# Diffusion of Development

*The proposition that there are limits under capitalism to the spontaneous diffusion of industrial development has been supported on the basis of a number of powerful and weighty arguments. But, there is a more immediate limit to such spontaneous diffusion, namely, the unwillingness of the leading capitalist economy to sustain a growing claim upon its wealth by outsiders.*

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When I was a student, one of the books that had a profound influence on all of us was Paul Baran's *The Political Economy of Growth* (1957) which argued that the modus operandi of world capitalism precluded any possibility of a spontaneous diffusion of capitalist development, of the sort that had happened in the case of the temperate regions of white settlement, to the countries of the third world. Even though Baran was a Marxist, and this particular thesis had originally been put forward and accepted at the Sixth Congress of the Communist International, it was not confined to Marxists alone. W Arthur Lewis, steeped in the neoclassical tradition, had also concluded in a celebrated article (1954) that the developing countries should have their own agricultural and industrial revolutions by putting restrictions on trade and using the state to act as an entrepreneur. He had even favourably cited the Soviet industrialisation strategy as an example worthy of emulation by other developing countries.

The Marxist tradition was sceptical of a bourgeois state within the third world achieving this, and hence of the prospects of sustained and successful industrialisation under the aegis even of a relatively autonomous national capitalism, because inter alia it saw the bourgeoisie as entering into an alliance with the landlords for political reasons and hence eschewing the radical land reforms that were required to broaden the mass market for industrial goods. It argued accordingly that the development of the third world could only occur under a regime that marked a transition to socialism. But most development economists, Marxists and non-Marxists alike, were agreed on one central point, namely, that the basic tendency of world capitalism was to prevent a spontaneous diffusion of industrial development to the third world. The diffusion of industrial development to the third world that did occur in the aftermath of decolonisation, far from being a refutation of this point, was on the contrary a confirmation of it: it was not a spontaneous diffusion, but one enforced by the post-colonial state through a policy of protectionism at home, which underlay both the import-substituting industrialisation characteristic of India and Latin America and the neo-mercantilist industrialisation characteristic of east Asia.

This proposition about the impossibility of spontaneous diffusion appears to have been invalidated by recent experience. The phase of dirigisme in the third world is over; a process of removal of restrictions on trade and financial flows is well under way. And yet, a process of diffusion of industrial development, though not to Africa and Latin America, which has witnessed stagnation under the neoliberal dispensation, but certainly to Asia, whether south or east, or south-east Asia, is clearly visible. China and India are by all accounts emerging as major world industrial powers, if we use the word industry in the somewhat broader sense as being inclusive of sectors like information technology. Can we not conclude then that the earlier views about world capitalism preventing a diffusion of development to the third world were mere groundless fears? Even if they could be shown to be based on historical experience, did they not ignore the fact that history does not necessarily repeat itself? I address myself to this question over here.

There is no gainsaying that notwithstanding the impressive growth rates of real gross domestic product (GDP) notched up by India and China in the recent years (though in India's case the growth rate of the material commodity producing sectors over the decade after liberalisation, i e, 1991-92 to 1999-2000, was no higher than over the decade 1981-82 to 1989-90 [Chandrasekhar and Ghosh 2004]), income inequalities have widened immensely within these countries. There is plenty of evidence that in India today the level of rural distress is higher than on the eve of liberalisation [Patnaik 2004]. And, in China too the gap between the country and the city has certainly widened in the more recent period. Indeed if one takes rural India and urban India as two separate countries, and likewise for China, then inequalities between the countries of the world so defined have widened in the last decade and a half. One can very pertinently therefore make the point that the diffusion of industrial development from the metropolitan centres to these countries has not meant a diffusion of development as far as the people are concerned. But I want to focus attention here on a different theme, namely, that even such diffusion as is occurring is unlikely to be sustainable. One can give several reasons for this, but I shall confine myself to discussing only one particular issue.

