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Structural Change in the World Economy and Forms of Protectionism

Warnings about the dangers of protectionism are being heard from all sides at present. However, rehearsing the advantages of free trade and the drawbacks of protectionism is to little avail if it fails to take account of the limitations that the international context imposes on national economic policy.

Protectionism is a dirty word, and its implications are almost universally condemned across the entire political spectrum, regardless of theoretical stance. It seems no-one likes protected economic areas any longer, at least not if they harbour the competitors to one's own exporters. For protectionism has a high price,[1] in both monetary and non-monetary terms. The path from protectionism to autarchy, as followed in the thirties, is a dangerous one, leading to nationalism and the formation of aggressive blocs in order to create the conditions necessary for "national self-sufficiency",[2] less peace in the world and a vicious circle of beggar-thy-neighbour policies that ultimately leave everyone worse off.

Despite the almost unanimous rejection of the temptations of protectionism, the International Monetary Fund reports that "Protectionist pressures increased significantly in the 1980s, posing a threat to the efficient allocation of international resources, the balanced growth of world trade, the sustainability of economic recovery, and the satisfactory management of the debt problem".[3]

Protectionist coalitions therefore clearly exist in many countries. The Cuomo Report[4] tentatively classifies total world trade according to types of trading system and reaches the conclusion that only 27 % of world trade can be counted as free trade; the remainder is regulated and protected by one means or another.

The period since the second world war has witnessed unprecedented rates of growth in foreign trade. The exports of six industrialised countries (France, Germany, Japan, the Netherlands, the United Kingdom and the USA) increased by an annual average of 9.42 % in real terms between 1950 and 1973, while their gross domestic product grew at an equally spectacular rate of 5.13 % a year over the same period. Hence, world trade expanded 1.77 times faster than the GDP of the industrialised countries. The magnitude of the expansion becomes apparent when the figures are compared with those for the period from 1913 to 1950, in which two world wars were fought; during that period GDP increased by an average of 1.85 % a year and world trade by only 0.49 % a year. Even in the period of stagnation from 1973 to 1984 the expansion of 3.61 % a year in world trade was 1.72 times faster than average GDP growth of 2.10 %.[5]

These impressive figures could be further elaborated and complemented by historical time series,[6] but they

* Free University, Berlin, Germany. This article is an edited and updated version of a paper presented at a conference organized by the Evangelical Academy, Loccum, between 16th and 18th September 1988.

1 Cf. W. Max Corden: Protection and Liberalization: A Review of Analytical Issues, IMF Occasional Papers No. 54, Washington D.C., August 1987; Fred C. Bergsten, William R. Cline: Trade Policy in the 1980s: An Overview, in: William R. Cline (ed.): Trade Policy in the 1980s, Washington D.C./London 1983, pp. 64 f.; World Bank: World Development Report 1988, Washington D.C. 1988, pp. 16 f.

2 John M. Keynes: On National Self-Sufficiency, 1933.

3 IMF: World Economic Outlook, Washington D.C., April 1988, p. 91.

4 Mario M. Cuomo: The Cuomo Commission Report. A New American Formula for a Strong Economy, New York, London, Toronto, Sydney, Tokyo 1988, p. 66.

5 Angus Maddison: Growth and Slowdown in Advanced Capitalist Economies: Techniques of Quantitative Assessment, in: Journal of Economic Literature, Vol. XXV (June 1987), pp. 649-698, here p. 670.

6 Cf. for example David Gordon: The Global Economy: New Edifice on Crumbling Foundations?, in: New Left Review, No. 168, March-April 1988, pp. 24-64.

tell us nothing about cause and effect. After all, Germany's rise to become a competitive industrial power took place behind protective tariff walls and the USA grew into the role of the predominant power of the twentieth century with a policy of splendid isolation, based on its massive, expanding domestic market and the extension of the frontier westwards. The ratio of foreign trade (exports plus imports) to GDP before the first world war was just 11 % in the case of the USA, compared with 38.3 % for Germany and 43.5 % for the United Kingdom.[7] These examples do not tell the entire story, however; the splendid isolation of the USA in the twenties did not extend to international financial relations, since the United States became the "super creditor" of European industrialised countries and Latin America, with the result that the reverberations of the 1929 Wall Street Crash quickly spread throughout the world as foreign loans were suddenly called in.[8] As today, debtors had to generate a trade surplus in order to earn the foreign exchange needed to meet their external payment commitments. This had far wider repercussions than the destruction of the monetary system that had been re-established at such effort and cost after the first world war; the collapse of financial markets in the USA and Europe in the early thirties and the serious debt crisis in many Latin American countries later in the decade provoked severe protectionist measures by all world trading countries, accompanied by a dramatic fall in prices, especially those of raw materials. It would therefore be misleading to believe that trends in world markets could be ignored simply because tariff protection or the possession of a large internal market – the privilege of being a large country – reduced the significance of foreign trade in relation to effective domestic demand.

