Silver Jubilee Special Lecture

Capitalism and Global Poverty

Prabhat Patnaik

November 26, 2014

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OKD Institute of Social Change and Development
VIP Road, Upper Hengrabari, Guwahati 781036

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I

David Ricardo, aware of the fact that certain commodities were produced under conditions of increasing supply price (for a given money wage), owing inter alia to their being produced on a fixed or not-easily-augmentable land mass, had visualized a tendency for a fall in the rate of profit with the progress of capital accumulation, leading eventually to a capitalist economy's arrival at a "stationary state". While a fall in the rate of profit in particular activities subject to increasing supply price was understandable, its generalization to the economy as a whole was supposed to occur because of the tendency under "free competition capitalism" for an equalization of the rate of profit across activities via capital flows. And the modus operandi of this generalization was supposed to be through the mechanism of terms of trade movements, i.e. through prices in other sectors falling relative to the ones where increasing supply price obtained.

* The argument of this paper is based on that of a forthcoming book A Theory of Imperialism by Utsa Patnaik and Prabhat Patnaik

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We can express this argument as follows. Let us assume for simplicity that all production takes place with circulating capital alone, and that wages are paid at the end of the period; then using w for the wage rate in terms of a money commodity (which itself is one of the produced commodities), we have (where other symbols have their usual meaning and row vectors are denoted with a prime): $p' = w.l' [I - (1+r)A]^{-1}$. If either the l-coefficient or the vector of a-coefficients, or both sets of coefficients, for the n-th sector increase, and if the n-th sector's output enters directly or indirectly as inputs into all other sectors, then r will fall for a given w and the n-th good's price will rise relative to every other good.

Ricardian theory would thus predict a secular shift in the terms of trade in favour primary commodities which are subject to increasing supply price, vis-à-vis manufactured goods which are not. But this is the very opposite of what has historically occurred, as a host of writers from Prebisch to Singer to Arthur Lewis have emphasized.

Ricardian theory however is not just historically invalidated; it is logically flawed as well. This is because such a secular shift in the terms of trade in favour of some commodities which are subject to increasing supply price is incompatible with a money-using capitalist economy. Consider a situation where the money commodity itself is not subject to

increasing supply price while say a primary commodity is. This primary commodity's money price will be expected to increase over time. Wealth-holders will then shift from holding money to holding this primary commodity, i.e. it will replace the money commodity in its role as money. (This would be true even if money has only a medium of circulation role, since even as a medium of circulation it also constitutes a fleeting repository of wealth).

It may be argued that since the money commodity does not have much carrying cost relative to its value (which after all is why historically it is chosen as the money commodity), while the primary commodity which is subject to increasing supply price has, unless the expected price appreciation of the latter in terms of money (owing to the increasing supply price) exceeds this carrying cost, it cannot possibly replace money as a form of wealth holding. But the basic point is that when its price is expected to increase in the next period compared to the current period, there is no reason whatsoever why the elasticity of price expectation in its case should be less than unity, in which case even if some people shift from money to the primary commodity, starting from some initial equilibrium, there would be a cumulative divergence, i.e. no equilibrium will be stable. The role of the money commodity will therefore be supplanted.

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Likewise if the money price of the primary commodity is not expected to change but that of the manufactured good is expected to fall, i.e. the money commodity too is subject to increasing supply price, then money will replace the manufactured good as the object of accumulation. In other words, more and more manufactured goods being held as capital stock, i.e. the phenomenon of the accumulation of manufactured goods as physical capital, which is the main feature of a capitalist economy, will become impossible.

It follows therefore that a money using capitalist economy will be impossible under Ricardian conditions. This proposition has nothing to do with any "stationary state"; it simply assert that a money using capitalist economy is impossible if there are some commodities whose money prices are expected to increase persistently but which are not exclusively the form in which wealth is held.

It follows therefore that in a money using capitalist economy, sectors which are subject to increasing supply price at given money wages, must experience decreasing money wages over time as more output is produced by them, so that their prices do not rise in terms of other commodities and in terms of the money commodity, even as the money wages in the latter commodities remain constant. In other words the existence of increasing supply in some sectors (at given money wages) must entail, for the viability of capitalism as a money-using

system, that the basic assumptions of free competition capitalism, namely there should be equal money wages and equal rate of profit in all sectors, must not hold. There cannot be free competition capitalism if there are sectors with increasing supply price.

Historically in fact there has never been free competition capitalism. Instead capitalism has been characterized from its very birth by the phenomenon of imperialism that systematically vitiates the assumption of free competition capitalism (as theories of unequal exchange, no matter how one views their own specific theories, pointed out long ago). But, before proceeding further, let us see the logic of the point being made here. For this we revert to a simple two-good world, one of which is a manufactured good (sector 1) which doubles as the money commodity, and the other a primary commodity whose input coefficients increase as more is produced.