## I

Among the many contradictions of capitalism there is one in particular that I wish to highlight here. Capitalism requires for its functioning a stable medium in which wealth can be held [Kaldor 1976]. What this means is not that all wealth is held only in this medium, but that any other form in which it is held must be expected to have a more or less fixed exchange ratio vis-à-vis this medium, in order to induce wealth-holders to shift to these other forms. Traditionally, gold and silver have constituted this stable medium, as have particular currencies linked to these commodities. Thus under the Gold Standard, the British pound sterling, linked

to gold, constituted such a stable medium in the eyes of the world's wealth-holders; under the Bretton Woods system the US dollar played the same role.

After the collapse of the Bretton Woods system, the world may appear to have finally gone off a commodity-money regime, but that impression is misleading. The US dollar, which is still seen as such a stable medium, or, putting it differently, which is still seen to be "as good as gold", derives this standing from the widespread confidence that the dollar values of commodities, especially of critical commodities like oil on which the prices of other commodities depend, cannot rise either significantly or persistently. (Even the current high oil prices are expected to be a transient phenomenon.) I shall come later to the reason *why* wealth-holders have this belief, but the point to note here is that the world has shifted from a Gold Standard to what, arguably, can be called an oil standard; but it has not done away with commodity money.

The country with the leading currency may thus be said to possess a virtually inexhaustible gold mine, since its currency is "as good as gold" in the eyes of the world. In return however it is implicitly forced to fulfil certain obligations, one of which is the following. At least from a certain point onwards in its career as a leader it must be willing to run a persistent current account deficit on its balance of payments vis-à-vis the newly industrialising and rival capitalist countries of the world taken together. Even if in the early years of its leadership it runs a current account surplus vis-à-vis these economies as a means of exporting capital to them, a time must necessarily come when this gets reversed; the leading currency country should be willing to accept this fact.

The reason for the emergence of such a deficit is not what is usually supposed, namely, the need to meet these latter countries' demand for the leading currency for transactions and wealth-holding purposes: this need could be fulfilled through purely capital account transactions without necessitating a current account deficit on the part of the leading country. The reason has to do with political economy. If it did not run a current account deficit, then it would not be accommodating the ambitions of its old and new rivals. It would thereby be creating a degree of disunity injurious to the system as a whole.

We certainly would never observe the leading country running a surplus vis-à-vis its rivals for any length of time. If at all it had such a surplus, then these other countries' currencies, not being "as good as gold", would soon be under pressure, necessitating adjustments to eliminate this surplus. But even a balanced current account between the leading country and its rivals is not sustainable for long. Even if there is a balance to start with, it would soon convert itself into a deficit for the leading country. This is because its rivals, especially the newly-industrialising countries, have the advantage, precisely because they are newly-industrialising, of simply picking up the frontier technologies, and also of being able to "embody" rapidly in their capital stock such changes as are occurring in the frontier technologies, which ensures that their rate of growth of labour productivity always tends to outstrip their rate of growth of money wages at any given exchange rate. Thus the tendency is always for these economies, once they have established themselves, to run current account surpluses vis-à-vis the leading country, and it is the leading country that has to live with this fact if it wants to prevent them from opting out of the international arrangement under its own hegemony. The leading country's willingness and ability to run a current account deficit vis-à-vis its old and new rivals, and indeed to run such a deficit persistently, is therefore a condition for the stability of the system.

But doing so creates two distinct kinds of problems for the leading country. First, absorbing such a deficit creates ceteris paribus domestic unemployment and recession. And second, it results in the building up of external debt for the leading country (or what comes to the same thing, in a diminution in its net creditor status). These two effects do not exclude one another. On the contrary both can occur together in what can be called a process of "debt-financed recession". Even if recession is avoided through a counteracting increase in some other element of aggregate demand, typically the fiscal deficit (though the use of the fiscal deficit as a means of overcoming aggregate demand problems is a recent phenomenon), the problem of debt pile up still remains. The fact of a country being the leader does not negate its persona as a nation, and that of its state as a nation state. It would not therefore like to see foreigners having an increased leverage against itself through a growing claim upon its wealth.[1]

Thus the stability of the world capitalist system requires, on the one hand, a leading currency widely regarded as being "as good as gold" and a current account deficit on the part of the leading currency country, at least from a certain point onwards, vis-à-vis its rivals, old and new, as a means of accommodating their ambitions; on the other hand, it also requires that the leading country should not plunge into recession in the process and its debt relative to wealth should be non-increasing. Reconciling these two conflicting conditions constitutes the major contradiction of the system referred to earlier.