This was one lesson that was acted upon after the second world war. A dual asymmetry that had prevailed throughout the interwar years was now swept away. Firstly, the contradiction was eliminated between the *economic supremacy* of the USA at world level and the unwillingness of its political and business elites to exercise *economic leadership,* in other words to establish an economic order based on hegemony and to provide political guarantees for its working, and secondly arrangements had to be found for a coherent system of world trade, monetary and financial relationships. After the second world war the European powers were too weak to afford the luxury of continued non-co-operation and the USA was now ready to perform the necessary stabilising function of the leading power in the world economy, in other words to impose the "rules of the game", the rules of *its game,* on all other countries. These rules provided *first* for free trade within the framework of a binding world trade order and *secondly* for the provision of the liquidity needed to settle international transactions in domestic currency; in this way the dollar to all intents and purposes became the world currency. *Thirdly,* at a series of international conferences and preliminary negotiating sessions, of which the Bretton Woods Conference was undoubtedly the most important, it was agreed to establish a regulated monetary system with fixed exchange rates and to set up a fund (the IMF) that would grant credit to finance short-term balance of payments deficits. *Fourthly,* an "aid-regime"[9] was set up, mainly by the USA, to assist with the reconstruction of war-torn Europe and to help the countries of what would later be called the Third World in order to integrate them into the Western system – in a subordinate role and to forestall "communist" tendencies.

System of Hegemony

This system, which became fully operational in the late fifties with the establishment of currency convertibility and actually lasted until the beginning of the seventies, is unique in the history of the capitalist world. Although the theory of "hegemony cycles" states that the capitalist system has never managed without a dominant power, there has never before been a hegemonical system based on *internationally agreed rules* such as existed after the second world war. Unlike the free trade concepts of the nineteenth century, when free trade was obtained forcibly by wielding imperial power if it was not granted voluntarily, the *"free trade"* of the post-war period was thoroughly *regulated and protected,* but according to rules and practices that were largely laid down at international level, embodied in the hegemonical order, "guaranteed" by the dominant power and supported by broad consensus among the ruling elites in the industrialised countries, and in most developing countries as well. This "regime" created and sustained a politically regulated and protected framework – in various national varieties of Keynesianism – for capital accumulation by private enterprises in member countries. To judge from rates of economic growth and the rise in employment, it was

[7] Martin Wolf: Why Trade Liberalization is a Good Idea, in: Michael Finger, Andrzej Olechowski (eds.): The Uruguay Round. A Handbook for the Multilateral Trade Negotiations, A World Bank Publication, Washington D.C. 1988, p. 16.

[8] Cf. Charles P. Kindleberger: The World in Depression, 1929-1939, Berkeley 1973; Derek H. Aldcroft: From Versailles to Wall Street, London 1977; Eugen Varga: Die Krise des Kapitalismus und ihre politischen Folgen, Frankfurt and Vienna 1986.

[9] Robert Wood: From Marshall Plan to Debt Crisis, Berkeley 1986.

highly successful until the beginning of the seventies. In the industrial countries GDP increased faster than labour productivity. The rates of growth in capital productivity were also positive almost everywhere,[10] so that with real wages rising only moderately – in the fifties, at least – profitability was also at an historically high level.[11] Accumulation rates were very high, though with timelags between countries; with justifiable pride, each industrial nation in turn proclaimed "its" economic miracle, until in the seventies some of the more advanced developing countries also experienced an economic miracle of industrialisation, which in not a few cases turned out to be quite different from what they had bargained for.[12]

The high rates of growth in world trade between 1948 and 1973 were on the one hand a *passive* expression of the vigorous capitalistic accumulation process, successfully sustained by the way in which the internationally agreed regulatory system of the world market operated, especially the Bretton Woods system. The dynamism of production and capital accumulation determines the circulation rate, and not vice versa. David Gordon[13] has pointed out that periods of accelerated growth in national product or industrial output during the "long cycles" in the history of the capitalist world system have always been accompanied by faster expansion in world trade. He therefore confirms the findings of Maddison quoted above.[14] On the other hand, high rates of growth in world trade are a condition for marketing the output, particularly if enterprises exploiting technical advances try to achieve economies of scale, which necessitate a disproportionately large expansion in demand.

Foreign trade is also an important means of increasing national rates of profit if it enables both labour costs and the cost of the means of production (fixed capital) to be reduced or their rate of increase slowed down. The improvement in the industrial countries' terms of trade until the first oil shock in 1973 had just such an effect.

