The Strengthening of the Dollar

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The Indian newspapers have been full of stories about the fall of the rupee vis-à-vis the US dollar in the last few days. Just over a month ago, on November 27, the value of the dollar was Rs 84.559; by December 29, it had risen to Rs 85.5. And this fall of the rupee has occurred despite a running down of foreign exchange reserves by the Reserve Bank of India to stabilise the rupee: the reserves which had amounted to $657.89 billion on November 22, had come down to $644.39 by December 20, and yet the fall of the rupee could not be prevented; without the running down of the reserves the fall would clearly have been even greater.

Of course, a fall in the value of the rupee vis-à-vis the dollar has been a long-term, persistent phenomenon. For a very long time during the dirigiste period the price of the rupee vis-à-vis the dollar was fixed (with an occasional government-determined devaluation) and it was sustained by foreign exchange control in the economy; but once such control was lifted, the rupee has drifted downwards. In 1991, immediately upon the lifting of such controls, when the rupee was first floated, the exchange rate was Rs 22.74 to the dollar; by 2014 when Narendra Modi came to power the rate had become Rs 62.33 to the dollar, and now it has even crossed Rs 85.5.

This persistent long-term decline of the rupee is not because the rate of inflation in India is higher than in the US; it certainly is higher but that is not the primary cause of the rupee's depreciation versus the dollar. Indeed, on the contrary, an important reason for the rate of inflation in India being persistently higher than in the United States is the depreciation of the rupee itself, which raises import costs of a whole range of essential inputs like oil and these higher costs get passed on as higher prices over the economy as a whole.Of course, whatever might have been the primary cause of the rupee's depreciation, once inflation does get stimulated by it, it certainly reacts back on the exchange rate of the rupee: speculators anticipate a further exchange rate depreciation because of the inflation and hence actually depreciate it further. But the primary cause of the rupee's depreciation is the preference of the Indian rich to hold their wealth in the form of US dollars rather than in Indian rupees. This gives rise to a persistent shift from rupees to dollars causing the rupee's depreciation.

Such a phenomenon of secular and persistent depreciation of the exchange rate vis-à-vis the dollar is not confined to India alone; it characterises most third world countries. And it is one very important reason why the exchange rate of the rupee should never be left floating but should rather be pegged against the dollar and sustained by capital controls, and foreign exchange controls to the extent necessary, as was the case during the dirigiste period.

This secular fall of the rupee however occurs unevenly: it occurs through more rapid falls in some periods and less rapid falls in others. And the question therefore arises: why has there been a sudden fall in the value of the rupee in the last few weeks? Newspapers have been discussing at length why the rupee should be falling so steeply at present, with commentators adducing factors like India's currently more rapid inflation rate than the US and also the current widening of India's trade deficit; but one factor that has not received much attention

is that the strengthening of the dollar of late, is not just against the rupee, but vis-à-vis almost every major currency of the world. In other words, quite apart from India-specific factors, there are certain basic reasons why the dollar is strengthening at present vis-à-vis not just the rupee but almost every other major currency. In fact the dollar has not been as strong as it is today at any other time over the last decade: the Bloomberg Dollar Spot Index has risen by 7 per cent this year, which makes it in absolute terms higher than in any other year after 2015.

This strengthening of the dollar appears intriguing at first sight. The US President-elect Donald Trump has just announced a hike in tariffs that he proposes to introduce in that country after assuming office. Now, we hear almost everyday sermons from various international organisations, ranging from the IMF to the World Bank to the WTO, lauding the virtues of free trade, which should therefore categorise the coming policy of Trump as retrogressive; and since the market is supposed to "know the best", the market should be losing some faith in the future of that country and should be witnessing some capital flight from there, lowering the value of the dollar. And yet what we find is exactly the opposite. What is more, most market observers list the prospect of US protectionism as a factor underlying the strengthening of the dollar. How can we explain this apparently puzzling phenomenon?

The simple answer to this apparent puzzle is that the sermons about the virtues of free or liberal trade which are meant for the ears of gullible or pliable third world politicians, are not taken seriously by the market itself. It is obvious that protectionism in the US will increase aggregate demand in that country, and hence output and employment, by shutting out a chunk of imports that had displaced domestic production there. Besides, even while improving US employment at the expense of the rest of the capitalist world, it will also improve the trade balance of the US; in fact it would improve aggregate demand in the US precisely by improving the trade balance of that country. The US in short would improve both its balance of payments position, as well as its employment and output, through its protectionist measures; and because of this the market's assessment of the US economy has improved rather than deteriorated, which is the very opposite of what free trade advocates would have us believe. This improved assessment translates itself into greater confidence in the dollar, compared to other major currencies,and hence into an appreciation in its exchange rate vis-à-vis the others.

Protectionism in the US would no doubt raise the inflation rate there to some extent; but it would certainly raise the inflation rate in the rest of the capitalist world to a greater extent. This is because the international prices of a number of commodities, especially critical inputs like oil, are fixed in terms of dollars; an appreciation of the dollar in terms of other currencies therefore would have the effect of raising such prices in terms of these other currencies and hence impart an inflation push to these other economies.

The workers in these other countries therefore would suffer a fall in their living standards for two quite distinct reasons: one, a fall in employment because of the loss of the American market owing to American protectionism; and, two, the rise in inflation rate because of the cost-push imparted by the depreciation of their currencies vis-à-vis the dollar. And if the governments in these countries attempt to control such cost-push inflation at the expense of the workers by pursuing "austerity" measures that increase unemployment and weaken the

workers’ bargaining strength, then that will be yet another route towards workers’ impoverishment.

In the case of externally-indebted third world countries, in addition to unemployment and inflation through the above-mentioned routes, there is an additional way in which the burden on the working people will rise; and that is through the increase in the local currency value of their external debt which is typicallyincurred in US dollars. The burden of debt-servicing therefore will increase for them and this burden will necessarily fall on the working people.

What is unfolding in the world economy is an expression of a fundamental irrationality of the capitalist system, namely, the conditions of life of millions of people become dependent upon the whims and caprices of a bunch of speculators. The fact that the American economy might experience an increase in aggregate demand, and hence employment and output, is of course a material factor of significance caused byUS protectionism; but its impact on exchange rates elsewhere is a result of expectations on the part of market operators which are governed by speculative behaviour; and such behaviour is what matters under capitalism

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