government's fiscal deficit. As a result, the government has become subject to acute fund shortage and there has taken place drastic fall in public investment in infrastructure that caters to the needs of the small producers and the poor (see in this context Mishra (2006) and Godara et. al.(2014)) . We have shown here how this decline in government expenditure will lead to unproductive real estate development at the cost of the land and output of the small producers substantially impoverishing the poor.

4.2 The Model

To accomplish the objective of this study, we divide India into two sectors: the organized sector and the unorganized sector. The former consists of the corporate sector, the government sector and the large unincorporated private enterprises. The unorganized sector consists of small enterprises including small farming units and cottage and village industries. We will delineate the relevant main features of the two sectors below:

The Organized Sector

Following Keynes(1936), we assume that aggregate output in the organized sector is demand determined. However, unlike Keynes(1936), here aggregate demand for the organized sector's output is completely under the control of the capitalists. The prices in the organized sector are set by the capitalists. We will not try to explain in this model how capitalists set the prices of their products and simply assume the prices in the organized sector to be given. We will divide the people engaged in the production of the organized sector into two categories: The rich and the low skilled workers. The rich consist of the capitalists, their entourage of large businessmen running the unincorporated large private enterprises and high skilled workers. The low skilled workers and the small producers who carry out production in the unorganized sector constitute the class of the poor. The output of the organized sector is used for the purpose of consumption by the rich. It is also used for the purpose of investment. The small producers of the unorganized sector also uses it as intermediate inputs. The low skilled workers do not save. They consume only the output of the unorganized sector and spend their entire income on it. We will, henceforth, refer to the low-skilled workers simply as workers. Given these assumptions, the equilibrium condition of the organized sector may be written as follows:

$$Y = c_c \cdot \left(Y - \frac{W}{P_Y} Y \right) + I + a\tilde{X} \quad (4.1)$$

Let us now explain (4.1). Y denotes the output of the organized sector. To produce Y , the producers have to employ workers. The capitalists pay them a wage income of W per unit of Y . Accordingly, the income of the rich in terms of Y is given by $\left(Y - \frac{W}{P_Y} Y \right)$. The rich spend a fixed fraction of their income, c_c , on consumption. I denotes investment demand. The standard assumption regarding I in the mainstream economics is that it is a decreasing function of the interest rate. However, as we have argued in earlier chapters, in a capitalist country, the capitalists have in their complete control all the prices, wages and interest rates. In such circumstances, we consider it reasonable to postulate that the capitalists raise I to the maximum possible level so that Y is at its full capacity level, denoted \bar{Y} . This they do to maximize their command and use of produced goods and services so that they can use the maximum possible amount of produced goods and services to set up facilities for producing newer varieties of luxury consumption goods, better varieties of existing consumer goods and for making production less labour intensive.

We divide the output of the unorganized sector, which we denote by X , into two parts. One part is produced without using any intermediate input bought from the organized sector. We denote this part of the output by \bar{X} . \bar{X} denotes that part of the output of X , which the producers of the unorganized sector can produce utilizing their lands and capital fully using traditional technology and inputs that they themselves produce. \bar{X} is, therefore, given. To produce more than \bar{X} , the unorganized sector producers have to utilize their land and capital more intensively by using intermediate inputs bought from the organized sector. The part of its output, which is produced with intermediate inputs bought from the organized sector, is denoted by \tilde{X} . Finally, a denotes the requirement of Y per unit of production of \tilde{X} . Since it is not relevant for our

purpose at the present, we have not incorporated taxes and government consumption in (4.1). Substituting \bar{Y} for Y in (4.1), we rewrite it as follows:

$$\bar{Y} = c_c \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{Y} \right) + I + a\bar{X} \quad (4.2)$$

The Unorganized Sector

We assume that the producers in the unorganized sector are credit constrained. They need loans to buy the essential intermediate inputs from the organized sector. As they have little collateral to offer, they are able to secure only a small amount of loan, which does not enable them to fully utilize the labour, capital and land they have in their command. They produce the output using only family labour. We denote the given amount of loan they are able to secure by L_X . Hence, the amount of X they are able to produce with the loan is given by $\frac{L_X}{aP_{YX}}$, where P_{YX} denotes the average price of the intermediate inputs bought from the organized sector by the small producers. As we have already pointed out, we also assume that even if the producers fail to secure any credit and buy any input from the organized sector, they are able to produce a given amount of output, which we denote by \bar{X} . If they can secure loan, they can utilize their land and capital more intensively and raise their output above \bar{X} . (For example, farmers can produce some crop in their land using traditional technology and inputs, which they themselves produce. Similarly, weavers and hand looms can produce some clothing without using inputs of the organized sector.) Therefore, the output of the unorganized sector is given by

$$X = \bar{X} + \frac{L_X}{aP_{YX}} \quad (4.3)$$

We further assume that the producers of the unorganized sector keep aside a fixed amount of X for their subsistence. Since this amount is fixed, we do not explicitly consider it here for simplicity. They, therefore, sell off the whole of X and uses the revenue to pay back their loan along with interest. If their sales revenue exceeds their debt service charges, we assume that they save it and hold it in the form of currency for simplicity. Usually, this saving is quite negligible and not much is lost if we ignore it for simplicity.

The small producers do not have the resources to market their produce directly. They sell their produce to the traders who buy the produce at a given price \bar{P} . The traders are enormously mighty relative to the small producers and, therefore, they set \bar{P} at the minimum possible level. Therefore, the sales revenue earned by the small producers denoted R is given by

$$R = \bar{P} \cdot \left(\bar{X} + \frac{L_X}{aP_{YX}} \right) \quad (4.4)$$

Following a given increase in L_X by dL_X , R goes up by $\bar{P} \cdot \frac{dL_X}{aP_{YX}}$. We assume that this is larger than the increase in the debt service charges given by $dL_X(1 + r_X)$, where r_X is the given interest rate at which loans are available to the small producers. This is the boundary condition of this model. If this condition is not satisfied, the small producers will not take any loans.

The traders sell the produce of the small producers in the market to the workers of the organized sector. Therefore, the equilibrium condition of the unorganized sector is given by

$$\frac{W\bar{Y}}{P_X} = \left(\bar{X} + \frac{L_X}{aP_{YX}} \right) \quad (4.5)$$

We assume that the P_X is market clearing so that (4.5) determines P_X and this market clearing P_X is much larger than \bar{P} so that the traders make large profit. We assume for simplicity that the traders consume only X. However, since they are rich and X belongs to the category of necessities, their demand for X is fixed. Hence, we have ignored it for simplicity.