## II

Colonialism was a means of overcoming this contradiction, i e, the role of colonialism inter alia was to reconcile these two conflicting requirements at the expense of the colonies.[2] Throughout the late 19th century, right up to the first world war, Britain, the leading country of the time ran a persistent current account deficit vis-à-vis continental Europe, the US and the other temperate regions of white settlement, which were the newly-industrialising countries of the time. Its own market in short was open to them in order to permit them to fulfil their ambition of achieving rapid industrialisation. Had it not done so, they might have opted out of the Gold Standard, truncating much earlier the prolonged Victorian and Edwardian boom. Even while running this current account deficit vis-à-vis them, however, Britain neither entered into any serious recession, nor did she get increasingly indebted; on the contrary, she undertook, precisely over the same period, massive capital exports to these very temperate regions of white settlement, and became the world's largest creditor nation. In fact, the very countries, such as the US and other temperate regions, vis-à-vis which she had a current account deficit, were the countries to which she was making capital exports!

An explanation of this paradox has been given by S B Saul (1970). Britain had a current account surplus vis-à-vis colonies like India that not only covered her current account deficit vis-à-vis continental Europe, the US and the temperate settlements, but also even exceeded this deficit by a substantial amount, which constituted her capital exports. Thus Britain had a surplus vis-à-vis colonies like India, and the latter had a surplus vis-à-vis continental Europe, the US and the temperate settlements, which did not need British goods

but relied on raw materials from these colonies. And this triangular pattern not only balanced the British current account but also financed her capital exports.[3]

The crucial aspect of Britain's surplus vis-à-vis the colonies, however, is that it was an outcome of a coercive relationship. The two main contributing factors to this surplus according to Saul were, first, the payments from India covered under the term "Home Charges"; and second, the "wide open markets" provided by the colonies for the import of British goods, especially textiles, which were not wanted elsewhere but which could be unloaded in the colonies. Both these items arose from an exploitative relationship, though this is not the way that Saul puts the matter. The "Home Charges" were included in what the nationalist writers called the "drain", which represented an unrequited export from countries like India but was justified by the colonial government as a payment for "good administration"; and the "wide open" colonial markets to which British imports came, caused deindustrialisation in the colonies. Thus, the "drain" and deindustrialisation, the two features of the colonial economy so persistently criticised by the nationalist writers, were precisely the features that helped in the overcoming of the basic contradiction of capitalism referred to earlier during the heyday of British hegemony.

The role of the colonies, especially the Asian colonies of Britain, in sustaining the long boom of the "long nineteenth century" became retrospectively evident when these colonies could no longer play this role during the interwar period. Japanese competition severely challenged Britain's position in the markets of her Asian colonies. And to face this competition Britain had to enter into alliances with the local bourgeoisies and make concessions to them. Both these developments meant that these markets were no longer "on tap" (to use Saul's phrase) for Britain, which implied in turn that the Gold Standard could not be sustained. When Britain did return to the Gold Standard in the interwar period she could no longer manage her balance of payments. And when in a desperate bid she decided to impose a domestic wage deflation, it provoked the 1926 General Strike. Finally, the Gold Standard had to be abandoned in 1931 giving rise to competitive exchange rate depreciations, a spate of beggar-my-neighbour policies all around the capitalist world, and the Great Depression.

The blame for the disaster associated with Britain's "return to gold" has usually been laid at the door of the exchange rate at which she chose to do so, which was the pre-war rate but which had become too high by this time. But the real reason for the disaster, because of which the exchange rate appeared "too high", was the loss of Asian markets for Britain. There are several alternative explanations for the Great Depression, ranging from Alvin Hansen's "closing of the frontier" to Schumpeter's coincidence of the troughs of the three business cycles, to the Kalecki-Steindl-Baran and Sweezy theories regarding the emergence of monopoly capitalism. But without entering into the merits of these theories, I would like to emphasise an additional factor of great importance which has received scant attention till now, namely, the decline of British colonial power in Asia.

