The Spectre of the Thirties*

Prabhat Patnaik

The Reserve Bank of India, as is to be expected, has been denying that its Governor Raghuram Rajan had ever suggested that the world was facing the possibility of a 1930s-type Great Depression. Members of the "global financial community" are not supposed to say such things; so even if Dr. Rajan did, a denial was inevitable.

The point however is not whether Rajan actually said this. The point is not even whether the world would actually slip into a 1930s-type depression. The point is whether the issues raised by Rajan at the event organized in London were valid and significant.

He was referring to the competitive easing of monetary policy that is occurring all around the world owing to the pressure to revive growth which has been elusive ever since the 2008 crisis. Such competitive easing, however, instead of creating growth, is having the effect at best of shifting growth from one country to another, causing the world to get caught in an updated version of the "beggar-my-neighbour" policy that had characterized the 1930s, and had actually worsened the slump by effectively destroying the international economic arrangements that had existed till then and undermining the "state of confidence" of the capitalists everywhere.

When the Gold Standard collapsed in 1931, competitive devaluations of currencies had ensued everywhere. Now, if a country devalues its currency, while others do not, then its goods, other things remaining the same, become cheaper compared to those of other countries, which therefore shifts demand from other countries' goods to its goods. This amounts to an attempt to increase domestic employment (because more home goods are now demanded and hence produced) at the expense of employment in other countries (because less of their goods are now demanded). Such an attempt, however, which amounts to becoming better off at the expense of one's neighbor (whence the term "beggar-my-neighbour" policy) does not work, if other countries too take protective action, by also devaluing their currencies. In such a case there is just a spate of devaluations all around, with no single country the gainer because of it.

But such competitive exchange rate depreciations do not just leave every country exactly where it was before it all began; they exacerbate uncertainty in the world economy, and serve to dampen investment still further, causing a further shrinking of aggregate demand and hence of employment everywhere. Beggar-my-neighbour policies, in short, with each trying to "steal" employment from its neighbours, have the effect of worsening all.

The modern version of the "beggar-my-neighbour" policy that Rajan was referring to works as follows. The leading capitalist country of the world, the United States, in order to stimulate growth in its economy, lowers its interest rate almost to zero and in the process floods the economy with dollars printed by its central bank, the Federal Reserve Board. These dollars then go all over the world since interest rates elsewhere have not yet been lowered. Such an increase in the supply of dollars would, other things remaining the same, lower the price of the dollar relative to other currencies, which would mean a shifting of demand from other countries' goods to American goods, or a "stealing" of jobs by the US from other countries. Other countries

obviously do not allow this to happen, i.e. they do not allow their currencies to appreciate with respect to the dollar; so, they prevent it by getting their central banks to hold on to the dollars pouring into their economies at the prevailing exchange rate. As the central banks hold more and more dollars, they print more and more domestic currency; an easing of their domestic monetary policy follows from this.

We thus have a competitive easing of monetary policy everywhere which actually camouflages a competitive drive not to be upstaged on the exchange rate front. It is thus the modern version of the 1930s spectre of competitive devaluations. In the process however an enormous amount of liquidity gets built up in the world economy, which has the potential to destabilize it and precipitate a worsening of the situation for all, reminiscent of the 1930s.

It is this to which Rajan was drawing attention, and rightly so. The problem with his argument however lies not in what he said but in what he did not say. And that is the following. Normally, there should be two instruments available to capitalist States for stimulating larger employment and growth: fiscal policy and monetary policy. Fiscal policy can have an expansionary impact on the economy if the government runs a fiscal deficit; it can even have an expansionary impact via a "balanced budget" (or with a ceiling on the fiscal deficit) through a sheer increase in the size of the budget.

This latter possibility, of a balanced budget causing an increase in aggregate demand, through a sheer increase in the size of the budget, arises for the following reason. Suppose the government spends an additional Rs.100. This generates Rs.100 of additional demand. But if the government balances this expenditure by raising additional taxes worth Rs.100, then only a part of it reduces consumption while the rest comes out of "savings". Suppose consumption is reduced by Rs.80 and "savings" by Rs.20. Since "savings" by definition were not being spent, this means that the reduction in demand because of taxation is only Rs.80. Even with a balanced budget therefore there is a net expansion of demand by Rs.20 (i.e. Rs.100- Rs.80).