The financial sector here consists of only the central bank and the commercial banks. The rich allocate their saving between bank deposits and real estate, which creates demand for land. The lower the interest rate (denoted r), the greater the fragility of the financial institutions (denoted μ) and the lower the price of land (denoted P_L), the higher is the fraction of saving the rich want to hold in the form of land. The higher the price of land, the greater is the incentive on the part of the capitalists to forcibly take away the land of the small producers and supply it to the savers. We assume for simplicity that the whole of the sales revenue adds to the profit of the capitalists and the capitalists save this entire additional profit in the form of currency. This assumption will not affect our results qualitatively, but simplify our analysis greatly. We also assume for simplicity that the past savings of the rich is zero. Denoting the fraction of saving held in the form of land by θ , we can write the land market equilibrium condition as

$$(1 - c_c) \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{Y} \right) \cdot \theta(\bar{r}, \mu, P_L) = L(P_L) \quad ; \quad \frac{\partial \theta}{\partial \bar{r}} \equiv \theta_{\bar{r}} < 0, \theta_{\mu} > 0, \theta_{P_L} < 0, L_{P_L} > 0 \quad (4.6)$$

Let us now explain (4.6). In every capitalist country including India, the monetary policy of the central bank consists in keeping r at a target level which we have denoted by \bar{r} . A ceteris paribus decrease in \bar{r} induces the rich to switch their saving from bank deposits to land. Therefore, θ is a decreasing function of \bar{r} . The fragility of the financial institutions is indexed by μ . An increase in μ indicates that the financial institutions have become more fragile. Hence, θ should be an increasing function of μ . Finally, a ceteris paribus increase in P_L makes investment in land less attractive. Accordingly, θ is a decreasing function of P_L . On the other hand, an increase in P_L makes it profitable for the capitalists to grab more land forcibly from the small producers. Hence, $\frac{dL}{dP_L} \equiv L_{P_L} > 0$. Since, as we have already pointed out, W and P_Y are set by the capitalists, we can solve (4.6) for the equilibrium value of P_L . For simplicity, we have ignored here the capitalists' cost of forcible acquisition of land. This will not scuttle the generality of our analysis, but simplify the algebra a great deal.

The Financial Sector

Let us now focus on the financial sector. The financial sector is a part of the organized sector and its value added is included in Y . It consists of the RBI and the commercial banks only. We will henceforth refer to the latter as banks. The rich hold $(1 - \theta(P_L, \bar{r}, \mu))$ fraction of their savings as bank deposits except for their profit from land, which they save, by assumption,

entirely in the form of currency. The banks hold a fixed fraction ρ of their deposits as cash reserve and lend out the rest. Hence, the supply of new bank loans in the period under consideration, denoted d^S is given by

$$d^S = (1 - \rho) \cdot (1 - \theta(P_L, \bar{r}, \mu)) \left[(1 - c_c) \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{Y} \right) \right] \quad (4.7)$$

The capitalists and their entourage of large businessmen finance their entire investment with new bank loans. The banks give a given L_X amount of new loans to the producers of the unorganized sector. Therefore, the equilibrium in the financial sector is given by the following equation:

$$P_Y \cdot (1 - \rho) \cdot (1 - \theta(P_L, \bar{r}, \mu)) \left[(1 - c_c) \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{Y} \right) \right] + b = P_Y \cdot I + L_X \quad (4.8)$$

In (4.8), b denotes the RBI's new lending to the banks in the period under consideration. It may be positive or negative. If at \bar{r} , there emerges an excess demand for new bank loans, the RBI lends to the banks so that they can meet the excess demand. In this case, b is positive. On the other hand, if there emerges an excess supply at \bar{r} , the banks lend out their excess supply of loans to the RBI. In this case, b is negative. This is how r is kept at \bar{r} by the RBI.

The New Economic Policy (NEP) came into force in 1991 replacing the Nehru-Mahalanobis Programme (NMP). Under the latter, the ownership and control of the financial sector rested solely with the government. The government administered all the interest rates and directed the financial institutions how much to lend to each of the different sectors so that the plan targets of production and investment were fulfilled. Through this directed credit programme, the government provided the unorganized sector with large amounts of loans at very low interest rates so that the unorganized sector could grow at a fast rate ensuring high rates of growth of both employment and supply of mass consumption goods. The government regarded the unorganized sector as the priority sector and specified the priority sector lending norm which made sure that the producers of the unorganized sector did not suffer any dearth of credit. Under the NMP, the financial institutions were not commercial organizations. They were social organizations and their purpose was to mobilize all the savings of the masses by providing them with completely safe and remunerative avenues of saving and to utilize this saving in such a manner that the plan targets of production and investment were fulfilled. The NEP, however, seeks to dismantle the directed credit programme, make the financial institutions profit driven and privatize the financial sector so that the market forces determine the allocation of credit. In other words, one of the objectives of the NEP is to transfer the ownership and control of the financial sector from the government to the capitalists enabling the latter to determine the interest rates and the allocation of credit across different sectors, firms and individuals. The Government of India (GoI) is seeking to achieve this objective through the process of financial sector reforms. The reforms have already diluted the priority sector lending norms substantially and seek to do away with them altogether. The government has also withdrawn its guarantee of bank deposits, which have made bank deposits unsafe and banks more fragile. At the present, the imposition of Basel norms, which put great emphasis

on the risk-weighted capital adequacy ratio, has made profit-driven financial institutions extremely cautious about lending to the small producers, who are financially weak. We, therefore, make L_X an increasing function of the amount of land in the possession of the small producers, since they can offer it as collateral against loan. We also make L_X a decreasing function of the default rate of the small producers, which we denote by D . Therefore, we have

$$L_X = \bar{F}(D, \bar{L} - L(P_L)) \quad (4.9)$$

In (4.9), \bar{L} is the given endowment of land of the small producers, while $L(P_L)$ is the amount of land that is taken away forcibly from the small producers by the capitalists.

Let us now examine what factors determine D . We will argue below that it is determined principally by R and it is a decreasing function of R . Using (4.4), we, therefore, write D as follows:

$$D = D\left(\bar{P}, \left(\bar{X} + \frac{L_X}{aP_{YX}}\right)\right); D_{\bar{P}} < 0, D_{\bar{X}} < 0, D_{L_X} < 0, D_a > 0, D_{P_{YX}} > 0 \quad (4.10)$$

We assume here that the small producers require some amount of loan to produce the subsistence requirement of their output. They sell to market only the excess of their output over and above their subsistence requirement. The amount of loan required to produce the subsistence amount of the output is referred to as the subsistence requirement of loan. Note that the subsistence requirement of loan varies across producers. The reason is that factors such as the amount of land in possession, ability, natural factors, quality and quantity of free public infrastructure services available vary across producers. Every small producer requires larger than the subsistence amount of loan to be able to service his debts. The minimum amount of loan that a small producer requires to service his debt is his break even amount of loan. Note that, at the time of securing the loan, a small producer does not know what his subsistence loan requirement and break even loan requirement are since he is uncertain about the natural factors (not explicitly considered here) that makes values of \bar{X} and a uncertain. He is uncertain about \bar{P} . He may have to buy the intermediate inputs all through the production period. That will make P_{YX} uncertain also. We assume here that when L_X increases, every small producer gets more loan. Hence, given everything else the larger the L_X , the larger is the number of producers who get more than their respective break even amounts of loans. Hence, D falls. Again, given L_X , the less the value of R , the larger is D . This explains the signs of the partial derivatives of (4.10).

Substituting (4.10) into (4.9), we rewrite it as follows:

$$L_X = \bar{F}\left(D\left(\bar{P}, \left(\bar{X} + \frac{L_X}{aP_{YX}}\right)\right), \bar{L} - L(P_L)\right) \equiv F\left(\bar{P}, \left(\bar{X} + \frac{L_X}{aP_{YX}}\right), \bar{L} - L(P_L)\right) \quad (4.11)$$

We can solve (4.11) for the equilibrium value of L_X , given P_L , if the following two conditions are satisfied: $F\left(\bar{P}, \left(\bar{X} + \frac{0}{aP_{YX}}\right), \bar{L} - L(P_L)\right) > 0$ and $0 < \left(\frac{\partial F}{\partial R} \cdot \frac{\partial R}{\partial L_X}\right) \equiv l < 1$. The specification of the model is complete. It contains three key equations, (4.3), (4.6) and (4.11) in three endogenous variables: X , P_L and L_X . We solve them as follows. We solve (4.6) for the equilibrium value of P_L . Putting this value of P_L in (4.11), we get the equilibrium value of L_X . Putting this value of L_X in (4.3), we get the equilibrium value of X . We are now in a position to examine how the monetary policy and the financial sector reforms that make the banks more fragile affect our economy.

