

# The Fall of the Rupee

Prabhat Patnaik

At the end of the nineteenth century, Oscar Wilde in his famous play *The Importance of being Earnest* had talked of the precipitous fall in the value of the Indian rupee. Well over a century later alas, the Indian rupee is still falling, its latest fall as precipitous as any in Oscar Wilde's time. On July 12, 2011, the exchange rate was 44 rupees to a US dollar; by end-June 2013, it has plummeted to 60 rupees per US dollar, a 27 percent decline in two years.

The Government has attributed this decline to the fact that [Ben Bernanke, the Chairman of the U.S. Federal Reserve Board, announced on May 22nd that an end was in sight to the Fed's policy of quantitative easing](#), i.e. the policy of keeping down US interest rates by injecting liquidity into the system. Bernanke's announcement made speculators shift funds to the U.S. where the interest rates are expected to rise, and this has reduced the value of all other currencies, including the Indian rupee (and even of gold), vis-a-vis the US dollar. The Government therefore claims that what is happening to the rupee is happening to other currencies as well, so that there is nothing specifically to worry about. Sooner or later the "markets" will settle down.

This explanation however is patently untenable. True, in the wake of Bernanke's announcement the dollar has appreciated vis-a-vis other currencies; but, as already mentioned, the rupee has been falling for quite some time vis-a-vis the dollar, long before Bernanke's announcement. Besides, the rupee has depreciated vis-a-vis not just the dollar but vis-a-vis all major currencies, which means that even though Bernanke's announcement might have had an additional effect on the rupee, as on other currencies, the basic problem underlying the depreciation of the rupee is quite different. What is this problem?

It is important first to appreciate a fundamental structural fact. If the prospective rates of return were the same between India and the U.S. then wealth-holders would shift their wealth out of India to the U.S. because the latter is the home base of capitalism where they feel safer compared to India. And even if India offered a higher rate of return that prevented such a shift in normal times, even then occasions might arise when suddenly wealth-holders got sufficiently panic-stricken to take funds out from India, and other economies in the periphery, to the U.S. In other words, there is a basic asymmetry in the world economy, such that wealth-holders never get panic-stricken at the centre of the capitalist world to shift funds to the periphery, while they do feel occasionally panic-stricken at the periphery to shift funds to the centre, which after all is why the centre is the centre and the periphery only the periphery.

It is this incidentally which constitutes the fundamental argument against opening up the economies of the periphery to free capital flows: with such freedom, the movement over time, no doubt through fluctuations, will be for funds to flow out from the periphery. And this means that there is a secular tendency for the exchange rate of peripheral economies to decline in a world of free capital flows, which would ultimately mean that the wealth of the periphery will pass into the hands of wealth-holders from the Centre who hold the strong currency of the Centre. Not that this happens suddenly; there is however an undeniable tendency towards this, which manifests itself sporadically, but in a pronounced fashion, followed again by long

periods when the peripheral currency does not depreciate, and everybody begins to think that no such asymmetry ever characterized the world economy.

In particular, in periods of crisis in the metropolitan capitalist world, there is a tendency for the currency of peripheral economies to depreciate. This is so for two reasons: first, in such periods their current account deficit tends to widen, as has happened in the case of India, since the demand for their goods in the world economy tends to decline, while their imports, at least until they have themselves been submerged by the crisis (which they do precisely because of the decline in their currency value), do not decline as much. Secondly, capital tends to flow into the periphery from the centre in periods of boom in the centre, when the “exuberance” of investors makes them not only undertake large investments domestically (causing the boom itself), but also send out large amounts of funds to the periphery as well; conversely when there is a collapse of this exuberance, not only does domestic investment in the centre suffer, causing unemployment and recession, but also exports of capital. “Playing safe” becomes the motto; risk-taking and adventurous projects in far-away lands are avoided. And finance tends to home in to the Centre, especially to the bastion of capitalism, which is the US at present, from all over the world. Thus the secular tendency for funds to flow out of the peripheral economies manifests itself unevenly, as a pronounced tendency during the recession and crisis, which is somewhat offset during the boom years in the metropolis.