Surplus Profits

The expansion in the world market was also a necessary condition for the USA to realise the *surplus profits* (in the Marxist sense, roughly comparable to the windfall profits of Keynesian economics) due to its superior productivity. If the market does not grow sufficiently, above-average productivity must lead either to falling product prices with rising output or to declining inputs at constant output and product prices, with unemployment as a possible consequence. Though large by comparison with the United States' external market, the US *domestic* market would not have provided scope for earning surplus profits since the productivity advantage of particular industries or of an entire economy (as opposed to a lead enjoyed by individual enterprises *within* a national industry) operates only in relation to competitors *in the world market.* As long as the world market is expanding and hence allowing surplus profits to be made, it provides an effective incentive for technical inventions and product or process innovation both in the leading country and in competitors trying to reduce its lead. Since in the Bretton Woods system of fixed exchange rates this mechanism was not attenuated by exchange rate movements (appreciation of the currency of the leading country, depreciation elsewhere), rapid adjustment of the *real* economy to the highest productivity level was unavoidable, particularly as protecting tariff barriers were breached and currency inconvertibility eliminated during the same period.

Limitations of the System

Hence the expansion in world trade, national capital accumulation and technical innovation sustain and stimulate one another, leading to high rates of productivity growth, which in turn permit high increases in real wages. This model of development, which operated from the end of the second world war until the seventies, has been described as "Fordist". However, by the sixties it was already evident that Fordist accumulation and an international order based on hegemony are highly unstable owing to the unevenness and non-simultaneity of development. Successful capital accumulation heightens competition, but the success of capital accumulation by individuals also implies a relative decline in the intervention ability of national political systems, international organisations and hence the dominant power; the power of the market outgrows the regulatory capacity of the political organs.

The system's in-built limitations are responsible for the weakness of capital accumulation since the mid-seventies and the slowdown in the growth of world trade.

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[10] Cf. the data presented by Angus Maddison, op. cit.

[11] For an overview, see Philip Armstrong, Andrew Glyn, John Harrison: Capitalism since World War II, London 1984.

[12] Elmar Altvater: Die Enttäuschung der Nachzügler oder: Der Bankrott „fordistischer" Industrialisierung, in: Kurt Hübner, Birgit Mahnkopf (eds.): Der gewendete Kapitalismus, Münster 1988 (to be published shortly).

[13] David Gordon, op. cit.

[14] Angus Maddison, op. cit.

Firstly, the advocates of regulation[15] have drawn attention to unit labour costs as the central variable; rates of productivity growth are slowing down for a number of reasons (waning of the structural and capacity effects, the "long wave" of product innovation, etc.), as can be proved empirically for all industrialised countries. The growth in wages and social benefits is not, however, slowing down in proportion owing to the institutional organisation of the "wage relationship" (strong trade unions, social policy at company and state level, etc.), so that real unit labour costs are rising. Since *secondly* capital productivity is falling, mainly owing to the capital-intensive and hence labour-saving nature of most technical innovations, the rate of profit is declining. This is having an adverse effect on the rate of capital accumulation, in other words on investment and the growth in GDP; although the link between them is highly indirect, as I have described in detail elsewhere.[16] The utilisation rate of the capital invested in the means of production is showing a trend decline and unemployment is rising. *Thirdly,* at the same time the dominant power that has held the technological lead hitherto will not be able to realise the surplus profits that were possible at the start of the long cycle, since competitors are tending to reduce its original lead in labour productivity.

Table 1
Selected Industrial Countries' Exports of Industrial Goods as a Proportion of the Total Exports of Industrial Countries, according to R&D Content
(percentages)

	1970	1980	1985
A. High R&D content			
USA	29.59	26.15	26.79
Japan	8.29	12.41	18.33
Germany	16.69	16.56	13.85
UK	10.46	11.77	9.15
France	7.01	8.55	8.05
B. Medium R&D content			
Japan	9.36	14.68	20.17
Germany	21.33	19.58	17.92
USA	19.88	16.32	15.60
France	7.84	9.11	7.32
UK	10.77	9.88	7.18
C. Low R&D content			
Germany	12.47	13.66	13.44
Italy	7.21	9.27	10.21
Japan	11.16	8.90	9.66
France	8.99	10.28	9.13
USA	11.02	9.62	8.98

Source: UNCTAD: Trade and Development Report, New York 1987, p. 116.

Shrinking Technology Gap

The "technology gap", which was still being described in dramatic terms in Western Europe in the sixties, had been almost closed by the beginning of the eighties. In 1984 productivity in France and Germany averaged almost 90 % of the level of the USA, in Japan around 72 %.[17] An examination of the market shares in exported industrial goods according to their R & D content confirms that the competitors of the USA have succeeded in catching up, and in some sectors the USA has already been overtaken (Table 1).