4.3 Monetary Policy of Rate Cut and Financial Sector Reforms

The interest rates have been pushed down to the lowest possible levels all across the capitalist world at least since 2008. Prices are, however, rising continuously (see Table 4.2). The rise in prices is continuously eroding the real value of the principal amount of a loan and also that of the interest income from it. Both low interest rate and inflation make savings in the form of loans unattractive and induce people to switch their savings from financial assets to physical assets such as real estate leading to its proliferation. We can capture this phenomenon by examining how a cut in \bar{r} affects the economy. This we did in the previous chapter also. However, here, unlike what happened in the previous chapter, the cut in \bar{r} affects the economy through its impact on the land market.

Taking total differential of (4.6) treating all variables other than \bar{r} and P_L as fixed and, finally, solving for dP_L , we get

$$dP_L = \frac{S \cdot \theta_{\bar{r}} d\bar{r}}{L_{P_L} - S \cdot \theta_{P_L}} > 0; S \equiv (1 - c_c) \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{Y}\right) \quad (4.12)$$

Again, taking total differential of (4.11) treating all variables other than L_X and P_L as fixed and, then solving for dL_X , we get

$$dL_X = - \left[\frac{F_{L P_L}}{1-l} \right] dP_L \quad (4.13)$$

Let us now explain (4.12) and (4.13). Focus on (4.12) first. Following a given cut in \bar{r} by $d\bar{r}$, people switch their saving from bank deposits to land creating an excess demand for land of $S \cdot \theta_{\bar{r}} d\bar{r}$ at the initial equilibrium P_L . Therefore, P_L starts rising. Per unit increase in P_L , excess demand for loan goes down by $(L_{P_L} - S \cdot \theta_{P_L})$. Therefore, P_L will go up by the amount given by the expression on the RHS of (4.12). As P_L rises by the amount given by (4.12), the capitalists take away from the small producers $L_{P_L} dP_L = L_{P_L} \left[\frac{S \cdot \theta_{\bar{r}} d\bar{r}}{L_{P_L} - S \cdot \theta_{P_L}} \right] > 0$ amount of land. At the beginning of the next production season, therefore, the amount of loan they are able to secure goes down by $dL_{X1} = F_L L_{P_L} \left[\frac{S \cdot \theta_{\bar{r}} d\bar{r}}{L_{P_L} - S \cdot \theta_{P_L}} \right]$. As a result, their output and sales revenue fall by $\frac{F_L L_{P_L}}{a P_Y} \left[\frac{S \cdot \theta_{\bar{r}} d\bar{r}}{L_{P_L} - S \cdot \theta_{P_L}} \right]$ and

$\frac{\bar{P}F_L L_{P_L}}{aP_Y} \left[\frac{S.\theta_{\bar{r}} d\bar{r}}{L_{P_L} - S.\theta_{P_L}} \right]$, respectively. Given the boundary condition of this model, the fall in the sales revenue will be larger than that in the debt service charges. Hence, default rate of the small producers will go up at the end of the given production period. Therefore, at the beginning of the second production period, the amount of loan the small producers are able to secure will fall by $dL_{X_2} = l.dL_{X_1} = l.F_L L_{P_L} \left[\frac{S.\theta_{\bar{r}} d\bar{r}}{L_{P_L} - S.\theta_{P_L}} \right]$. This will, as before, lower output and revenue of the small producers and their default rate will rise at the end of Production Season 2. Hence, at the beginning of the third production season, L_X will go down further by $dL_{X_3} = l.dL_{X_2} = l^2 dL_{X_1}$. This fall in L_X will continue until the fall in L_X that takes place in each successive round eventually falls to zero. Thus, the total fall in L_X is given by

$$dL_X = -F_L L_{P_L} \left[\frac{S.\theta_{\bar{r}} d\bar{r}}{L_{P_L} - S.\theta_{P_L}} \right] - l.F_L L_{P_L} \left[\frac{S.\theta_{\bar{r}} d\bar{r}}{L_{P_L} - S.\theta_{P_L}} \right] - l^2.F_L L_{P_L} \left[\frac{S.\theta_{\bar{r}} d\bar{r}}{L_{P_L} - S.\theta_{P_L}} \right] - \dots = - \left[\frac{F_L L_{P_L}}{1-l} \right] \left[\frac{S.\theta_{\bar{r}} d\bar{r}}{L_{P_L} - S.\theta_{P_L}} \right] \quad (4.14)$$

The above discussion explains (4.13). As the small producers default on their loans, they lose land. However, we have not considered it for algebraic simplicity.

Finally, taking total differential of (4.3) treating all variables other than L_X and X as fixed, we get

$$dX = \frac{dL_X}{aP_{YX}} \quad (4.15)$$

From (4.15) it is clear that, with the decline in L_X , there will also take place a cumulative fall in X . Since X gives the aggregate consumption level of the poor, their misery will increase manifold. The above discussion yields the following proposition:

Proposition 4.1: The monetary policy of a rate cut will lead to diversion of land from the small producers to the rich and, thereby, from the production of food and other mass consumption goods to completely unproductive uses. The rich will hold the land idle, while the loss of land of the small producers will lead to a cumulative fall in the production of mass consumption goods substantially impoverishing the small producers and the low skilled workers who constitute the class of the poor.

As we have elaborated at length in the preceding chapters, following the adoption of the New Economic Policy (NEP), the banks and other financial institutions have become profit driven. The government has withdrawn its guarantee of support to the financial institutions in times of trouble. In addition to this, bank frauds of late are rising at an alarming rate in India (see for details Chandrasekhar and Ghosh (2018) and Ram and Ghosh (2022)). All the factors noted above have substantially increased the fragility of the financial institutions. In terms of our model, μ has increased substantially since the adoption of the NEP. Using our model, we can derive the impact of an increase in μ .

Taking total differential of (4.6) treating all variables other than μ and P_L as fixed and, then, solving for dP_L , we get

$$dP_L = \frac{s.\theta_\mu d\mu}{L_{P_L} - s.\theta_{P_L}} > 0; S \equiv (1 - c_c) \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{Y} \right)$$

(4.16)

Again, taking total differential of (4.11) treating all variables other than L_X and P_L as fixed and, then, solving for dL_X and using (4.16), we get

$$dL_X = - \left[\frac{F_L L_{P_L}}{1-l} \right] \left(\frac{s.\theta_\mu d\mu}{L_{P_L} - s.\theta_{P_L}} \right)$$

(4.17)

Finally, taking total differential of (4.3) treating all variables other than X and L_X as fixed and then solving for dX and using (4.17), we get

$$dX = \left(\frac{1}{a_{P_Y}} \right) \left(\frac{s.\theta_\mu d\mu}{L_{P_L} - s.\theta_{P_L}} \right)$$

(4.18)

It is clear that the explanations of (4.16), (4.17) and (4.18) are similar to those of (4.12), (4.13) and (4.15). This yields the following proposition:

Proposition 4.2: An increase in the fragility of the banks will contribute to unproductive growth in the real estate sector at the expense of the land and output of the small producers. Thus, the decline in the output of food and other mass consumption goods and the loss of land will impoverish the poor substantially.