Now, it so happens that the nineties of the last century and the early years of the present, i.e. precisely the period when India started its neo-liberal policies, were periods of boom in the metropolis, especially in the U.S., because of a series of “bubbles”, first the “dot-com bubble” and then the “housing bubble”. True, this boom was not as pronounced as the post-war boom that is often referred to as the “Golden Age of Capitalism”: in fact if we split the entire post-war period into two, one spanning 1950-73 and the other spanning 1980-2008, leaving out the crisis years of the mid-seventies, we find that the GDP growth rate for the advanced capitalist world in the latter period was distinctly lower than in the former. The point however is that nonetheless there was a boom, no matter whether as big as the earlier one, in the nineties of the last century and the first decade of the current one. Because of the exuberance associated with this boom there was also a flow of finance to the so-called newly emerging economies of the periphery which were opening up to capital flows for the first time since decolonization. This put an upward pressure on the currencies of these countries, which was checked only by their Central Banks holding on to large reserves of foreign exchange. All this created the illusion that these economies were as good as the Centre in terms of the “confidence of the investors”, that they had ceased to be considered peripheral economies by globalized finance capital, that they would continue to attract funds from the centre, and that their currencies were no longer subject to any secular tendency towards depreciation. And in India this illusion was particularly strong because the boom years of metropolitan capitalism coincided exactly with its journey into neo-liberalism. The crisis in the Centre however has put an end to all these illusions.

In the current travails of the rupee, there are no doubt India-specific factors which explain why the Indian rupee is doing even worse than other similarly-placed currencies; but these India-specific factors are superimposed upon a basic structural characteristic of the world economy, which explains for instance why the US dollar continues to remain strong despite the US persistently running a massive current

account deficit but the Indian rupee collapses in the face of a large current account deficit.

The rupee cannot be allowed to depreciate continuously as it is doing now. Every such depreciation increases the costs of imports, especially of oil, which, under the current regime of automatic-pass-through to the ultimate consumers, entails an inflationary burden on the people. In fact this burden is implicitly assumed by the government when it expresses the belief that the markets will ultimately “stabilize”. In economists’ jargon this burden is one of the “stabilizing” or “equilibrating” factors.

To see this imagine a simple world which produces one single commodity using an imported current input (oil), and labour, applied to capital stock. The price of the product, as is usual in oligopolistic markets, is a mark-up over the sum of the current input cost and the labour cost per unit of output. Now suppose the current input cost rises by 10 percent because of currency depreciation, then, with a given mark-up, if real wages remain unchanged, then the price level will also rise by 10 percent. The nominal depreciation of currency by 10 percent, accompanied by a price rise of 10 percent, will mean that the real effective exchange rate remains unchanged, i.e. the economy gets back to square one, where the same factors that had caused the initial depreciation would cause a further depreciation; and so on ad infinitum. It is only because real wages are not expected to remain unchanged that anyone would at all believe that some new “equilibrium” will be reached where the economy will settle down.

Now, this simple picture of the economy can be made more complicated but that will not affect the basic conclusion, whence it follows that the government is actually banking on a real wage decline, i.e. an erosion of the real living standards of the working people via inflation, to bring the economy to an equilibrium, where a further decline in currency value will not occur. This assumption must be resisted for its own sake, even as it stands, since the living conditions of the working people cannot be made hostage to the whims of finance capital. Besides, it is also a dangerous assumption, since there is no determinate limit to the degree to which the living standards of the working people will be pushed down in this manner.

The government of course is likely, when it moves at all, to supplement this income deflation imposed on the working population with a contraction of the economy, for managing the balance of payments and reaching some new “equilibrium”. But given the massiveness of the current account deficit at present, and that too despite a sharp deceleration of the GDP growth rate and a virtual stagnation in manufacturing, the scale of contraction required to manage the current account deficit within a regime of neo-liberalism (i.e. without recourse to trade and capital controls), will be so large that it will be infeasible, causing immense resistance as in several European countries.

Underlying the government’s inaction therefore there is something else, namely a belief that the world economy itself is going to turn around fairly soon, which means that the basic crisis that had caused this trouble for the rupee would itself disappear. This assumption however has no basis. And because of this, the Indian economy is entering a period of acute crisis. The people’s resistance in the face of this crisis, as during the 1930s when they rose against colonialism, will inaugurate a new phase of Indian history.

**\* This article was originally printed in the People’s Democracy, Vol. XXXVII, No. 27, 7 July 2013.**