Even on the basis of a cautious interpretation it is legitimate to speak of the USA falling back in relation to its competitors, just as countries such as Germany have lost ground in relation to Japan. Against the background of this general trend it should be noted, however, that the USA still has an overall lead in industrial goods with a high R & D content, whereas it has been overtaken in products in the medium and low categories. This may explain the Reagan Administration's anti-protectionist stance on "mature" products of the past product cycle, such as cars, chemicals and electronics; it fears that the "trading partners" whose exports to the USA are impeded by protectionism may retaliate in areas where the USA itself is vulnerable, namely in state-of-the-art technologies in certain industries (aircraft, aerospace, electronics, etc.) and in other goods and services with a high R & D content.[18]

Fourthly, the United States' loss of ground against competitors, which has been examined and discussed in a host of studies and debates,[19] has not only stripped away surplus profits but is also the economic reason for the political decline of the dominant power and hence a contributory factor in the erosion of the internationally instituted system of regulation, which *organised the so successful economic reproduction process politically* and made possible a form of "co-operative" global

[15] E.g. Alain Lipietz: Mirages and Miracles, London 1986; Robert Boyer (ed.): Capitalismes fin de siècle, Paris 1986.

[16] Elmar Altvater: Sachzwang Weltmarkt, Hamburg 1987, pp. 221 ff.

[17] UNCTAD: Trade and Development Report, New York 1987, p. 214.

[18] Cf. Ricardo Parboni: The Dollar Weapon: From Nixon to Reagan, in: New Left Review, No. 158, 1986, pp. 5-18, here p. 13.

[19] E.g. Lester C. Thurow: The Zero Sum Society, New York 1980; Lester C. Thurow: Zero Sum Solution. An Economic and Political Agenda for the 80s, New York 1985; Mike Davis: Phoenix im Sturzflug. Zur Politischen Ökonomie der Vereinigten Staaten in den achtziger Jahren, Berlin 1986; Bruce R. Scott, George C. Lodge (eds.): U.S. Competitiveness in the World Economy, Boston 1985; Mario M. Cuomo, op. cit.

capitalism over a period of several decades. However, with the dominant power ceasing to contribute to international regulation, *nation states* found themselves facing new responsibilities in a changed international environment. The world market stagnates at the end of the long cycle, as reflected in a slowdown in the growth of world trade. In such a situation, the strategy of expanding national exports comes close to being a *zero-sum game,* in which one nation's gains equal another's losses. It is only in this situation, in which the protection of free trade through political hegemony no longer functions, that national policies of export promotion and import restriction turn into protectionism; in other words, protectionism is a *contingent* national policy option if the co-operative protection of trade relations by an international system of institutions under the aegis of the dominant power encounters obstacles. "Reciprocity" in world trading relations transmutes from the principle of reciprocally reducing trade barriers, and hence expanding world trade by more than national product, into a principle of neo-mercantilistic discrimination designed to safeguard national economic growth and employment.[20]

Zero-Sum Game

Warnings are now being voiced about the dangers of protectionism; in most cases they are not referring to the establishment of customs tariffs to provide temporary "delinking" from the world market in order to protect "infant industries" as propounded by Friedrich List,[21] but to the *decline* of the order based on US hegemony and

[20] Alan L. Winters: Reciprocity, in: Michael Finger, Andrzej Olechowski (eds.), op. cit.; William R. Cline (ed.), op. cit.

[21] Friedrich List: Das nationale System der Politischen Ökonomie, Stuttgart and Tübingen 1841 (reprint: Berlin 1982).

to countries' attempts to "go it alone" in order to make up for the lack or decline of regulation by international institutions. A system that made "positive-sum games" for all the players possible has been replaced by the rules of the zero-sum game, in which co-operation can be to the players' disadvantage. When we speak of "protectionism", we should therefore distinguish between various forms, as suggested in Table 2:

Table 2
Four Forms of Protectionism

	National policy	Concerted and hegemonical
	"Zero-sum game"	"Positive-sum game"
1. Protection of traditional industries	Conservational protectionism	–
2. Development of modern industries ("infant industries")	Infant industry protectionism	Development policy
3. Aggressive competition	Defensive ("dirty") protectionism	–
4. Technology policy and modernisation	Offensive protectionism	Regulated by multilateral agreements

The current debate is concerned mainly with offensive and defensive ("dirty") protectionism, less with conservational and "infant industry" protection. Greater importance therefore attaches to the nation state and its policy. Paradoxically this is happening at a time when the state is increasingly turning away from Keynesianism and tending to withdraw from policy interference in economic processes, partly as a result of powerlessness in the face of capital that has been accumulated, and is roving around, in accordance with the logic of private profit-making, the more so if it has assumed the form of interest-bearing, internationally operating capital. The result is a supply-side protectionism aimed at improving the *competitiveness of national capital* in the world market. The protectionist emergency solution to which all countries are resorting in the eighties is to throw sand not only in the works but also in their own eyes.