An extremely important feature of the current world economy is that the leading capitalist country of the world today, the US, does not have colonies of the sort Britain had, for ensuring that while she runs a current deficit vis-à-vis today's newly industrialising countries, she does not get indebted in the process, i e, for ensuring that the basic contradiction of the world capitalist economy referred to earlier is kept in check. The US today has become the world's largest debtor country and is running huge current deficits each year, which have far-reaching implications.

## III

Before seeing these however, let us look at a few misconceptions surrounding these deficits. And for doing so, a brief analytical sketch of the contemporary world economy is in order. Let us for the moment keep primary commodities out of the picture and focus attention only upon two sets of economies, the leading country and its old and new rivals. We can imagine the world as consisting of only these two entities and the production structure within each as being vertically integrated.

We live in an era of globalisation of finance where no particular nation state can afford to ignore the caprices of international finance capital, or, what is euphemistically called the "confidence of the investors". And finance is opposed to an activist state in matters of public expenditure (except when the expenditure serves its own particular interests). This is so for at least three reasons: first, large public expenditure raises the level of activity in the economy and brings in its trail the fear of inflation and hence currency depreciation (which necessitates flight on the part of finance and hence paradoxically precipitates actual depreciation); second, any state activism entails an implicit loss of social legitimacy on the part of capital in general and of finance capital in particular, which basically represents a set of "functionless investors" to use Keynes' words (1949, p 376); and third, rolling back state activism brings big bonanzas for finance capital in the form of privatisation of state-owned enterprises at throwaway prices.

Finance's opposition to such state activism acquires a spontaneous effectiveness when it is international while the state is a nation state, since it is free to flee any country whose state policies it dislikes. The deflation of state expenditures takes the form specifically of a lowering of the fiscal deficit everywhere, except in the leading country, which, as long as its currency is considered to be "as good as gold" need not fear capital flight. It follows then that in the era of globalised finance the only country that can run fiscal deficits with impunity is the leading country, the US as of now, while every other economy is constrained to rein in its fiscal deficits in order to appease globalised finance.

With this preamble let us proceed with our analytical sketch of the world economy. Just as within any closed economy we can say that, barring brief periods of exceptional buoyancy, the level of output is determined by the level of aggregate demand and the distribution of this output across equipment vintages (and hence across firms if they differ with regard to equipment vintages) depends upon the relative labour productivities associated with these vintages, likewise for our "stylised" version of the world economy we can put forward a similar proposition.

If we make the simplifying assumption that the consumption-income ratio and the tax-income ratio are the same in the two economies and that globalised finance constrains the non-leading economy to balance its budget, then the total output in this stylised world economy depends exclusively upon the total world investment and the leading country's fiscal deficit (and of course the size of the multiplier which is determined by the tax and savings propensities). The distribution of this total output between the two economies would then depend upon their relative costs of

production, which means their relative levels of dollar wage (at the prevailing exchange rate) per efficiency unit of labour. The distribution of the world output in other words depends upon the exchange rate between the two economies, and their respective money wages and labour productivities. This distribution of world output in turn determines their respective current balances (which must add up to zero).[4]

When we drop these simplifying assumptions but persist with our stylised universe, the conclusions are not basically altered. The only difference is that instead of the world output and its distribution being separately determined, each by a separate factor, the two are simultaneously determined by the same two factors conjointly. And since our stylised universe is merely a device for obtaining conclusions relevant to the real universe, we can say that given the levels of investment, the leading country's fiscal deficit, and of course the various consumption and tax propensities, the current balance of the leading country depends upon its relative dollar wage per efficiency unit of labour.

This may appear at first sight to be a fairly innocuous conclusion. But this diagnosis of the US current account deficit differs fundamentally from those of influential writers. I shall confine myself here to an examination of just two such positions. The first is articulated by Ben Bernanke, the chairman of the US Federal Reserve, who argues that the blame for the widening US current account deficit should be laid at the door of east Asian economies like China. These economies are being made to save too much through high interest rates, and these savings channelled to the US, where they keep down interest rates and give rise to an excess of investment over domestic savings, which is identical with the current account deficit.