The price equations under free competition will be:

$$(a_{11} + p_2 . a_{21})(1+r) + w . l_1 = 1$$
$$(a_{12} + p_2 . a_{22})(1+r) + w . l_2 = p_2 \qquad \text{(i)}$$

which for any given w will determine r and p2. Now a rise in l2 or a12 or a22 will lower the rate of profit of the system as a whole and will turn the terms of trade in favour of

sector 2, as Ricardo had visualized, if w is fixed and equal in both sectors. But if w is lowered in sector 2, when any of its input coefficients increases, then there is no reason for this to happen.

In fact if we have two separate wage rates, w1 and w2, but equal rates of profit across sectors, then the price equations become:

$$(a_{11} + p_2 . a_{21})(1+r) + w_1 . l_1 = 1$$
$$(a_{12} + p_2 . a_{22})(1+r) + w_2 . l_2 = p_2 \qquad \text{(ii)}$$

Suppose to start with w1 = w2 and we have the prices of production as Ricardo had visualized. But then as input coefficients in sector 2 rise, with more of its good being produced, we need not have any change either in the terms of trade or in the rate of profit. if w2 is appropriately compressed. In other words, for any given w1 the terms of trade between the sectors, i.e. p2 , will remain unchanged and so will r, even as the input coefficients of sector 2 increase, provided w2 becomes a variable, i.e. can be suitably adjusted. With w1 and p2 being specified (to have the same values as they had in the original situation when the wage rates were equal across sectors) w2 and r get determined by equations (ii), and this r, determined from within the system, will be exactly the same as in the original situation even when the

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input coefficients of sector 2 increases. There is in other words no reason why increasing supply price (at given money wages) or what Ricardo called "diminishing returns" should change either the rate of profit or the terms of trade between sectors if the money wage rate in the sector subject to "diminishing returns" is compressible. (We have assumed here that r is the same between the two sectors but this need not be the case; we continue with this assumption however for the time being).

A wage squeeze in sector 2, which is subject to increasing input coefficients as its output increases, ensures in other words that both the terms of trade and the rate of profit in the system remain unchanged. But this requires that the state of labour and capital mobility should be such that the cheaper sector 2 labour is not used to produce the sector 1 good.

This is exactly what colonialism entailed. It ensured that the real wage rate (or real incomes of producers) in sector 2, the primary producing sector, much of which was located in the "outlying regions" away from the metropolitan centre of capitalism but subject to its political control, could be squeezed appropriately; and yet at the same time, sector 2 labour (with the low real wages) was not used to produce the sector 1 good. Let us see its modus operandi.

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II

The problem of fixity of land which Ricardo was concerned about, related in reality to the tropical land mass above all. Massive emigration from Europe, which drove away the local inhabitants in the temperate regions of white settlement and got hold of their lands for meeting European needs, overcame any possible problem of increasing supply price for temperate products. In the case of tropical products however matters were completely different. The densely populated tropical land mass prevented any large scale eviction of local populations. At the same time, "land augmenting" investments or technological progress such as irrigation, required, in the tropical countries like India, as Marx had observed, substantial expenditure on the part of the State, which the colonial State was loathe to undertake.

The problem of land fixity and hence of difficulty in increasing output to match the growing needs of European capitalism as it embarked on capital accumulation, related in a very fundamental sense therefore to the tropical regions, whose products too were sui generis and could not be produced elsewhere.

It is here that the colonial State came into its own. It imposed "income deflation" on the tropical population to squeeze

local demand, either to obtain directly the goods needed for metropolitan capitalism, or to divert tropical land away from its existing use to produce goods required by metropolitan capitalism. (In the "stylized picture" presented in the model above, we have assumed that the output of sector 2 increases but wages are squeezed, as its input coefficients rise; but the same end can be achieved, and indeed was, through an income squeeze that restricts local demand).

The two main mechanisms for such income deflation were: first, "deindustrialization" which threw local artisans and craftsmen out of work because of the import of manufactured goods from the capitalist metropolis, and thereby released the material inputs and the food products (or what Francis Seton had called the "labour-feeding inputs") that had sustained such activities earlier; and, second, the colonial tax system which simply took away tropical goods gratis for meeting the requirements of the metropolis. These two ways of imposing income deflation and reducing local absorption of goods needed in the metropolis, were additive to one another.

At the same time, there was neither any free labour mobility from these tropical colonies and semi-colonies to the metropolis or even to the temperate regions where the migrants from the metropolis had settled, nor any migration

of metropolitan capital to produce in the tropics, where the wages were much lower than in the metropolis, the goods manufactured in the metropolis itself; and even local capital in the tropical colonies and semi-colonies was so hemmed in by restrictions that it too could not produce with local cheap labour the goods manufactured in the metropolis.