Debt and Economic Hegemony

It is only since the mid-seventies that the world market has been "perfect", in the sense that not only has merchandise trade been internationalised and enterprises transnationalised but the credit system has also assumed international proportions and a world money market has come into being. This leads to a contradiction between the ever increasing volume of volatile and barely controllable capital circulating *internationally* and *national* attempts to gain control over the national economy following the collapse of the international, politically regulated system of economic hegemony. The reactions to this contradiction are inconsistent and equally contradictory. If governments do not in any case opt for free market "self regulation" in preference to an actively managed economic policy, they adapt their national economic policy to suit the conditions set by the internationalised financial system: if "interest rate sovereignty" has been lost, firms' costs must be reduced within the national economy so that yields at least equal the interest rates set externally.[22] Economic policy therefore attempts to sidestep the turbulence generated by the world money market. However, countries that have incurred heavy debts cannot afford this strategy, since they cannot develop options for improving their competitiveness through modernisation until they have met their debt servicing obligations, which today are beyond the resources of the heavily indebted developing countries. Hence the fortunate countries resort to offensive protectionism to improve their competitiveness, while the rest have no choice but to practise defensive "dirty" protectionism. Rehearsing the advantages of free trade and the disadvantages of protectionism[23] does little to counter these tendencies if the limitations that the international context imposes on national economic policy are not also taken into account.

Borrowing is normal in capitalist societies. The present problem therefore lies in the fact that borrowing has been markedly one-sided, with particular countries, country groups and sectors incurring heavy debts vis-à-vis the international banking system. Debts and credits should be more or less in balance over a foreseeable timespan, that is to say debtors must have a chance of extinguishing their debt in the course of a "debt cycle", during which creditors move into a debtor position. This assumption underlay the developing countries' strategies of "industrialisation cum debt" in the seventies and it determines the World Bank's development strategies today.[24] If the debt cycle is blocked, however, as it is at present, the one-sided debts increase with each rescheduling scheme until the debtor or debtors become insolvent. In the history of the capitalist world system, private or state bankruptcy has been the most effective means of solving debt crises.

[22] Fritz W. Scharpf: Sozialdemokratische Krisenpolitik in Europa, Frankfurt and New York 1987; for a critique, cf. Elmar Altvater: Nationale Wirtschaftspolitik unter Bedingungen globaler „finanzieller Instabilitäten", in: Prokla, No. 72, 1988 (to be published shortly).

[23] W. Max Corden, op. cit.

[24] Cf. World Bank: World Development Report 1985, Washington D.C. 1985, pp. 55 ff.

Threat to the Financial System

If only a few debtors take this course of action, if creditors can cope with the amounts to be written off and if the fragile institutional system of international finance is not overburdened, then bankruptcy can be highly useful and therapeutic and can sweep away obstacles to development. However, when entire continents become insolvent, when the developing countries' debts reach $1,300 billion and in addition the dominant power itself has foreign debts of $400 billion, then this path leads to economic disaster, particularly as the USA also has around $3,000 billion in domestic government debt and many hundreds of billions of dollars in defaulted loans to the agricultural sector, declining industries and consumers (debts of $628.76 billion in March 1988). The debt of non-financial sectors in the USA is admittedly lower than in many other industrialised countries as a percentage of GDP,[25] but the quality of the debts, or from the point of view of creditors the claims, is so low in many sectors such as agriculture and the oil industry that the number of bank failures has increased rapidly since the beginning of the eighties:[26] "Whatever the method, the investment arena was flooded with debt, much of it low quality, while there was a generalised shrinking of equities".[27] The "financial instabilities"[28] have therefore increased,[29] as testified by the rise in interest rates and the resultant stock exchange crash of October 1987.[30] The point at which the financial system is in jeopardy will

[25] Cf. IMF, op. cit., p. 48.

[26] Mario M. Cuomo, op. cit., pp. 8 f.

be reached if debtors seriously curtail or even suspend their debt servicing.

The figures in Table 3, which have not been broken down further, show not only the problem of indebtedness but also the monetary erosion of the United States' dominant position. At the end of 1987 US foreign debt was almost four times as high as that of the most heavily indebted country in the Third World, Brazil, whose debts totalled $115 billion. The trend is steeply upwards. The function of the dominant power was and is to supply the world economy with liquidity, and not to suck in liquidity from the rest of the world to finance the double deficit in the current account of the balance of payments and in the Federal budget. If the USA wants to regain hegemony, it must reduce its external debt.