All across the capitalist world crises of stupendous proportions have occurred leading to the collapse of the financial institutions. The crisis that occurred in Japan in 1991, the crises that occurred in the USA and Europe in 2007-08 etc. have brought to the fore the fragility of the financial institutions. In India also, the withdrawal of the government's guarantee of support to the financial institutions and the recent spate of bank frauds have exposed the vulnerability of the financial institutions. The central banks also all across the capitalist world have pushed down the interest rates to the lowest possible levels. Our study shows that these factors will lead to growth in the real estate sector by diverting land from the small producers to completely unproductive real estate development. This will lead to a cumulative decline in the output of the mass consumption goods substantially hurting the poor.

4.4 Fiscal Policy, Unproductive Real Estate Development and the Poor

The NEP has drastically changed the fiscal policy of the government. It has reduced direct tax rates substantially to the lowest possible level, extended the coverage of the indirect taxes to include all the basic necessities of life and all the basic ingredients of their production and raised indirect tax rates to high levels. The Government of India at the present raises indirect tax rates on such basic goods as diesel all the time to raise more revenue. As a result, the share of indirect taxes in total tax revenue has steadily increased since the adoption of the NEP and at the present contribute the major part of the tax revenue (see Table 4.1). In what follows we will examine how a hike in the indirect tax rate and a cut in the direct tax rate affect the economy.

4.4.1 Hikes in Indirect Tax Rates and the Poor

We will examine here how hikes in indirect tax rates affect the poor. Note that the capitalists wield State Power. The rest of the rich enjoy their patronage. Accordingly, it is reasonable to assume that the rich evade the indirect taxes, while the poor pay them. Hence, the indirect tax rate applies to P_{YX} at the rate τ so that the price of the intermediate inputs that the small producers face is given by $P_{YX}(1 + \tau)$. For simplicity and without any loss of generality, we assume that the government expenditure is nil and the government saves the tax revenue in the form of currency. Given these assumptions, the key equations, (4.2), (4.6) and (4.8), remain unaffected. However, (4.3) and (4.11) have to be, respectively, rewritten as follows:

$$X = \bar{X} + \frac{L_X}{aP_{YX}(1+\tau)} \quad (4.19)$$

And

$$L_X = \bar{F} \left(D \left(\bar{P} \cdot \left(\bar{X} + \frac{L_X}{aP_{YX}(1+\tau)} \right) \right), \bar{L} - L(P_L) \right) \equiv F \left(\bar{P} \cdot \left(\bar{X} + \frac{L_X}{aP_{YX}(1+\tau)} \right), \bar{L} - L(P_L) \right) \quad (4.20)$$

Taking total differential of (4.20) treating all variables other than L_X and τ as fixed and, then solving for dL_X , we get

$$dL_X = - \frac{F_R \bar{P} \left[\frac{L_X}{aP_{YX}(1+\tau)^2} \right] d\tau}{1-l} \quad (4.21)$$

Again, taking total differential of (4.19) treating all variables other than X , L_X and τ as fixed and, then, solving for dX , we get

$$dX = - \left[\frac{L_X}{aP_{YX}(1+\tau)^2} d\tau + \frac{dL_X}{aP_{YX}(1+\tau)} \right] \quad (4.22)$$

Let us now explain (4.21) and (4.22). Following a given increase in τ by $d\tau$, intermediate inputs become costlier. As a result, food output falls by $dX_1 = - \left[\frac{L_X}{aP_{YX}(1+\tau)^2} \right] d\tau$ lowering R by $-\bar{P} \left[\frac{L_X}{aP_{YX}(1+\tau)^2} \right] d\tau$. This raises the default rate of the small producers. Hence, supply of loans to them at the beginning of the next production season falls by $dL_{X1} = -F_R \bar{P} \left[\frac{L_X}{aP_{YX}(1+\tau)^2} \right] d\tau$. This is the end of Round 1. This fall in L_X in the second-round lowers X by $dX_2 = \frac{dL_{X1}}{aP_{YX}(1+\tau)}$. Given the boundary condition of this model, this fall in X will reduce the small producers' revenue by an amount larger than their debt service charges raising their default rate further. Hence, in the second round, at the beginning of the next production period, L_X will fall by $dL_{X2} = l dL_{X1}$. Therefore, in the third round, X will fall by $dX_3 = \frac{dL_{X2}}{aP_{YX}(1+\tau)}$. This will, as before, lower L_X by $dL_{X3} = l dL_{X2} = l^2 dL_{X1}$. This process of contraction will continue until

the fall in X that takes place eventually falls to zero. When that happens, the economy achieves the new equilibrium. Therefore, the total fall in X and L_X are given, respectively, by

$$dX = \left[\frac{L_X}{aP_{YX}(1+\tau)^2} \right] d\tau + \frac{dL_{X1}}{aP_{YX}(1+\tau)} + \frac{dL_{X2}}{aP_{YX}(1+\tau)} + \dots = \left[\frac{L_X}{aP_{YX}(1+\tau)^2} \right] d\tau + \frac{dL_X}{aP_{YX}(1+\tau)} \quad (4.23)$$

$$dL_X = -F_R \bar{P} \cdot \left[\frac{L_X}{aP_{YX}(1+\tau)^2} \right] d\tau + l dL_{X1} + l^2 dL_{X2} + \dots = - \frac{F_R \bar{P} \left[\frac{L_X}{aP_{YX}(1+\tau)^2} \right] d\tau}{1-l} \quad (4.24)$$

(4.23) and (4.24) explain (4.21) and (4.22).

The above discussion yields the following proposition:

Proposition 4.3: A hike in indirect taxes will lead to a cumulative contraction of the output of the small producers substantially impoverishing them and the low-skilled workers of the organized sector.

Even though it is not explicitly considered here, all through this process of contraction, the defaulting small producers will lose the land pledged as collateral to the lenders. This will increase the misery of the poor manifold.

4.4.2 Cuts in Direct Tax Rates, Real Estate Development and the Poor

We have already pointed out that the New Economic Policy has drastically cut direct tax rates. Accordingly, we will examine here how a cut in direct tax rates impacts the economy. Incorporating direct taxes in (4.2) and (4.6), ignoring government expenditures and assuming that the government holds its saving in the form of currency for simplicity and without any loss of generality, we rewrite them as follows:

$$\bar{Y} = c_c \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{Y} \right) (1-t) + I + a\tilde{X} \quad (4.24)$$

$$(1-c_c) \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{Y} \right) (1-t) \cdot \theta(\bar{r}, \mu, P_L) = L(P_L) \quad ; \quad \frac{\partial \theta}{\partial \bar{r}} \equiv \theta_{\bar{r}} < 0, \theta_{\mu} > 0, \theta_{P_L} < 0, L_{P_L} > 0 \quad (4.25)$$

Given the assumptions made above and the fact that the poor (consisting of the small producers and the low-skilled workers of the organized sector) fall outside the scope of the direct taxes, the rest of the equations remain unaffected.