All this is so well-documented that we need not dwell upon the evidence for supporting all such claims here. The basic point here is that colonialism overcame the Ricardian problem without either a shift in the terms of trade in favour of primary commodities or any tendency towards a fall in the rate of profit of the system as a whole. But it did so by giving rise to large-scale absolute poverty in the tropical and sub-tropical colonies and semi-colonies.

And this poverty, as I have argued so far, had a tendency to increase, as capital accumulation occurred in the metropolis which increased the demand for tropical products. The consequence of the phenomenon highlighted by Ricardo, namely the difficulty in increasing the outputs of a range of products required by capitalism owing to the fixity of natural resources ("the niggardliness of nature"), especially land, was neither an increase in the relative prices of such products, nor a fall in the general rate of profit of the system as a whole, but a squeeze on the real absolute living standards of the working population engaged in such production (or more

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generally of those living in the tropical and sub-tropical regions).

I am not suggesting by any means that deprivation did not exist in tropical societies before the advent of colonialism. I am simply making two points. First, modern mass poverty which must be distinguished from mere deprivation, in so far as it is associated with individual insecurity, is in these societies a product of capitalist incursion via colonialism; and secondly, that, with capital accumulation in the metropolis, there is a tendency for the level of absolute poverty of the working population to increase. Both these propositions can be supported by historical evidence, though I shall not go into it here.

The point I now come to is that with globalization this tendency, for absolute poverty to increase as capital accumulation progresses in the metropolis, itself gets globalized, in the sense that the working population in the metropolis too, not just in the periphery, becomes a victim of this tendency.

III

Globalization creates a situation where metropolitan products can be produced using the labour of the periphery. This is not because labour itself becomes free to move from the periphery to the metropolis: while there has been much

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migration from the periphery to the metropolis, such migration has always been controlled migration that does not per se entail the free mobility that is supposed to characterize "free competition capitalism" (the mobility within the European Union itself is a separate matter). What globalization does entail however is that, unlike in the past, capital from the metropolis now moves to the periphery where wages are lower, at least to some segments of it, to locate plants there for producing for the global market, including above all the metropolitan market. Likewise the constraints upon capital from the periphery itself, producing goods hitherto produced only in the metropolis and exporting them to the latter, become relaxed.

In terms of the discussion set in the context of the above model, what this means is that w1 is no longer independent of w2; even though the two may not actually get equalized because of the possibility of diffusion of activities from the metropolis to the periphery to take advantage of the wage difference, they get linked, i.e.

$$w1 = ?.w2 \qquad \text{(a)}$$

where ? is some constant greater than 1. Its being greater than 1 captures the degree of reluctance (whether consumer resistance or metropolitan capitalists' resistance) which may have to be overcome before the production of metropolitan products is located in the periphery.

Let us assume that when wage rates have this relative value in order to offset any tendency for a shift of activity from the metropolis to the periphery, they actually succeed in doing so, i.e. that sector 1 continues to be located exclusively in the metropolis, but only because wages there have also become downward-compressible and linked to the wages prevailing in the periphery. This of course is unrealistic (in view of the massive shift of activities from the metropolis to the economies of the periphery like India and China that we actually witness today), but we assume it here entirely for simplicity, and to avoid notational confusion; our argument below does not depend upon it.

If (a) holds, then we are back in a sense in a Ricardian world (except that in Ricardo ? = 1): in such a world (where (a) holds), with a given money wage rate in either sector (or in both when ? = 1), a rise in the input coefficients in the production of sector 2 will lower the rate of profit as Ricardo had visualized. But, w2 we know is flexible, and because of (a) so is w1; hence the question of the rate of profit falling on account of rising input coefficients in sector 2 simply does not arise. But in this case because of assumption (a) above, the rate of profit in the two sectors will no longer be equal, which in turn will be possible only because of the existence of monopoly in the production of non-primary products. There will in this case in other words be two separate rates of profit, and our system of price equations,

after incorporating (a), will be:

$$(a_{11} + p_2 .. a_{21})(1+ r_1) + ?.w_2 . l_1 = 1$$
$$(a_{12} + p_2 . a_{22})(1+ r_2) + w_2 . l_2 = p_2 \qquad \text{(iii)}$$

If p2 is fixed, say, at the pre-globalization level, i.e. there is no reason for any secular shift in the terms of trade on account of globalization (there may be other reasons for such a secular shift but those need not concern us here, and even if globalization does cause a secular shift it can be incorporated into the argument without invalidating it), and if r2 is also fixed (say, at the pre-globalization level, to ensure that sector 2 output keeps increasing to meet the demand for it), then w2 and r1 get determined by the two equations in (iii). Here, as the input coefficients in sector 2 keep increasing with increasing output because of the "niggardliness of nature", the wage rates in both sectors decline over time while the profit rate in sector 1 increases over time.