New Major Creditors

There is another aspect of the data that is also interesting. The debts of the Third World are rising, even though the USA has ceased to be a creditor and has incurred heavy debts very rapidly, in fact in accordance with the debt cycle hypothesis. It is therefore simple to deduce that other nations must have emerged as major creditors holding net claims not only on the Third World but also on the USA. Global financial assets (shares, securities, bonds, etc.) are therefore no longer concentrated mainly with the dominant power but in Japan and to a lesser extent in Western Europe. Between 1984 and 1987 the net inflow of capital to the USA came to $442.1 billion; the USA therefore undertook heavy commitments towards foreign creditors. Over the same period, Germany exported $82.9 billion in capital, in other words acquired substantial claims on the rest of the world. The same applies on a larger scale to Japan, whose capital exports amounted to $199.6 billion over the period in question.[31] In view of the temptation this trend affords, models are already being formulated in Japan for a monetary and financial "pax nipponica",[32] a kind of financial Pearl Harbour.

Table 3
Foreign debt (–) of developing countries and the USA, 1980-88

Year	Developing countries	USA
1980	– 635.8	+ 106.03
1981	– 747.7	+ 141.14
1982	– 846.6	+ 136.96
1983	– 897.0	+ 89.60
1984	– 942.0	+ 3.64
1985	–1016.6	– 111.88
1986	–1099.0	– 263.56
1987	–1194.8	– 402.35[a]
1988	–1228.9	n.a.

Sources: IMF: World Economic Outlook, Washington D.C. 1988, p. 174; US Department of Commerce: Survey of Current Business, balance between investments by US citizens abroad and non-residents' investments in the USA.

[a] Own calculation on the basis of Economic Indicators, May 1988, prepared for the Joint Economic Committee by the Council of Economic Advisors, Washington D.C.

Table 4
Current Account Balances of Selected Countries, 1980-88
(in billions of dollars)

Country	1980	1985	1986	1987	1988	1989
USA	1.9	–116.4	–141.4	–160.7	–141.1	–133.8
Japan	–10.7	49.2	85.8	86.7	77.8	75.4
Germany	–13.8	16.3	38.1	44.2	41.4	40.7
Four Asian NICs[1]	– 6.8	5.2	10.2	11.5	8-10	6-9

Source: IMF: World Economic Outlook, Washington D.C. 1988, p. 16; projections for 1988 and 1989.

[1] Hong Kong, South Korea, Singapore and Taiwan.

The switch in monetary claims and obligations mirrors the shift in trade balances; since the beginning of the eighties the USA has recorded a growing deficit on its trade and current accounts, whereas Japan, Germany and some newly industrialising countries have achieved correspondingly large surpluses (Table 4).

The USA is behaving in accordance with the debt cycle hypothesis in that the Asian and Latin American NICs are achieving a large part of their trade surpluses in the USA. The aggregate trade surplus of the four Asian NICs with the USA was around $35 billion in 1987, but it fell short of Japan's surplus of $56.9 billion.[33] It may be noted in passing that Germany's surplus on merchandise trade with the USA came to about DM 40.7 billion in 1987. As a group, the industrialised countries are not easing the debt burden by accepting trade deficits; instead, new financial claims are being

[27] Robert Sobel: Panic on Wall Street – A Classic History of America's Financial Disasters – with a New Exploration of the Crash of 1987, New York 1988, p. 459.

[28] Hyman P. Minsky: Stabilizing an Unstable Economy, New Haven and London 1986; see also Elmar Altvater: Die Enttäuschung der Nachzügler, op. cit.

[29] This is questioned by the IMF, op. cit., pp. 51 ff., in reviewing the crash of 1987.

[30] Cf. Robert Sobel, op. cit., pp. 444 ff.

[31] According to OECD: OECD Economic Outlook, June 1988, Paris 1988, p. 63.

[32] Cf. The Japanese Economic Research Center: Can the World Economy be Restructured? – Japan's Role as a Leading Creditor Country, May 1988 (mimeo).

[33] Cf. Mario M. Cuomo, op. cit., pp. 58 ff.

accumulated that contain the seed of the debt crisis of the nineties, this time centred on the USA.

