The Emerging International Regime

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Third world economies are now facing a reduced export demand for their goods and services for two distinct reasons. One is the world capitalist crisis which entails a reduced aggregate demand in the world economy and hence reduced aggregate exports for all countries taken together; the other is the protectionism of the U.S., which, by garnering for that country a larger share than it would have otherwise had of this reduced world market, leaves correspondingly less for others.

Since the imports of several of these third world countries are more sluggish to change, these countries face an enlarged trade deficit, and hence current account deficit, on their balanced of payments, which is a combined result of the world capitalist crisis, and of U.S. protectionism. Since in the new situation financial flows to the third world would be smaller than earlier (thanks to the uncertainty about the future of the neo-liberal regime which has been introduced by U.S. protectionism, and thanks also to the prospects of a rise in U.S. interest rates), these third world countries, of which India is a prime example, will have to take their own steps to overcome these deficits.

The obvious measure, and also the soundest, for overcoming the current account deficit is protection against imports via tariffs and quantitative restrictions. Protection is sound because it need not be inflationary. While the imposition of a tariff on oil imports raises the rupee price of imported oil, and, if "passed on", can cause a general price-rise, as oil is an essential input that enters directly or indirectly into all productive activities, the imposition of a similar tariff on imported cars or gold has no such general inflationary impact. Neither imported cars nor gold is an essential input for production in most sectors; so a rise in their prices has no general inflationary impact.

Now if there is such a general inflationary impact of a tariff then it affects the real living standard of vast numbers of the working people whose money wages are fixed. Hence a tariff on oil can adversely affect the living standard of the working people in a way that a tariff on imported cars or gold does not, since the latter do not enter into the wage-basket either as inputs or directly as wage-goods. *Tariffs* *therefore can be so designed that they bring down imports and improve the trade balance without an inflationary squeeze on the people.*

This is not the case with other instruments for improving the trade balance, which is why import protection is the soundest way of effecting such an improvement. An exchange rate depreciation for instance raises the price of *all imports*, not just specific ones as in the case of tariff protection, and hence has necessarily a general inflationary impact that adversely affects the working people. Of course a tariff, as we saw in the oil example above, *can* be inflationary but it *need* not be. It is not intrinsic to the nature of tariff the way it is intrinsic to exchange rate depreciation.

But even though the United States itself has introduced tariff protection against several imports from China, and had even earlier introduced punitive fiscal measures against corporations that outsourced service activities to India, neither the U.S. itself nor international finance capital will approve of protectionist measures being adopted by other countries, especially by a host of third world countries, since the very discriminatory nature of protectionism which is its virtue also shows up the hollowness of the ideology of "leaving things to the market". Discrimination means discretionary intervention in the functioning of the market, and hence underscores the superiority of the visible hand over the "invisible hand". We are likely therefore to move towards an international trade regime where the U.S. and a few advanced countries will engage in tariff protection, while most of the third world economies (barring those like China which have export surpluses anyway) will have relatively freer trade, with balance of payments adjustments being attempted through exchange rate depreciation or domestic wage and price deflation.

This is very similar to what had prevailed in the colonial regime in the nineteenth century. Colonies like India were not allowed to impose tariffs on imported goods from the metropolis, essentially Britain, while Britain imposed heavy tariffs on Indian goods until 1846, and even though afterwards Britain moved to a free trade regime, continental economies like Germany, and the United States, continued to have high tariffs on their imports. The international economy in short seems set to move back towards a colonial-style trade regime, where one way free trade is imposed on the third world countries.

An important implication of this must be noted. Non-protectionist adjustment mechanisms for the balance of payments, as we have noted, are necessarily, intrinsically, anti-people. Consider an exchange rate depreciation. We have already seen that it has a generalized inflationary impact. Now, if the working people succeed in protecting their real living standards against this inflation by obtaining higher money wages (or money incomes), *then there is no real effective exchange rate depreciation.* A 10 percent exchange rate depreciation can result in a less than 10 percent rise in the price-level, and hence cause a real effective exchange rate depreciation, so that imports become more expensive in the domestic market compared to before the depreciation, and exports cheaper in the international market, only if money wages do not rise at all, or do not rise as fast as prices, i.e. only if real wages fall.

Exactly the same is true, in an obvious sense, for the other instrument that can be used for improving the trade balance, which is to cut money wages while keeping the exchange rate constant. At any constant exchange rate a 10 percent fall in money wages will cause a less than 10 percent fall in the price-level (since one component of costs, namely those of imported inputs, would have remained unchanged). This means a fall in real wages but a lowering of prices of domestically-produced goods compared to foreign goods both in the domestic and in the international markets.

A money wage-deflation at a given exchange rate in other words has exactly the same effect as an exchange rate depreciation at given money wages. Both lower real wages as a means of improving the competitiveness of domestically produced goods vis-à-vis foreign goods. Both these non-protectionist measures for improving the trade balance therefore, unlike protectionism, necessarily require a lowering of real wages.

Exactly the same can be said for the other possible measure for improving the trade balance which is domestic demand deflation, where the idea is to compress domestic demand as a means of cutting down the import-bill. The typical ways in which such deflation is carried out is reducing government expenditure on subsidies and transfer payments to the poor, keeping down the salaries of government employees, and such like measures, all of which again lower the real incomes of the working people.

The new international trade regime is thus likely to institutionalize an attack on the working people as the means of improving the trade balance in third world countries, because of which we are likely to witness even greater efforts to undermine workers' organizations like trade unions through the introduction of so-called "labour market flexibility" or complete freedom for employers to hire and fire workers at will.

But this trade regime will not succeed in alleviating the crisis of world capitalism any more than a general adoption of protectionism will do, notwithstanding the important differences between the two that we have noted above. Such a general adoption of protectionism, while nullifying the advantage that being the first to go protectionist may have given the U.S., will create further uncertainty among the capitalists, dampening their incentive to invest, and thereby aggravating the crisis. Exactly the same will happen if instead of a " beggar my neighbour" policy being followed via all countries going protectionist, a "beggar my neighbour" policy is followed via some adopting protectionist measures and others adopting wage deflation or exchange rate depreciation. Likewise demand compression through domestic expenditure cuts would also aggravate the crisis by further lowering the level of aggregate demand in the world economy.

Overcoming the world economic crisis requires an increase in world aggregate demand; each country fighting for a larger share of a *given* world market, no matter what the instrument that is used in *this* fight, cannot alleviate the crisis. If anything, it can aggravate it by dampening the incentive to invest.

As for the third world, protectionism may be a better instrument to follow for improving trade balance; but for a durable improvement in employment it must be accompanied by measures to expand the domestic market.

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