Finance capital however does not like fiscal deficits, and prefers "sound finance" instead (i.e. balancing budgets), drumming up all kinds of spurious arguments for it, which Joan Robinson the renowned economist had called "the humbug of finance". Likewise, in a world in which attracting foreign investment (and, more generally, boosting the "inducement to invest" of the capitalists) is seen as the chief instrument for generating greater activity, any larger taxation of capitalists (who institutionally save a larger proportion of income, via undistributed profits of firms, and hence are the best candidates for taxation for increasing demand via a "balanced budget") is eschewed. Indeed, if anything, tax concessions are given to them in a futile bid to generate larger activity. The use of the fiscal instrument therefore is prevented in neo-liberal capitalism, marked by the hegemony of international finance capital. Monetary policy, within which interest rate policy has the pride of place, becomes the sole instrument for promoting growth.

Now, a lowering of the interest rate is the means for "creating" growth. But a lowering of the interest rate is also the means for weakening the currency and depreciating the exchange rate. To use Rajan's distinction, the same instrument that is supposed to "create" growth, also happens to "shift" growth from other countries via its exchange rate effect. Of course if growth was being actually "created", and the American economy (which has taken the initiative to lower interest rates) was

expanding rapidly, pulling up the entire world economy with it, then conflicts over exchange rates, arising from who grew at what rate, would be rather muted. But growth is not being "created", i.e. even the regime of near-zero interest rates in the U.S. has not unleashed a boom in the U.S. itself, let alone in the world economy. It is in this context that concerns over "beggar-my-neighbour" policies, such as those expressed by Rajan, have surfaced.

Rajan's concern in short, though itself valid, derives from a context about which he is silent, a context in which the "competitive easing of monetary policy" around the world is not boosting world aggregate demand to any significant extent, and in which the use of the instrument other than monetary policy, viz. fiscal policy, which is a sure-fire instrument for boosting aggregate demand, is barred by finance capital. The world capitalist economy is getting trapped in a syndrome of at best merely "shifting growth" because it is incapable at present of "creating growth".

This is exactly the situation in which world capitalism had been caught in the 1930s. Finance capital had prevented even then the running of fiscal deficits. And the ideology of "sound finance", which had characterized the Gold Standard, was carried over even after its collapse. And governments, keen to boost capitalists' "inducement to invest" were loath to raise taxes upon them. The fiscal instrument was thus not used, while the instrument of monetary policy was ineffective, since the capitalists' "inducement to invest" remained extremely low. Not surprisingly, "stealing employment" from other countries through "beggar-my-neighbour" policies came into vogue. These policies in short come into vogue and become a matter of concern in a situation of crisis that arises because of more basic structural factors. They may compound the crisis, but they are not the cause of the crisis.

It follows that as long as these basic structural factors operate, attempts merely to prevent competitive easing of monetary policy will neither end the crisis, nor even be at all successful: since easing of monetary policy is the only instrument available to governments under contemporary capitalism for dealing with the crisis, the alternative to easing monetary policy is simply doing nothing. It is no accident that Rajan who suggested co-ordination between central banks under the supervision of the IMF to prevent such competitive easing of monetary policy, was silent about what exactly such coordination would entail and how it would help alleviate the crisis.

Competitive easing of monetary policy in short is located within a capitalism that is structurally crippled; and this is so for at least three reasons: one, the scope for overcoming crises in the metropolis by inflicting "de-industrialization" on the colonies (which amounted to "stealing" employment from the third world) no longer exists, for, third world markets are already penetrated, and in any case too meager in today's world to provide a solution. Two, the Keynesian prescription of using the fiscal instrument, which was never acceptable to finance capital, is particularly ruled out in contemporary capitalism where finance capital is internationalized and therefore has the upper hand. Three, the internationalization of capital has made the vector of real wages everywhere in the world subject to the baneful effect of the massive third world labour reserves, so that this vector does not increase even as labour productivity increases all over the world, causing an ex ante tendency towards global over-production.

In the face of this structural malaise the only offsetting factor that capitalism has is the emergence of occasional "bubbles". The easing of monetary policy is a means of stimulating such a "bubble"; but it cannot force a "bubble" to arise, which is why, despite all this easing, world capitalism remains stuck in a crisis even eight years after it first broke, with little hopes of any recovery in the foreseeable future. "Beggar-my-neighbour" policies arising in the context of this crisis can only make it worse, as would a rise in the interest rate in the U.S.

* **This article was originally published in the People's Democracy, Vol. XXXIX No. 26, July 05, 2015.**