To derive the impact of a cut in the direct tax rate on P_L , we take total differential of (4.25) treating all variables other than t and P_L as fixed and, finally, solving for dP_L , we get

$$dP_L = \frac{s\theta(-dt)}{L_{P_L} - S \cdot (1-t)\theta_{P_L}} \quad ; \quad S \equiv (1-c_c) \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{Y} \right) \quad (4.25)$$

Again, taking total differential of (4.11) treating all variables other than L_X and P_L as fixed and, then, solving for dL_X , we get (using (4.25))

$$dL_X = - \left[\frac{F_L L_{P_L}}{1-l} \right] \left[\frac{S\theta(-dt)}{L_{P_L} - S.(1-t)\theta_{P_L}} \right] < 0 \quad (4.26)$$

Finally, taking total differential of (4.3) treating all variables other than X and L_X and, then, solving for dX and using (4.26), we have

$$dX = - \left(\frac{1}{aP_Y} \right) \left[\frac{F_L L_{P_L}}{1-l} \right] \left[\frac{S\theta(-dt)}{L_{P_L} - S.(1-t)\theta_{P_L}} \right] \quad (4.27)$$

Let us now explain (4.25), (4.26) and (4.27). Following a cut in the direct tax rate by a given amount $dt < 0$, the rich people's post-tax saving increases by $S(-dt)$ and, therefore, their demand for land at the initial equilibrium P_L increases by $S\theta(-dt)$. As a result, P_L begins to rise. Per unit increase in P_L , demand for land declines by $(L_{P_L} - S.(1-t)\theta_{P_L})$. Therefore, P_L increases by $\left[\frac{S\theta(-dt)}{L_{P_L} - S.(1-t)\theta_{P_L}} \right]$ and restores equilibrium in the land market. The producers take away from the small producers $L_{P_L} \left[\frac{S\theta(-dt)}{L_{P_L} - S.(1-t)\theta_{P_L}} \right]$ amount of land. This much of land with real estate developed on it goes into the hands the savers who leave it idle. As the small producers lose the above-mentioned amount of land, the amount of L_X they secure goes down by $-F_L L_{P_L} \left[\frac{S\theta(-dt)}{L_{P_L} - S.(1-t)\theta_{P_L}} \right]$. As a result, X falls by $-\left[\frac{F_L L_{P_L}}{aP_Y} \right] \left[\frac{S\theta(-dt)}{L_{P_L} - S.(1-t)\theta_{P_L}} \right]$. This will start a cumulative process of decline in L_X and X for reasons explained in the case of the cut in the interest rate and the total fall in L_X and X will be given by (4.26) and (4.27), respectively. Since X represents the aggregate consumption level of the poor, there will take place substantial impoverishment of the poor. The above discussion yields the following proposition.

Proposition 4.4: If direct tax rates are cut, the capitalists will get the incentive to take away forcibly some of the land of the small producers and sell it to the savers who will keep it idle. As a result, there will take place a cumulative fall in the output level of the small producers. Both the loss in land and the fall in the output of the small producers will substantially impoverish the poor.

4.4.3 Fiscal Deficit Target, Government Consumption Expenditure and the Poor

The government provides the small producers with infrastructure services such as power, water, roads etc. The government also provides the poor with health care services. The NEP recommends strict adherence to the fiscal deficit target and all the countries all across the capitalist world including India follow this recommendation. We have already pointed out that under the NEP, the government has drastically cut down direct tax rates. To make up the shortfall in revenue, it has raised indirect tax rates. However, hiking indirect tax rates is problematic, since it generates inflation. Moreover, as we have already pointed out in our earlier chapters, the capitalists wield State Power and they patronize their entourage of large businessmen and high-skilled workers. Therefore, the rich evade paying taxes to a large extent.

Government of India (2018) points out that more than seventy percent of the direct tax revenue comes from salaried people. It is highly likely that the major part of these salaried people consist of government employees. In this scenario, given the strict fiscal deficit target under the NEP, the government has to cut down its expenditure. Since the rich enjoy the State Power, the government has to cut down its expenditure on infrastructure that caters to the small producers and the low-skilled workers. Decline in public investment in irrigation, drainage, flood control, rural roads, power infrastructure, health care and education are quite well-documented in the literature (see Mishra (2006), Godara et. al. (2014)). Obviously, this will adversely affect the quality and quantity of the infrastructure services noted above adversely affecting the productivity of the intermediate inputs used by the small producers. In terms of our model, a should be made a decreasing function of G . Again, a cut in G will make the government drag its feet on rescuing troubled financial institutions leading to larger number of bankruptcies of financial institutions in any given period. This will induce the savers to divert their saving from the financial assets to real estate raising the demand for land. Therefore, we consider it reasonable to make θ a decreasing function of G .

In what follows, we will examine how a cut in G affects the economy. However, for simplicity and without any loss of generality, we will not show how G is financed so that the effect of a cut in G does not get mixed up with the effects produced by the cuts in direct tax rates etc. on the economy. Incorporating G in (4.2), (4.3), (4.5), (4.6) and (4.11), we get

$$\bar{Y} = c_c \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{Y} \right) + I + G + a(G)\bar{X} ; a_G < 0 \quad (4.28)$$

$$X = \bar{X} + \frac{L_X}{a(G)P_{YX}} \quad (4.29)$$

$$(1 - c_c) \cdot \left(\bar{Y} - \frac{W}{P_Y} \bar{Y} \right) \cdot \theta(\bar{r}, \mu, P_L, G) = L(P_L) ; \theta_G < 0 \quad (4.30)$$

$$L_X = F \left(\bar{P} \cdot \left(\bar{X} + \frac{L_X}{a(G)P_{YX}} \right), \bar{L} - L(P_L) \right) \quad (4.31)$$

To derive the impact of a cut in G on Y , we have to first take total differential of (4.30) treating all variables other than G and P_L as fixed and, then, solving for dP_L , we get

$$dP_L = \frac{S\theta_G dG}{L_{P_L} - S \cdot (1-t)\theta_{P_L}} > 0, \text{ when } dG < 0 \quad (4.32)$$

The explanation of (4.32) is quite simple. Following a cut in G , people divert their saving from the financial assets to land creating an excess demand for land of $S\theta_G dG$ at the initial equilibrium P_L . Hence, P_L , as we have elucidated in the context of (4.25), will go up by the expression on the RHS of (4.32).

Again, taking total differential of (4.31) treating all variables other than L_X and P_L as fixed and, then, solving for dL_X and using (4.32), we get

$$dL_X = - \left[\frac{F_L L_{P_L}}{1-l} \right] \left[\frac{S\theta_G dG}{L_{P_L} - S.(1-t)\theta_{P_L}} \right] - \left[\frac{F_R \frac{L_X \alpha_G}{P_{YX} \alpha^2} dG}{1-l} \right] < 0 \quad (4.33)$$

Finally, taking total differential of (4.29) treating all variables other than X, L_X and G as fixed and, then, solving for dX, we get

$$dX = \frac{dL_X}{a(G)P_{YX}} - \frac{L_X}{a^2 P_{YX}} a_G dG < 0 \quad (4.34)$$

Let us explain (4.33) and (4.34). Following a given cut in G by dG, a falls. As a result, X goes down in the first round by $dX_1 = -\frac{L_X}{a^2 P_{YX}} a_G dG$. The given cut in G produces another effect. As we have already explained, the incidence of bankruptcy of the financial institutions increases inducing the people to divert their saving from the financial assets to real estate leading to an excess demand for land at the initial equilibrium P_L . As a result, P_L increases by $\left[\frac{S\theta_G dG}{L_{P_L} - S.(1-t)\theta_{P_L}} \right]$ making it profitable for the capitalists to take away from the small producers $L_{P_L} \left[\frac{S\theta_G dG}{L_{P_L} - S.(1-t)\theta_{P_L}} \right]$ amount of land. The fall in R due to the decline in X and the consequent increase in the default rate of the small producers together with the loss in land prompts the lenders at the beginning of the next production period to reduce the loan supply to the small producers by $dL_{X1} = -F_L L_{P_L} \left[\frac{S\theta_G dG}{L_{P_L} - S.(1-t)\theta_{P_L}} \right] - F_R \frac{L_X \alpha_G}{P_{YX} \alpha^2} dG$. This is the end of Round 1. We have seen earlier that this fall in L_X will lead to a cumulative decline in L_X and X and, finally, they will fall, respectively, by the quantities given by (4.33) and (4.34).