This argument is full of logical flaws. First, it completely ignores the stock equilibrium. In economies open to capital flows, as Mundell and Fleming had pointed out, interest rates across countries must bear a certain relationship to one another (they had suggested that interest rates must be equal). The question of governments, at least in those east Asian countries which are exposed to capital flows, pushing up interest rates at will simply does not arise: if they do, then there would be large, persistent and escalating financial inflows into those countries, which would either worsen their current account deficits through exchange rate appreciation, or produce growing reserves at the prevailing exchange rate with no effects on the current balance. Second, even in the case of those economies like China which may not be fully open to financial flows and where the government consequently has an autonomy with regard to the fixing of the interest rate, even if we assume with Bernanke that they have a strong demand for US securities, this need not lower US interest rates if the Federal Reserve, which he himself currently heads, undertakes appropriate countervailing monetary policy. Bernanke's view amounts to saying that the interest rate is determined by the flow equilibrium between savings and investment, rather than the stock equilibrium into whose shaping monetary policy enters. Third, even this view that the interest rate is determined by the flow equilibrium between savings and investment is logically erroneous, since the position of the curve linking savings to the interest rate depends on the level of income itself. He is obviously making an implicit assumption that the levels of income are given everywhere in the world (presumably at universal full employment) and are independent of aggregate demand, which is wrong and constitutes an example of the "humbug of finance" pilloried by Joan Robinson (1966). Fourth, even leaving aside the question of the interest rate, if, say, starting from some equilibrium, the savings propensity in China goes up, then it would adversely affect the level of world aggregate demand and world employment. What impact this has on the current balances of the different countries would depend upon their relative dollar wages per efficiency unit of labour, the very factor we had emphasised earlier but which Bernanke forgot. In short, the impact of an increase in the saving propensity anywhere on current balances is a fallout of its impact on world aggregate demand and is dependent on the relative dollar wages per efficiency unit of labour.

Let me now turn to a second common position. This states that the reason for the US current deficit is that east Asian countries like China, by holding dollar reserves, are preventing the US currency from depreciating, which it needs to do. This position too is logically flawed. If China decided not to hold dollars then the depreciation in the dollar would entail an appreciation in her own currency, which ceteris paribus would reduce her domestic demand, output, and employment. The flaw in this position arises from the fact that it makes a legitimate defence of employment within China appear as if it is a wilful act of a perverse government. The fact that it does so however, is because of a specific reason: underlying this position too, like Bernanke's, there is an implicit assumption of a perpetual absence of any involuntary unemployment. It is only when we abandon this assumption, and the approach that comes with it, that we can get some understanding of the contradiction of contemporary capitalism referred to above.

## IV

To recapitulate, unlike Britain in an earlier epoch which used her colonial possessions for sustaining a current account deficit vis-à-vis the emerging rival capitalist powers without herself getting indebted, and instead making substantial capital exports, the US today is in a predicament where her similar sustenance of a current account deficit vis-à-vis rivals and newly-industrialising countries is getting her deeper into debt. And her efforts to acquire "economic territory" which can potentially play the role that, say, India did in the case of Britain earlier, have backfired badly as in the case of Iraq. The question therefore arises: what does this contradiction portend for the future?

Let us consider a range of alternative possibilities. First, the US may choose to do nothing about it. The more indebted she is, i e, the greater the amount of the rest-of-the-world's wealth held in her currency or currency-denominated assets, the greater would be the latter's stake in ensuring that her currency retains its value, and the less therefore would be the latter's incentive to destabilise the dollar. To be sure, capitalism is not a planned system, and no one can prevent or negate the outcome of wealth-holders, singly or in a herd, shifting away from the dollar in anticipation of its weakening, and thereby precipitating such a weakening. But since the position of the leading currency is buttressed ultimately by the political-military might of the leading country, as long as that might remains overwhelming, even such herd behaviour on the part of some wealth-holders would not precipitate any serious crisis for the dollar.

