Financing War: Who Pays and Who Benefits?

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The ghastly terror attack in Pulwama, J&K, on February 14, 2019 in which 44 CRPF personnel were killed, had brought India and Pakistan almost to the brink of yet another war. Although, in the subsequent days, particularly since the release of Wing Commander Abhinandan, the captured IAF pilot by Pakistan, tensions between the two countries eased to some extent, yet, the spectre of another escalation loomed large in the region. The present discussion focuses on financing a war and its impact on the country's economy. More specifically, in this essay, I analyse the impacts of financing a war on the economy in India and on its citizenry.

Broadly, there are three ways of mobilising resources for financing war. These are internal and external borrowings and taxation. Borrowing is economically costly since the state must repay the principal amount along with interest. Thus, it results in diversion of resources of government in meeting debt obligations rather than incurring productive expenditures with strong forward and backward linkages in the economy. External borrowing results in increase in indebtedness to a foreign country or multilateral funding agencies which eventually lead to leakage of nation's scarce resources and loss of country's autonomy in terms of policy making.

Of these, taxation is perhaps least economically costly as it avoids indebtedness and loss of economic sovereignty to any foreign agency/nation. It is perceived to be politically costlier in comparison of other measures as it extracts resources, sometimes forcibly, from the citizens of the country. However, when the citizens are in high favour of war, it becomes easy for the state to finance war through taxation (Cappella, 2012). That is why taxation is viewed as an enabling factor to provide for 'war and the means of war' in some countries (Tilly, 1990). However, many states have experienced a decline in revenue during conflict (Van Den., et.al., 2018). Also, post war impact on taxation in developing countries may not necessarily be positive. War may cause negative impact on economic activity, which in turn may reduce resource mobilization through taxation, and further reduce public spending.

In India, mobilization of resources through taxation is primarily done through indirect taxes which reflects the class bias of the state that desists from taxing the urban and rural elites to the required extent so as to further the process of accumulation. Kalecki (1952) argued that state led investment strategy by mobilising resources through indirect taxation is essentially regressive and inflationary. Patnaik (1983) argued that inflation leads to redistribution of incomes from the commodity buyers to the commodity sellers except for the sellers of labour power, i.e. the workers. These imply that the inevitable outcome of such a financing strategy is erosion of purchasing power and shrinkage in the size of the market which, in turn, adversely affects the effective demand and output of the economy.

Moreover, a substantial proportion of defence procurements in India are imported, primarily from the advanced capitalist nations like the USA and France. According to the *Economic Times,* "*India increased its arms imports by 43 per cent, between 2007–11 and 2012–16. In the last four years India's imports were far greater than those of its regional rivals China and Pakistan…*". Financing for imports of arms will have positive multiplier effects on the economies of these nations which are exporting defence equipment. In other words, state expenditure on defence will lead to increase in employment and incomes of economies like France and the USA, albeit not to the desired extent, which are already plagued by a severe economic recession. Hence, arms manufacturers that have strong connections with the political establishment in these nations will welcome escalation of conflicts in the South Asian region where Pakistan and India are major purchasers of weapons since it will enable them to attain the objective of profit maximisation. Also, increase in defence imports has the potential to adversely affect the trade balance and can lead to downward pressure on the exchange rate that can trigger an economic crisis.