At the present, hostility with the neighbouring countries has escalated significantly. This is likely to have diverted quite a significant part of G to defence from infrastructure building and maintenance in the areas that cater to the poor. That will also produce, as one can easily deduce, the same kind of impact as that a cut in G produces.

During the Nehru-Mahalanobis era, the government used to invest heavily in irrigation, flood control facilities, power supply in rural areas, rural roads, drainage etc. However, following the adoption of the NEP, with the drastic decline in the direct tax rates, the limits to hiking indirect tax rates and the stringent restrictions imposed on the size of the fiscal deficit, government's income became too low to sustain its investment levels in the areas mentioned above. Moreover, as we have already pointed out, the objective of the NEP is to hand over all the capital and natural resources of the country to the capitalists. Since 85 percent of agricultural land is still cultivated by the small farmers (see NAABARD (2020)), it is necessary to impoverish them by depriving them of the government provided free infrastructure services so that they become too poor to pay off their debts and, thereby, lose their land. For both the reasons stated above, there has taken place since 1991 a drastic cut in public investment in infrastructure that caters to the small producers. Our study shows that, under such circumstances, the small producers will lose their land substantially and the land will be held by the savers and it will remain idle in their hands. Thus, we get the following proposition:

Proposition 4.5: If the government cuts down its consumption expenditure, the capitalists will take away the land of the small producers forcibly, develop real estate on it and sell it to the savers and the land will remain idle in their hands. The small producers will not only lose land, their output will also decline substantially bringing about a significant deterioration in the economic condition of the small producers and low-skilled workers.

4.5 Conclusion

At the present, the monetary policy of the central banks all across the capitalist world including the RBI consists in keeping the nominal interest rate pegged at the minimum possible level. At the same time, prices increase continuously in all the countries of the capitalist world including India eroding the real value of not only the interest income but also the principal amount of a loan. The Government of India has also withdrawn its guarantee of bank deposits or insurance policies even of its own financial institutions. This situation prompts the people to divert their savings from financial assets to real estate. This study shows that, the policies noted above induce the capitalists to forcibly take away land from the small producers, develop real estate on the acquired land and sell it off to the savers, who keep the real estate idle in their hands. As a result, the small producers' land holding and output fall substantially bringing about a significant impoverishment of the poor.

There have taken place considerable changes in the government's fiscal policies as well in the post-reform period in India. Under the NEP, there has taken place drastic cuts in the direct tax rates and hikes in indirect tax rates. However, since hikes in indirect taxes generate inflation, there is a limit to such hikes. The NEP also imposes stringent restrictions on the size of the fiscal deficit. This forces the government to cut down its expenditures on infrastructure that cater to the small producers. This is also in consonance with the NEP, which seeks to hand over all the capital and natural resources of the country to the capitalists. Our study shows that cuts in direct tax rates, hikes in indirect tax rates and cuts in government expenditures in the areas mentioned above, make it profitable for the capitalists to forcibly take away land from the small producers and bring about completely unproductive real estate development on it. The small producers not only lose their land, but also suffer a cumulative fall in their output. Both lead to substantial deterioration in the economic condition of the poor.

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Table 4.1

Percentages of Direct and Indirect Taxes in Total Tax Revenue

	2009-10	2013-14	14-15	15-16	16-17	17-18
Direct Tax	60.78	56.32	56.16	51.13	49.66	49.41
Indirect Tax	39.22	43.68	43.84	48.87	50.34	50.59

Source: RBI

Table 4.2

Rate of Consumer Price Inflation (Annual %)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
France	1.5	2.1	1.9	0.8	0.5	0.04	0.2	1.03	1.9	1.1
Germany	1.1	2.1	2.0	1.5	0.9	0.5	0.5	1.5	1.7	1.4
UK	2.5	3.9	2.6	2.3	1.4	0.4	1.0	2.5	2.3	1.7
USA	1.6	3.1	2.0	1.5	1.6	0.1	1.3	2.1	2.4	1.8
HIC¹	2.0	3.4	2.7	1.5	1.0	0.32	0.4	1.5	1.8	1.6
India	11.1	8.9	9.3	10.9	6.4	5.9	4.1	2.5	4.9	7.7

¹High Income Countries (Source: International Monetary Fund)

Chapter 5

Conclusion

5.1 Introduction

We will summarize here the main results of this Ph.D. thesis. It has three core chapters: Chapters 2, 3 and 4. India adopted the New Economic Policy (NEP) in 1991 replacing the Nehru-Mahalanobis Programme (NMP). The objective of the NEP is to remove all the restrictions and regulations of the NMP and establish free market. It also seeks to transfer the ownership of all the capital and natural resources of the country to the capitalists. The NEP is being implemented through the process of economic reforms. Chapter 2 focuses on the impact that some of the economic reforms produce in India. Under the NEP, the counter recessionary monetary policy consists in a cut in the interest rate. The larger the output gap the lower is the level to which the interest rate is cut down to. Chapter 3 examines how the counter recessionary policy is likely to affect India. Finally, Chapter 4 shows how the counter recessionary monetary policy and the reforms undertaken in the realm of the financial sector and fiscal policy under the NEP are likely to affect the land holding of the small producers in India. In what follows, we will summarize the main results of the three chapters.

5.2 Chapter 2: Economic Reforms and the Common Man in India

The economic reforms that this chapter focuses on are the financial sector reforms, deregulation of investment and prices and forcible acquisition of land. We summarize their impacts below:

5.2.1 Impact of Financial sector Reforms

We have examined first how financial sector reforms are likely to impact the economy. They have made banks profit driven, imposed on the banks lending norms that have made the banks extremely wary of lending to the small borrowers. As a result, supply of loans to the small producers have gone down lowering their output. In consequence, their revenue has gone down more than their debt service charges. Hence, their default rate has increased reducing loan supply to them further. Thus, there has taken place a cumulative contraction in their output. The fall in their demand for the output of the organized sector is also likely to have enabled the capitalists to raise their investment. We, therefore, get the following proposition:

Proposition 2.1: Financial sector reforms are a weapon at the disposal of the capitalists to increase their market share at the expense of the unorganized sector creating mass unemployment and poverty. These reforms are also likely to allow the capitalists to grab a larger fraction of the GDP for their own use at the expense of the masses.

In order to fully appreciate the implications of the cumulative contraction in the output of the unorganized sector following the financial sector reforms, one has to take into account the following facts. From the data given in Tables 2.1 – 2.4 in Chapter 2, we find that the organized sector employed only 6 percent of the work force in 2004-05. The employment in the organized sector had been virtually stagnant during 1994 – 2014, while the work force had been growing at the rate of more than 2 percent per year during 1999-00 to 2004-05. There is no reason to believe that these trends have reversed since then. However, the recent data on employment,

which are, of course, not comparable to the data mentioned above, do indicate that the trend has reversed. Still, it may be safe to say that most of the ordinary Indians derive their livelihood from the unorganized sector at the present. Under these circumstances the cumulative contraction in the output of the unorganized sector due to the financial sector reforms is a cause of major concern. It will lead to a substantial increase in the level of unemployment and poverty threatening the survival of the ordinary Indians.