Globalization in other words brings about a decline in money wages (and in real wages) in both the sectors because of a rise in the input coefficients in sector 2. Or, putting the matter in the actual context of the world economy, of which the above model seeks to provide a "stylized" depiction, the fixity of the tropical land mass, the demand for whose products increases owing to the process of capital

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accumulation in the world economy as a whole (including in particular in the metropolitan economies), causes a rise in input coefficients in such products, whose consequence is absolute impoverishment of all the workers, those in the periphery as well as those in the metropolis. Globalization, as mentioned earlier, thus globalizes the tendency towards absolute impoverishment of the working population. Such impoverishment is no longer confined to the periphery alone, but now afflicts even the workers in the metropolis.

As regards the workers in the periphery, globalization does not entail anything new compared to the colonial period. (Even when, unlike in the colonial period, there is a diffusion of activity from the metropolis to the periphery, so that products hitherto produced in the metropolis now begin to get produced in the periphery, i.e. when within the periphery there is a shift of work-force towards these new activities, the wage rate of the work-force in these new activities, since it is tethered to the wage rate of workers in the primary producing activities, does not increase, and in fact declines as the input coefficients rise in primary production. Diffusion of activities in other words makes no difference to the tendency towards the impoverishment of the workers in the periphery, defined as a decline in their vector of wage rates; hence globalization in their case merely recreates the situation that had prevailed in the colonial period. But where it does make a difference is to the workers of the metropolis who

now also become subject to the process of absolute impoverishment.

Of course, globalization, though not making a difference to the position of the workers in the periphery that obtained in the colonial period, does make a difference compared to the immediate pre-globalization era, i.e. compared to the era of dirigiste development. This era had seen "land augmenting" investment and technical progress, undertaken by a post-colonial State embarking on a process of "planned development" within a "mixed economy", and such "land augmentation" had cut the link between capital accumulation and absolute impoverishment. This link however gets re-established in the era of globalization when "sound finance" once again comes to prevail in budgetary policy, and land augmentation ceases to occur, because State spending that is so essential for it is curtailed.

The mechanisms of income deflation imposed on the working population in the era of globalization are of course different from those in the colonial period, owing to the absence of any direct political control by the metropolis. No doubt, "de-industrialization", defined broadly as the displacement of several petty producers and traders from their traditional activities by competition from the metropolis or from activities established within the periphery in imitation of the metropolis (including for instance the

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construction of large swanky shopping malls to replace petty shop-owners), continues to be a mechanism of income deflation; but, instead of the colonial tax system, an alternative mechanism is used, and that consists in expenditure deflation by the State. The pursuit of neo-liberal policies imposes such expenditure deflation upon the State in the name of "sound finance"; and it causes income deflation for the working population within the periphery.

IV

The foregoing discussion has thrown up two extremely striking and completely counter-intuitive propositions relating to the era of globalization: first, a rise in the input coefficients in the primary production sector, owing, above all, to the fixity of the tropical land mass, has the effect of lowering the money and real wage rates of workers in the metropolis too, and not just of the working population in the periphery. Second, the rise in input coefficients in the primary production sector owing to the fixity of the tropical and mass, has the effect of raising the rate of profit in the manufacturing sector, including that which is located in the metropolis. We thus have a diametrically anti-Ricardo conclusion: the existence of "diminishing returns" causes not a fall but a rise in the rate of profit, since the manufacturing sector's profit rate goes up while that of the

primary production sector remains unchanged (causing a vector-wise increase for the system as a whole).

Now, suppose there is an increase in labour productivity in the manufacturing sector (which, we continue to assume, for simplicity, remains located in the metropolis), i.e., in terms of our discussion, the labour input coefficient falls in sector 1; then this has the effect not of raising the wages of workers in the metropolis, but of raising the rate of profit there even further (if we assume away, as Ricardo did, any problem of deficiency aggregate demand which could of course lower the realized rate of profit). Not only is the absolute wage rate of the workers in the metropolis unaffected by the level of labour productivity, but even the tendency towards absolute impoverishment of metropolitan workers is unaffected by the pace of increase in the labour productivity of those workers.

There is enough evidence to support the proposition of increasing absolute impoverishment of the workers, both in the periphery and in the metropolis, but I shall not go into this evidence here, except only to quote Joseph Stiglitz who says that, when adjusted for inflation, the income of a male worker in the U.S. in 2011 was lower than in 1968. During this period, when real incomes of the workers stagnated or even declined, there has been obviously an immense increase in labour productivity, causing a sharp decline in the share

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of wages. And what is true of the U.S. would be broadly true of other advanced capitalist countries as well. Is it surprising then that the widening of income and wealth inequalities in recent years in the advanced capitalist world is becoming the central focus of all critical intellectual and political activity in the West ?

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