

The Global Scenario and The Indian Economy

Prabhat Patnaik

Two features of the present global scenario are of particular interest: the first is the stagnation of the world economy, and the second is the threat to the dollar. The stagnation of the world economy which is typically located in the post-pandemic period in fact predates it: the annual growth-rate of world GDP over the decade of the 2010s was lower than during any decade since the second world war.

It is attributable to the fact that there has been a massive increase in income inequality for the world economy as a whole and within individual countries during the period of the neo-liberal regime. This is because, under neo-liberalism, capital, including finance, has become globally mobile, while workers continue to be organized within particular countries: demands for higher wages in countries of the Global North therefore are countered with threats of relocation of activities to the Global South; in fact, Joseph Stiglitz, the distinguished American economist, estimates that the average real wage of a male American worker in 2011 was marginally lower than in 1968. At the same time, since under neo-liberalism competition between countries in the global market becomes more intense, the rate of growth of labour productivity increases, including in the Global South. This keeps down the rate of growth of employment even below the work-force growth rate, and even in countries like India where the GDP growth is supposed to have increased under neo-liberalism, so that the labour reserves inherited from colonial times in the form of unemployment, underemployment and disguised unemployment, increase in relative size instead of diminishing; the real wage rate therefore does not increase in the Global South either. Taking both the North and the South, since wages remain sluggish even as labour productivity increases, there is a rise in the share of economic surplus that manifests itself as increasing inequality. In India for instance, according to the Paris-based World Inequality Database the share of the top 1 percent of the population in total national income, which had been 12 percent in 1951 and had fallen steadily to 6 percent by 1982, exceeds 23 percent at present, which is the highest in the last century. Since the propensity to consume out of income is much higher for the working people than for those whose incomes come from the surplus, this redistribution towards surplus has the effect of lowering consumption demand relative to producible output and hence aggregate demand; this is what underlies the tendency towards stagnation and hence higher unemployment rates (often camouflaged as lower work-participation rates) that we are now observing under neo-liberalism.

The second feature of the contemporary world capitalism is the fact that economically the most powerful country is also the most indebted. The leading capitalist country has to run a current account deficit vis-à-vis all non-colonial countries taken together, to accommodate exports from the new industrializers and also to incur expenditures all over the world in defending the system. When Britain was the leader of the capitalist world, it paid for this deficit, and indeed more (for it made capital exports too) by generating a surplus vis-à-vis its colonies, by exporting manufactured goods to unprotected colonial markets and also by appropriating without any *quid pro quo* the export surplus of the colonies to the rest of the world (what the Indian nationalist writers like Dadabhai Naoroji had called a “drain of wealth”). After decolonization however these ways of overcoming its current account deficit were not available to the new leader of the capitalist world: the US. Hence starting with a current account surplus

immediately after the war the US began to run a persistent current account deficit after the mid-seventies (an important reason for this being its maintenance of 750 military bases across the globe).

This did not matter since the world was willing to hold on to the dollars (and dollar-denominated assets) with which the US was meeting its current account deficit. But the pouring out of billions of dollars poses a threat to the dollar's continued hegemony. The threat arising from a possible shift by the world's wealth-holders to some other *currency*, which has been the focus of discussion till now, is generally underplayed since no other currency is as yet important enough to challenge the dollar; but the threat remains. What is more, there is always the danger of a shift from the dollar to some *commodity*, in particular oil; even if this happens for some time, the inflationary boost it would give to the world economy, would bring forth, as a counteracting measure, policies of "austerity" that would precipitate a serious depression. A continuation of yawning US current account deficits therefore poses a threat to the financial system of the capitalist world that cannot be ignored.

Donald Trump's policies have to be seen in the context of these two features of the global scenario. One strand of Trump's policy is to get European countries to share the burden of defence expenditure by spending up to 5 percent of their GDP on defence which would reduce US expenditure abroad and hence its current account deficit. The other strand is to recreate for the US vis-à-vis the countries of the Global South the kind of economic relationship that Britain had vis-à-vis its colonies, namely, to create captive markets for American goods by imposing unequal trade treaties upon them, and to have control over their primary commodities.