Financial Instabilities

Global financial relationships have been largely divorced from the processes of world production and world trade, but they are not independent of these factors. The debts of the USA stem from the twin deficit in the trade account and in the Federal budget and they can be redeemed only if the trade deficit is reduced, and with it the current account deficit. A move in this direction was attempted by bringing the dollar down from the heights it had reached in 1984 to its lowest level ever at the end of 1987; after appreciating by around 45% against trade-weighted OECD currencies between 1980 and 1985, the dollar fell by around 60% in value between then and 1988, only to rise by a few percentage points again in response to the first reports of a decline in the monthly trade deficit. Extreme exchange rate volatility is one of the problems that constitute the "financial instabilities" of the eighties and increase the risks for world trade.

The devaluation of the dollar did not achieve much, however, owing partly to the J-curve effect but also to the decline in the competitiveness of the US economy in recent years due to the fall in the investment ratio.[34] If exchange rate policy is no help and internationally co-ordinated countermeasures are less effective than would be desired, there is a powerful incentive to look to "dirty" protectionist measures.

Global Cycle

The days have passed in which economies were defined as "national economies" and national economic cycles could be discerned whose peaks and troughs were often not synchronised between countries. Unevenness and non-simultaneity in the development of the world market are features that national economic policymakers can exploit; cyclical phases of stagnation and recession can be overcome by means of neo-mercantilistic export promotion strategies, an instrument Germany has used to the full. The Bretton Woods system of fixed exchange rates meant that, ceteris paribus, cyclical downturns accompanied by lower inflation or even falling prices for internationally traded goods brought an improvement in competitiveness. Global demand flows were thus diverted, since they cannot be halted by countervailing exchange rate movements. A country in recession therefore receives increased orders from abroad and hence sees effective national demand rise, with multiplier effects on output, incomes and employment. In times of stagnation or recession, demand from abroad can therefore perform a counter-cyclical function.[35] This occurred in Germany in 1962-63 and 1967-68, when export demand offset the slowdown in the growth of other demand components (investment and consumption) and also increased the contribution of net exports to national product.[36] A very similar situation was to be seen in the United Kingdom in 1962 and in Italy after the 1963 recession. Of course, the higher the proportion of foreign trade to national product, the greater the effect of the export multiplier, and conversely the less a country is dependent on exports and imports, the lower will be the multiplier.[37]

In 1974-75, however, demand stagnated in all national economies simultaneously. National economic cycles synchronised to form a *global cycle,* at least in the industrialised countries.[38] As a result, the stimulatory effects of export demand on the effective total demand in a particular national economy were bound to be absent. The changeover to floating exchange rates in 1971-73 also meant that exports had less impact than under a system of fixed rates owing to the tendency for the currency of a deflating country to appreciate, and vice versa, not to mention the offsetting effects of erratic monetary capital movements.

Locomotive Theory

Nevertheless, it was precisely during this phase in the development of the world market that the *locomotive theory* was formulated. The Carter Administration and the economic policy debates within the OECD assumed that the USA had taken on the role of locomotive of the world economy after the "oil crisis" of 1975-77. The United States had supposedly paid a high price for this: rising inflation, a depreciation of the dollar against the other major currencies and a very large trade and current account deficit.[39] It was claimed that the trading partners of the United States, especially Japan and

[34] This is mentioned in the Cuomo-Report, ibid., pp. 19ff.

[35] Elmar Altvater, Jürgen Hoffmann, Willi Semmler: Vom Wirtschaftswunder zur Wirtschaftskrise, Berlin (West) 1979, pp. 163 ff.

[36] Cf. Werner Glastetter, Rüdiger Paulert, Ulrich Spörel: Die wirtschaftliche Entwicklung in der Bundesrepublik Deutschland 1950-1980, Frankfurt (Main) and New York 1983, pp. 481 ff.

[37] Cf. Martin Bronfenbrenner: On the Locomotive Theory in International Macroeconomics, in: Weltwirtschaftliches Archiv, Vol. 115, 1979, pp. 38-50, here p. 40.

[38] On the modification of the theory through econometric tests, see Arthur MacEwan: Interdependence and Stability: Do the Levels of Output in the Advanced Capitalist Countries Increasingly Move Up and Down Together, in: Review of Radical Political Economics, Vol. 16, 1984, pp. 57 ff.

[39] Martin Bronfenbrenner, op. cit.