Nonetheless two problems would emerge increasingly. First, wealth-holders would increasingly demand that their choice of wealth-forms within the US should become more unrestricted, and if the US

government is forced to concede this demand then there would be much domestic opposition to it, since it would entail a large-scale "denationalisation" of US assets. Second, while the dollar may be invulnerable to speculative pressures, it would not be invulnerable to determined attacks; and it would also not be invulnerable to determined moves by governments to shift away from it. Such shifts are inevitable, given the US government's track record in using its access to other country's assets for exercising political control, such as for instance the freeze on Iranian assets after the Islamic revolution. True, any determined move to shift out of dollars on the part of any country would be strongly resisted by the US (some even trace the military action against Saddam Hussein to his efforts to shift from dollars to euros), but such resistance nonetheless takes its toll on the US. The current, historically unique, situation of the most powerful economy being the most indebted cannot therefore be expected realistically to continue indefinitely.

The second possibility is a depreciation of the US dollar. But any such depreciation not only entails capital losses for vast numbers of wealth-holders in the world, and not only requires the consent of the other countries, both for this reason and for preventing retaliation from others, but also jeopardises the dollar's continuance as the leading currency. One only has to recollect the fierce and protracted struggle of the city, the bastion of British finance capital, against any depreciation of the pound sterling, even in the face of substantial erosion of competitiveness of British industry, to realise the hurdles in the way of a dollar depreciation.

The third possibility is a contraction of activity within the US. The problem here is that any such contraction, while bringing recession and unemployment to the capitalist world as a whole, would not even have much impact on the US current deficit unless it is of a substantial order. This is because any reduction, say, in the fiscal deficit in the US by $ 1 reduces domestic demand by $ 0.8 and demand for imported goods by only $ 0.2. To have any noticeable impact on the US current balance, therefore, the magnitude of contraction would have to be quite severe, which will have far-reaching implications for the stability of the system as a whole.

The same can be said of the fourth possibility, which is a deflation of the US wages. Such a measure in the case of Britain had caused the 1926 General Strike, and notwithstanding the weaknesses of the American trade union movement, which years of ruthless suppression have engendered [Zinn 2005], it would greatly undermine the social and political stability of the system.

The fifth possibility is for the surplus countries to enlarge their domestic demand, or, better still, to redirect their surpluses, in the form of grants preferably, to the poorest regions of the world. This is not only the most humane and reasonable course, but would also kill at least three birds with one stone: first, it would resolve the problem of the US current deficit; second, it would do so in a manner that increases total world output and employment; and third, it would at the same time provide some relief to the world's poorest.

The second of these effects needs some explanation. If the current account surplus of the surplus countries, which is now being absorbed in the US, is absorbed elsewhere instead, whether domestically or as grants to the least developed countries, then the gap created by such redirection would entail an excess demand in the US for home-produced goods, if her domestic output remains unchanged. To meet this excess demand, output will have to expand, together with employment, within the US. The US current deficit therefore would have been closed not through a contraction of output and employment as in the third case above, but through an expansion.

Proposals of this kind, which are broadly characterised as "global Keynesianism", have been mooted from time to time. Lord Kahn elaborated the theoretical case for it in his Richard T Ely memorial lecture to the American Economic Association in 1971; the Brandt Commission put a practical proposal to this effect forward. But nothing has come out of all these proposals. The reason for such failure lies no doubt in the absence of altruism in the outlook of the advanced countries. But the question still remains: even assuming that such a transfer to the least developed countries is not feasible, why don't surplus countries go in for larger domestic absorption of their own goods?

This is not a new question. It used to be asked of Germany and Japan in the 1960s and early 1970s, and now it can be asked of a larger number of countries including from east Asia. One answer lies no doubt in the same absence of altruism noted earlier. Many of these countries already have high rates of investment and growth (as did Germany and Japan in the 1960s), so that larger domestic absorption in the form of higher investment is a course that has little appeal for them. And when it comes to larger domestic consumption of the working people and the poor, the fact that higher consumption of these sections is not favoured by capitalist regimes should cause no surprise. As Kalecki had said long ago (in 1943), a policy of enlarging the consumption of the workers goes against the capitalist ethic, which says: " 'You shall earn your bread in sweat' – unless you happen to have private means" (1971, p 140). And, especially when it is compared to the alternative of piling up reserves and thereby gaining some strength and leverage, associated with big power status, it clearly gets ruled out.

What does come as a surprise in this context is China. But whether China's adopting this course, of running a persistent current account surplus rather than increasing domestic consumption, is because of a similar callousness vis-à-vis the workers, or a calculated move to build up her defences against US hegemony, is a question which only time can answer.