5.2.2 Deregulation of Prices

During the Nehru-Mahalanobis era, prices of all the essential industrial goods were administered by the government. The government also provided the small producers with inputs at highly subsidized prices. Economic reforms under the New Economic Policy (NEP), however, have done away with price regulation and input subsidy. In the post-reform period, therefore, prices of inputs used by the small producers have gone up steeply. This reduces the output of the unorganized sector and the revenue of the small producers. The fall in revenue raises the default rate of the small producers lowering the supply of loans to the small producers. Hence, output of the small producers falls again. Thus, there takes place a cumulative fall in the output of the unorganized sector enabling the capitalists to grab more of the market of the unorganized sector. The capitalists may also be able to raise their consumption and investment. This yields the following proposition:

Proposition 2.3: Prices of the inputs used by the small producers are an instrument of exploitation at the disposal of the capitalists. By raising them, they bring about a cumulative contraction in the output of the unorganized sector that produces for the masses and employs in India in all likelihood more than ninety-nine percent of the work force. This leads to a substantial increase in unemployment and poverty. The capitalists grab more of the market of the unorganized sector and may be able to use the resources released from the production of the output of the small producers to raise their consumption and investment.

5.2.3 Forcible Acquisition of Land of the Small Producers

In the post-reform period, laws have been passed to facilitate forcible acquisition of land of the small producers. This lowers the collateral of the small producers. As a result, supply of loans to them falls leading to, through the process described in the earlier cases, a cumulative fall in the output of the unorganized sector. This yields the following proposition:

Proposition 2.4: Forcible acquisition of land of the producers of the unorganized sector will lead to a cumulative decline in the output of the unorganized sector bringing about a substantial increase in unemployment and poverty. This will enable the capitalists to grab more of the market of the unorganized sector and may enable the capitalists to raise their investment on a large scale

5.2.4 Decline in Public Investment in Infrastructure for the Unorganized Sector

Mishra (2006), Godaraet et al. (2014)) show that public investment in agriculture, which is by far the largest segment of the unorganized sector, has declined steadily in the post-reform period. This steady fall in public investment may lead to deterioration in the quality of services

provided by the already existing public infrastructure facilities. Hence, quality and quantity of the supply of power, water etc. may deteriorate; drainage and flood control facilities may lose gradually their efficiency. Hence, the producers of the unorganized sector may get less protection from the adverse impacts of drought, water logging, flooding etc. Hence, the productivity of the intermediate inputs they use may fall lowering their output. This in turn, just as in the earlier cases, will lead to the following proposition:

Proposition 2.5: A decline in public investment in agriculture will bring about a cumulative contraction in the unorganized sector causing cumulative increase in unemployment and poverty. This will enable the capitalists to grab more of the market of the unorganized sector and may enable the capitalists to raise their investment on a large scale

5.2.5 Conclusion

This study is based on the hypothesis that at the present India is under the complete control of the capitalists. They are making the Government of India undertake a series of Economic Reforms to implement the New Economic Policy (NEP), whose objective is to establish a free market and transfer the ownership of all the capital and natural resources to the capitalists. In sum, the NEP seeks to handover India to the capitalists so that they can run and manage India in whatever way they want. Our study shows that economic reforms in the financial sector and deregulation of prices coupled with forcible acquisition of land from the small producers and decline in public investment in agriculture lead to a large and cumulative shrinkage in the output of the unorganized sector enabling the capitalists to grab the market of the unorganized sector and have in their command a larger part of the aggregate output of goods and services for consumption and investment.

Since most of the ordinary people in India derive their livelihood from the unorganized sector and the organized sector grows without generating any employment, the shrinkage of the unorganized sector is a matter of grave concern. If the capitalists, through the process of economic reforms and other means, succeed in obliterating the unorganized sector grabbing its market and resources, most of the ordinary Indians will perish. Thus, in the absence of mass awareness of and strong mass movement against capitalistic exploitation, ordinary people in India might be extinct.

5.3 Chapter 3: Monetary Policy in the Post-Reform Period and the Common Man in India

During the Nehru-Mahalanobis era, monetary policy consisted in a credit policy. The financial sector became the exclusive preserve of the government. The government administered all the interest rates and determined the total volume of credit to be disbursed by the financial institutions and dictated the allocation of the total amount of credit across different sectors and economic agents. The financial institutions had to abide by the dictates of the government. The objective of the credit policy delineated above was to make sure that all the sectoral production and investment targets specified in the Five-Year Plans were fulfilled and no leakage of credit took place in non-planned areas. The financial institutions were social organizations whose objective was not to make profit but to provide the people with fully safe avenues of saving and disburse credit in accordance with plan targets at interest rates administered by the government. The prices of all the non-agricultural essential goods and services were

administered by the government. The financial sector and the credit policy were subservient to planning.

The New Economic Policy (NEP) that the Government of India adopted gave up planning and along with it the directed credit programme. It has opened up the financial sector to the private entrepreneurs, made the public financial institutions autonomous commercial organizations that are free to decide whom to lend, how much to lend and at what interest rates. The RBI under the NEP seeks to regulate the interest rates indirectly through policies such as open market operations (OMO), liquidity adjustment facility (LAF) etc. The RBI's monetary policy under the NEP consists in adoption of measures to reduce nominal interest rates to counter recession and to raise nominal interest rates to lower inflation rate when it goes beyond a tolerable level. The objective of this chapter is to subject this monetary policy to close scrutiny to unravel its ulterior motive.

We have used the model developed in the previous chapter for our purpose. We have based our study, as before, on the hypothesis that the capitalists drive a capitalist economy. It is they who create recession and inflation to exploit the masses. We will show here that the monetary policy delineated above instead of countering the recession reinforces them it and, thereby, facilitates the process of exploitation. It is subservient to the objective of the capitalists.

5.3.1 Counter-Recessionary Monetary Policy

As we have already pointed out, the monetary policy of the RBI consists in keeping the interest rate at a target level through policies such as the OMO, LAF etc. In times of recession, it cuts the interest rate to a low level. If that happens, workers' interest income in our model will fall. Hence, their spending on the output of the unorganized sector will fall. This will lower the revenue of the small producers raising their default rate. Loan supply to them will, therefore, fall reducing their output. This will set in motion, for reasons explained in the previous chapter, a cumulative process of decline in the output of the unorganized sector enabling the capitalists to grab the market of the small producers and, in all likelihood, raise their investment. This yields the following proposition:

Proposition 3.1: A cut in the interest rate brings about a cumulative contraction in the output of the unorganized sector and, thereby, deepens recession. It, therefore, brings about a cumulative increase in unemployment and poverty. It enables the capitalists to capture a part of the market of the unorganized sector. It is also highly likely that the capitalists will be able to use a larger part of the output of the organized sector for their own use.

5.3.2 A Tightening of the Lending Norms and the Monetary Policy

We will show here how the counter recessionary monetary policy deepens the recession generated by a change made by the capitalists in the value of an instrument of exploitation. Thus, the counter recessionary monetary policy facilitates the capitalists' plan of reducing the unorganized sector. We will establish this claim by considering the example where the capitalists using the State Power make the lending norms such as the Basel norms more stringent. Since the interest rate is cut to counter recession, it should be a decreasing function of the output gap defined as the excess of the potential real GDP and the actual real GDP. In our perception, the recession remains confined to the unorganized sector. Hence, we have made the interest rate an increasing function of the output of the unorganized sector, since the potential level of the output of the unorganized sector is given in the period under consideration. Thus, following a tightening of Basel norms, as we have shown in the previous chapter, there will take place a cumulative contraction in the output of the unorganized sector widening the output gap. This will induce the RBI to lower the interest rate. This will lead to, as shown

above, a further cumulative contraction in the output of the unorganized sector. This process will continue until a new equilibrium is achieved. This yields the following proposition:

Proposition 3.2: A tightening of Basel norms brings about a cumulative contraction in the output of the unorganized sector. This contraction is magnified significantly by the counter recessionary policy of the RBI. The capitalists, through the tightening of Basel norms, grab not only a large part of the market of the unorganized sector but also, in all likelihood, a larger part of the aggregate output of the organized sector for their own use.