The treaty that the Trump administration wishes to impose on India is an example of such an unequal treaty; and it is imposed by presenting as an alternative very high American tariffs on Indian goods, so that India would choose the unequal treaty as the "lesser evil". The proposed treaty is unequal in two obvious ways: one, under it the tariffs imposed by the US on Indian goods would be generally much higher than those imposed by India on US goods; and, two, it stipulates the absolute amounts that India must buy from the US, but not the other way around. This second feature is completely novel which was unprecedented even under colonialism: the market of colonial India was completely open to British goods but the *amount* of such goods that was imported depended entirely on the demand of the Indian buyers and was not pre-ordered; under Trump's treaty it is pre-ordered and far above the current level of India's imports from the US. The US would no doubt be having such treaties with other countries of the Global South, with the objective of increasing its net exports and closing its current account deficit.

Increasing net exports simultaneously serves to increase domestic employment and output in the US, and counter the tendency towards stagnation mentioned earlier. In fact, increasing net exports is at present the *only policy-induced way of raising the level of aggregate demand*. The other obvious way, of raising government expenditure, would work only if the government expenditure is financed either by a fiscal deficit or by a tax on the affluent segments. If the working people are taxed and the revenue so earned is spent by the government, then there is hardly any net increase in aggregate demand, since the working people spend the bulk of their incomes on consumption anyway: if say \$100 are raised from them and spent by the government then there is only a change in the *composition* of aggregate demand, away from workers' consumption towards government expenditure, but not in its *aggregate amount*. But both the ways of raising fiscal resources for government expenditure, if it is to be expansionary,

are opposed by globalized finance capital, whose writ must be obeyed under neo-liberalism if capital flight is to be avoided. (British Prime Minister Liz Truss had to resign because her Chancellor of the Exchequer had proposed a larger fiscal deficit which triggered a capital flight and hence a fall in the value of the pound sterling). Government intervention for raising aggregate demand therefore becomes infructuous within a regime of liberalized financial flows; a rise in net exports then becomes the only policy weapon for employment expansion (as well as for closing the current account deficit). This is what Donald Trump is attempting.

The second component of Trump's strategy vis-à-vis the Global South is to acquire control over the primary commodities of the South, especially oil. The attack on Venezuela whose President was abducted was motivated by this, as Venezuela is the country with the largest oil reserves in the world. Similarly the attack on Iran, meant to enforce a regime change was for acquiring control over Iranian oil, though of course Trump grievously underestimated the strength of Iranian resistance. Even his designs on Greenland have to be placed in this context: Greenland possesses rare earths, which are crucial for several uses.

The US is already the world's largest oil producer. Acquiring control over Venezuelan and Iranian oil, not to mention other countries it would target, would give it a stranglehold over the oil economy of the world. This would be useful for shoring up the dollar in at least three ways: first, it can ensure that oil transactions occur in terms of dollars, which would preserve the dollar's pre-eminence and prevent any other currency from coming anywhere near it in terms of importance. Second, it can ensure that the dollar price of oil, though it may fluctuate in the short-run, would be expected to remain more or less stable in the long-run, which would prevent any flight from dollar to oil. And third, by controlling the oil resources of the Global South, it can induct American firms into oil extraction, refining and the production of petro-products on a much larger scale; what the oil companies get out of this would help to close the US current account deficit (rather like what the "drain of wealth" had done in colonial times). Control over the resources of the Global South, which has been called an economic recolonization of the Global South, therefore becomes a crucial means of maintaining the position of the dollar.

The economic problems that India is facing have to be located within this context, where the US is trying to maintain a regime of free financial mobility across the globe, while taking its own economy out of a regime of relatively unrestricted trade but adopting "beggar-thy-neighbour" policies vis-à-vis countries of the Global South. Most people attribute India's current economic travails, especially the falling rupee, to the West Asian war; but the rupee was already falling before the war. At the end of 2024 the exchange rate was 85.47 rupees to a dollar; on February 27, the eve of the war, it had fallen to 91.08 and on May 26 it was close to 96 per dollar. The fall that had already preceded the war was itself a part of a prolonged fall ever since the rupee was floated in 1992-3, when the exchange rate had been 22.74 to a dollar. While the war has certainly aggravated matters, its impact has to be seen within a much larger context.