A second reason why larger domestic absorption is not resorted to in the surplus countries lies in a basic asymmetry of the international economic system, both in the Bretton Woods era and now, namely, that the surplus countries are never under any obligation to make adjustments, while the deficit countries are.

To these however, one has to add a third, in my view, weighty reason. Any larger domestic absorption in the surplus countries has to occur through the mediation of the state, which would entail a larger fiscal deficit. This, as already noted, is fundamentally contrary to the predilections of international finance capital. Any economy, even one with a current account surplus, if it is exposed to the movements of globalised finance, would simply not dare to increase its fiscal deficit, no matter how progressive its government may be, for fear of capital flight. For enlarging the fiscal deficit it has to get out of the vortex of globalised finance, which requires a basic regime shift of a sort that we are ruling out ex hypothesi.

This brings us to the sixth and last possibility, which is precisely what the

Bush administration is trying to realise, and that is to impose a currency appreciation on the Asian countries. This has a major advantage from the point of view of the US: it reduces its current account deficit without disturbing the value of the dollar (except of course vis-à-vis these particular currencies which are as yet not of great significance). This means that the wealth-holders who hold their wealth in dollars or dollar-denominated assets suffer no capital losses, and hence the position of the dollar as the leading currency is not compromised. For the Asian economies however, unless this appreciation is accompanied by an increase in the fiscal deficit, which is ruled out inter alia owing to exposure to globalised finance, it entails a reduction in the level of output and employment. Is it surprising then that they are resisting the pressure to revalue their currencies upwards?

What we have in short is a return to the "beggar-my-neighbour" policies of the interwar period, with the US trying to improve its current balance, and with it ceteris paribus its level of activity, by bringing about a reduction in the current balance and the level of activity in the Asian countries. Such a reduction in the case of the latter countries would act as a serious constraint on the spontaneous diffusion of industrial development towards them.

The theoretical argument advanced for demanding such a revaluation of Asian currencies is that they are "undervalued". This argument, however, is logically flawed for at least two reasons: first, to claim that a currency is "undervalued" presupposes that it has a "true value". Hence it invokes the notion of an equilibrium exchange rate. This is never explicitly defined, but let us (without any loss of generality) take it as that rate at which the current balance would be zero. Now, since the current balance depends also on the level of activity, it follows that we have a separate equilibrium exchange rate in this sense for every level of activity. To talk of the equilibrium exchange rate therefore is to presume a particular level of activity, which can only be the full employment level. This whole argument in short presupposes the spontaneous prevalence of universal full employment, which is erroneous. Second, even if a currency was "undervalued" in a world of universal full employment vis-à-vis some other currency, the onus of adjustment surely is not exclusively on itself, as the American argument suggests.

It is also instructive that no such demands for currency revaluation are being made vis-à-vis Europe with which too the US has a current account deficit. Partly no doubt this is because the euro is a far more serious challenger to the dollar, as a potential leading currency, than the Asian currencies. But partly it is based on an asymmetry in the approaches of the leading country towards Europe and Asia, which is reminiscent of colonial times.

The diffusion of industrial development to the temperate regions of white settlement during the Pax Britannica was made possible through British economic control over the tropical colonies, which, far from experiencing any such diffusion, had witnessed on the contrary a process of de-industrialisation. The diffusion of industrial development towards some countries had thus gone hand in hand with the retrogression of others, the latter in fact being a condition for the former. Not only is diffusion under capitalism not an unmixed phenomenon, but, what is more, when the scope for imposing sufficient burdens on economies capable of being made to retrogress is limited, as is the case today, the scope for diffusion of industrial development too gets constricted.

## V

The proposition that there are limits under capitalism to the spontaneous diffusion of industrial development has been supported on the basis of a number of different arguments. Some emphasise the natural resource constraints because of which it is not in the interests of the advanced capitalist countries to permit diffusion of industrial development to the backward countries. Some emphasise the inflationary consequences, through an exhaustion of the world's labour reserves inter alia, of a general diffusion of industrial development. These no doubt are powerful and weighty arguments. But in addition to these, indeed even before these constraints have made themselves felt (and indeed even if these constraints were never to make themselves felt), there is a more immediate limit to such spontaneous diffusion, namely, the unwillingness of the leading capitalist economy to sustain a growing claim upon its wealth by outsiders, which I have tried to highlight in this lecture. And if the diffusion of development is constrained by any of these considerations, then it follows that an authentic development strategy for backward economies cannot take the direction of neoliberalism.