The tightening of the Basel norms is just an example to show how the counter recessionary monetary policy deepens the recession in the unorganized sector caused by a change in a policy instrument of the capitalist aimed at reducing the output of the unorganized sector. Thus, a fall in the employment level of the organized sector brought about by the capitalists by bringing about more automation in production or a capitalist induced worsening of attitude of the banks towards the unorganized sector will lead to a shrinkage of the unorganized sector and this process of shrinkage will be facilitated greatly by the counter recessionary monetary policy. We will discuss another example where the banks raise the interest rate at which they lend to the small producers.

5.3.3 The Effect of an Increase in the Interest Rate on the Loans Given to the Small Producers

As we have pointed out earlier, we regard the lending rate to the small producers as an instrument of the capitalists to exploit the small producers. This rate is independent of the risk-free interest rate at which the capitalists secure loans for financing investment. In fact, in times of recession, the lending rate to the small producers often goes up despite the fall in the risk-free interest rate. This happens because in times of recession, banks become more cautious regarding their lending and in their perception the risk of lending to the small producers increases phenomenally. Thus, the risk premium that they charge on loans given to the small producers increases steeply in times of recession. This was in evidence in the USA (see Bernanke (1983), Bernanke, Gertler and Gilchrist (1996) and Mishkin (2009)). The capitalists by exercising State Power in India can make banks raise r_x . We will derive its impact mathematically now.

A ceteris paribus increase in the lending rate to the small producers should increase the default rate of the small producers inducing the banks to reduce loan supply to the small producers. This, just as in the earlier cases, will lead to a cumulative contraction in the output of the unorganized sector, which will be aggravated considerably by the counter-recessionary monetary policy and the increase in the risk premium with the deepening of the recession. This yields the following proposition:

Proposition 3.3: An increase in the lending rate to the small producers brings about a cumulative contraction in the output of the organized sector. This contraction is magnified significantly by the counter recessionary monetary policy of the RBI. The capitalists, by raising the lending rate to the small producers, grab not only a large part of the market of the unorganized sector but also, in all likelihood, a larger part of the aggregate output of the organized sector for their own use.

5.3.4 Conclusion

This chapter shows that the counter recessionary monetary policy is a part of the exploitative machinery of the capitalists. It brings about a large and cumulative contraction in the output of the unorganized sector and enables the capitalists to grab a large part of the market of the unorganized sector. The capitalists, in all likelihood, are also able to use a larger part of the

output of the organized sector for their own use. The capitalists have many instruments at their disposal to bring about a shrinkage in the unorganized sector. The counter recessionary monetary policy deepens manifold the recession created by these instruments in the unorganized sector.

The scenario is obviously extremely scary in view of the fact that the major part of the workforce derives their livelihood from the unorganized sector. The shrinkage of the unorganized sector raises unemployment and poverty significantly. If the capitalists swallow up the whole of the unorganized sector, the ordinary Indians will perish.

The interest rate is falling steadily since 2015 in India (see Table 3.6 in Chapter 3). The prices on the other hand are rising at an alarming rate (see Table 3.5 in Chapter 3). As a result, the real value of the savings of the workers and that of the interest income yielded by the savings are falling at a high rate benefiting the capitalists, who are net borrowers, and making the lives of the workers precarious. The central banks all across the capitalist world and its satellites such as India are carrying on with this extremely unjust monetary policy in the name of fighting recession, which the capitalists create to reduce the unorganized sector.

Clearly, unless the ordinary people become aware of the real cause of their plight, unless they become united, form their own party and grab the State Power, they are likely to become extinct. However, the spontaneous farmers' movement against the reforms in agriculture keeps the hopes for the ordinary people alive.

5.4 Chapter 4: Monetary Policy, Financial Sector Reform, Fiscal Policy and Land Grab in India

At the present, the monetary policy all across the capitalist world including India consists in pushing down the interest rates to the lowest possible level. Prices on the other hand, increase continuously all over the capitalist world including India. As a result, both the principal amount of a loan and the interest income from it fall in real value continuously. This makes loans or financial assets such as bank deposits or bonds unattractive as instruments of saving. Again, the financial sector reforms undertaken in recent years such as the withdrawal of government guarantee of bank deposits and the introduction of the Financial Regulation and Deposit Insurance (FRDI) Bill that allows a distressed bank to take over the deposits of the depositors to tide over its troubles have contributed to the vulnerability of the financial assets. Under these conditions, the savers get induced to divert their savings from the financial assets to real estate. This makes it profitable for the capitalists to appoint land sharks to force the small producers to part with their land. The capitalists sell this land to the savers and, thereby, make a huge profit. The capitalists are able to do so because, as we have explained in Chapters 2 and 3, they own all the political parties and wield the State Power. Obviously, the land lost by the small producers gets locked in unproductive uses, while the output of food and other mass consumption goods falls impoverishing the poor substantially.

The government's fiscal policy these days consists in switching from direct taxes to indirect ones so much so that the fraction of the total tax revenue contributed by the indirect taxes has been rising steadily of late and at the present the major part of the total tax revenue comes from the indirect taxes (see Table 4.1 of Chapter 4). We have shown here that a fall in the direct tax

rates will also raise demand for land making it profitable for the capitalists to take away more land from the small producers impoverishing the poor. A hike in indirect tax rate will also, as we show here, will bring about a cumulative fall in the small producers' output substantially increasing the poverty of the masses.

The NEP has drastically cut down the direct tax rates. Even though the government has hiked indirect tax rates to make up for the shortfall in revenue, there are limits to such hikes as they produce strong inflationary forces. The NEP has also put stringent restrictions on government's fiscal deficit. As a result, the government has become subject to acute fund shortage and there has taken place drastic fall in public investment in infrastructure that caters to the needs of the small producers and the poor (see in this context Mishra (2006) and Godara et. al. (2014)). The cut in the government expenditure will also make the government reluctant to rescue the troubled financial institutions making them more fragile. This will add to the unattractiveness of the financial assets. We have shown here how this decline in government expenditure will lead to unproductive real estate development at the cost of the land and output of the small producers substantially impoverishing the poor.

5.5 Conclusion

After gaining independence, India adopted the Soviet model of planned economic development. It modified the strategy a bit and drew up the Nehru-Mahalanobis Strategy of economic development. The objective of this strategy was to establish socialism. With this end in view, the government nationalized all natural resources and financial institutions. All the essential industrial sectors were made exclusive preserves of the government. The government played the major role in developing industry, agriculture and the financial sector of India. The capitalists were not allowed to invest in most sectors. To generate employment, quite a large number of sectors of production and distribution were reserved only for the small producers. All the prices and interest rates were under the control of the government. Through a system of licensing, the government used to regulate production, investment, import and export of the private sector. On the basis of the support received from the Soviet Union, India could adopt and carry on with this strategy of socialist development. However, with the weakening of the Soviet Union since the mid-eighties, the western capitalists finally succeeded in forcing India to give up the Nehru-Mahalanobis Programme and adopt the NEP in its place in 1991(see Ghosh and Ghosh (2016), (2019^a, 2019^b). The objective of the NEP is to remove all kinds of government restrictions and regulations on economic activities of the capitalists, to sell of all government enterprises and natural resources to the capitalists and to do away with all restrictions on cross-border trade of goods, services and capital. In other words, the objective of the NEP is to hand over India to the capitalists so that they can run and manage India the way they want to. The NEP is being implemented through a series of economic reforms. This thesis shows how the process of economic reforms is benefiting the capitalists causing immense misery and suffering to the masses.

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