The logic of neo-liberalism entails that there is some equilibrium price at which each market clears; hence there is an equilibrium exchange rate at which the foreign exchange market would clear where the actual exchange rate would settle if left free. There is however no such accessible equilibrium exchange rate where our current account deficit would disappear, which

is why the actual exchange rate keeps falling over time, acquiring only temporary perches in every period but not a state of equilibrium.

There is a second factor here. No country can afford to let its exchange rate appreciate because of financial inflows, because then its goods would become uncompetitive compared to imported goods and it would experience “deindustrialization” and that too, financed by inflows of funds, i.e. by borrowings; it would then be borrowing to finance its own ruin. So, when finance flows in, the central bank steps in to hold the exchange rate steady and builds up foreign exchange reserves; but when finance flows out, it is chary about maintaining the exchange rate by decumulating reserves, since that would strengthen speculators’ expectations about a currency depreciation (because of reduced reserves) and hence reinforce the financial outflow. Currency depreciation therefore occurs even when a country holds large exchange reserves. In India on the eve of the West Asian war, there were \$728.5 billion dollars of reserves, but that has not prevented the downward slide of the rupee. Thus if a country of the Global South has a persistent current account deficit, there is only one direction its currency will take if left free, that is downwards, which is why the rupee was pegged for a long time (prior to the neo-liberal regime), and there were capital controls along with foreign exchange rationing.

All this has a bearing on what we should do now. The standard suggestion one comes across these days is to have more “reforms”, which means two things: one, worsening the state of workers’ rights and living conditions, so that Indian goods can become cheaper and more competitive, and the country can also attract more foreign investment; and, two, raising the interest rate or giving tax concessions so that finance does not flow out as it is doing now and the rupee’s fall comes to an end.

This however is utterly unwise. The neo-liberal regime in its pristine form is now *passee*, as Donald Trump himself is demonstrating through his actions (of imposing heavy tariffs). With the US pursuing “beggar-thy-neighbour” policies vis-à-vis the Global South, for India to repose faith in the “free market” would amount to further increasing the burden on the working people and further squeezing employment opportunities of the youth, just for the sake of chasing a non-existing market equilibrium. On the contrary, the present is an opportunity for getting out of the neo-liberal regime altogether, by pegging the exchange rate; imposing capital controls; introducing foreign exchange rationing; expanding the home market by taxing the rich (through wealth and inheritance taxation) and using the proceeds to increase government expenditure on education, health and social services; and reviving the public sector.

The transition to such a regime would be painful no doubt, but so would a continuation of neo-liberalism: even if the rupee gets stabilized for the time being through the provision of inducement to finance capital in the form of higher interest rates and greater fiscal concessions (which of course would be contractionary measures further reducing employment in the economy), its downward slide would resume soon after, and we would once again be back to square one. The focus at present, on the contrary, should be on minimizing the pains of transition away from neo-liberalism.

Does my suggestion mean a return simply to the pre-neo-liberal *dirigiste* regime? The answer is no. The people cannot be made to wait indefinitely for an improvement in their lives; and for this a set of fundamental, universal, Constitutionally guaranteed, economic rights should be introduced, on a par with the civil and political rights we currently have. A set of five such rights: a right to food (providing everybody with food on the same terms as the BPL population

enjoyed before the pandemic), a right to employment (failing which a full wage must be paid), a right to free quality healthcare through a National Health Service as in the UK or Scandinavian countries, a right to free quality education (at least up to the Higher Secondary Level), and a right to a non-contributory living old-age pension and corresponding disability benefits, can be financed by just two taxes levied only on the top 1 percent of the population: a 2 percent wealth tax, and a 1/3 inheritance tax on any wealth that is passed on by this segment. Of course, alongside these financial provisions, there have to be major adjustments in the real sectors of the economy, but a Welfare State in India is possible and must be on the country's agenda.