## Appendix

Let us use 1 to denote variables relating to the leading country and 2 to denote variables relating to its rival in a 2-country universe. Since the interest rate in 2 is fixed in relation to the interest rate in 1 (modified Mundell-Fleming hypothesis), we can take investment in both countries simply to be a function of the first country's interest rate. With the usual notations, we have the following:

$$Y_1 = c_1 Y_1 + I_1 (i_1) + t_1 . Y_1 + F + NX_1 \ldots \text{(i)}$$

$$Y_2 = c_2 . Y_2 + I_2 (i_2) + t_2 . Y_2 + d . Y_2 + NX_2 \ldots \text{(ii)}$$

where NX refers to current balance, F denotes the leading country's fiscal deficit and d denotes its rival's fiscal deficit as a ratio of Y. This asymmetry is because the leading country has an autonomy with respect to its fiscal deficit while in its rival's case fiscal deficit as a proportion of income is fixed. If we assume for simplicity that $c_1=c_2=c$ (say), and $t_1=t_2=t$, and that d=0, i e, the non-leader balances its budget, then, keeping in mind that current balances add up to zero, the total world income, obtained by summing (i) and (ii), is given by

$$Y_1+Y_2 = (I_1 + I_2 + F)/ (1- c + t) \ldots \text{(iii)}$$

The leading country's monetary and fiscal policies thus have a crucial impact on the total world income. The distribution of this world income between the countries depends on their relative dollar wage per efficiency unit of labour, which we denote by $\omega$. We have

$$Y_1 / Y_2 = f(\omega), \ldots f' < 0 \ldots\ldots \text{(iv)}$$

and $\omega = (w_1 / \beta_1).e / (w_2 / \beta_2) \ldots$ (v)

where w denotes the money wage in local currency, $\beta$ the labour productivity and e the exchange rate (non-leading currency per dollar).

When the simplifying assumptions of balanced budget in country 2 and identical savings and tax ratios in the two countries do not hold, we have

$$Y_1 + Y_2 = c_1.Y_1 + c_2.Y_2 + t_1.Y_1 + F + t_2.Y_2 + d.Y_2 + I_1(i_1) + I_2(i_2) \text{ (iii')}$$

Equations (iii') and (v) here simultaneously determine the level of world income and its distribution across countries. Putting it differently, given the investment functions and the tax and consumption ratios in the two countries, and the second country's fiscal deficit ratio, the leading

country's monetary and fiscal policies, together with the relative dollar wage per efficiency unit of labour, conjointly determine world output and its distribution.

It can be seen that a fall in $c_2$, i e, a rise in the savings propensity of country 2, produces ceteris paribus a reduction in world output, including in country 2 itself. It no doubt affects current balances, but only as a fall out of such reduction. EPW

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## Notes

[This is the text of the author's inaugural lecture upon being appointed to the Sukhamoy Chakravarty chair in planning and development at the Centre of Economic Studies and Planning, Jawaharlal Nehru University, New Delhi.]

1 The term "growing" here may be questioned on the grounds that the ratio of current account deficit to total investment need not be rising. But since the leading country was not always the leading country and did not always have a current account deficit, its debt relative to wealth must keep increasing once such a deficit arises even if the magnitude of the deficit relative to investment remains constant.

2 Throughout this paper, the term "colonies" is used not in a mere juridical sense, but in the sense of entailing economic domination and exploitation (of a kind discussed later). Thus, Australia was a British colony as much as India in a juridical sense, but Australia as we know it was not exploited in the same way as India. One major problem with Hobsbawm (1969) is that it remains confined to the juridical definition and hence misses important issues, such as those brought out by Bagchi (1972) and Patnaik (2006).

3 For an elaborate discussion of the issues involved, see Patnaik (1997).

4 See the Appendix for the derivation of these and other formal results used in the text of this paper.

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