Germany, had profited without sharing the cost of stimulating economic activity; they had simply hitched a ride on the train being pulled by the USA locomotive: "It is now allegedly time (1978-79) for these trading partners, Japan and West Germany above all, to cease international free riding and assume the locomotive roles which they have shirked. They can thereby assist both the American and the world economy, and encourage the United States to continue its own locomotive activity by sharing its cost."[40]

It is indicative that recourse was not taken to the "locomotive theory" until a situation had arisen in which *firstly* all the (major) national economies were in a cyclical downturn simultaneously and thus an expansionary national *economic policy* to stimulate the economy was needed, in other words when asynchronous national economic cycles had nothing more to offer, *secondly* expansionary impulses in one country could spread to other national economies as a result of world market integration and *thirdly* the dominant power was no longer performing its regulatory function to safeguard the institutional framework for rapid growth. The underlying problem is therefore very simple, and concerns the manner in which *national* (Keynesian) economic policy operates in the fully developed economic context of the *world market,* in other words when "a simple Keynesian multiplier process (is) modified by explicit consideration of leakages through imports . . .".[41] On that supposition, a series of technical questions arise as to the working of the "locomotive" mechanism: these concern the relative size of countries participating in the "train" (as "free riders" or "paying riders"), the savings ratio of each of these countries on which the magnitude of the multiplier depends, the level of autonomous expenditure and the use to which it is put (investment or consumption), and the price and volume effects and income elasticities of imports and exports. The locomotive's pulling power is limited in any case if "the locomotive countries seek to promote expansion mainly by means of export promotion, which is not an unusual occurrence. This is more likely to result in a relocation of employment or in the export of unemployment than in a general improvement in the global level of employment".[42] Rothschild adds that this is none other than a modern variant of the beggar-thy-neighbour policies of the thirties. Admittedly this also applies if domestic consumption and/or investment are increased. If demand is directed towards imports, it can lead to an increase in employment in the exporting country and thus imply a reduction in employment in the locomotive country. The "free rider" stance is therefore the equivalent of beggar-thy-neighbour policies in a world economy in which there is little or no *overall* growth in output and employment. This could also be examined in the light of the expansionary economic policy of France in 1981-82, whose failure was due not least to the fact that its impact was "transnationalised", benefiting German exporters, and hence output and employment in Germany, rather than boosting production and employment in France, a consequence of the inadequacy of national economic policy in the global, or even merely European, context of the world market.

Global Keynesianism

If economic cycles are synchronised, thereby indicating that national economies have become mere segments of a single world market, there will inevitably be either the problem of beggar-thy-neighbour policies or that of "free riding" as long as expansionary fiscal and monetary policies can be applied by only one nation state and not by all together, in other words as long as international economic policy co-ordination is either lacking or inadequate. Despite the "economic summits" of the leading industrialised countries, the national economic policies of the countries involved are not geared to the working of the system as a whole, a sign of lack of hegemony and the breakdown of consensus. The co-operative playing of the game according to the rules of the post-war order is therefore a thing of the past.[43] Many analysts of the current crisis in the world market are logically seeking a solution by proposing a "global Keynesianism", which would come about by means of informal (trilateral) co-operation among the major industrial countries[44] or the establishment of a world central bank and the creation of a new monetary system with fixed exchange rates.[45] Scharpf[46] is of course right to acknowledge the economic feasibility of global Keynesianism while taking a very sceptical view of the "political and institutional chances of

[40] Ibid., p. 39.

[41] Ibid., p. 40.

[42] Kurt W. Rothschild: The Neglect of Employment in the International Economic Order, in: The Annals of the American Academy of Political and Social Science, July 1987, pp. 49-60, here p. 59.

[43] Ricardo Parboni, op. cit.

[44] Helmut Schmidt: Eine Strategie für den Westen, Berlin (West) 1986.

[45] Wilhelm Hankel: Die aktuelle Finanzkrise – Vor dem Debakel? Oder vor einer weltwirtschaftlichen Vorausverteidigung der Vollbeschäftigung?, in: Gewerkschaftliche Monatshefte, Vol. 39, January 1988, pp. 1-14; Jan Priewe: Eine internationale Wachstumsstrategie als Alternative, in: Blätter für deutsche und internationale Politik, December 1987, pp. 1537-1539; Kurt W. Rothschild, op. cit.

[46] Op. cit., pp. 319 ff.

implementing these reform proposals".[47] His assessment merely takes account of the fact that the context for economic activity has been globalised in all respects since the seventies but the jurisdiction for political action remains national. The "functional range" of political regulatory instruments and institutions no longer matches that of economic activity. In the scope remaining for national policy-making, countries therefore attempt to concentrate on a package of measures aimed at bringing about "economic adjustment" to world market conditions in order to improve their "competitive position".[48] The options open to them range from offensive to defensive protectionism, depending on their political resources in the global economy.

Expression of Helplessness

While the USA enjoyed undisputed hegemony, it could perform the necessary regulatory function, which was less onerous than now because the world market was not fully developed in all aspects and especially because countervailing movements in international credit could be ignored. Today it would have to be empowered to carry out more complex regulatory functions without the benefit of economic supremacy. Regulatory *requirements* and regulatory ability are therefore moving in opposite directions, not a particularly good social and institutional basis for global Keynesianism, however it may be shaped. Moreover, if interest-bearing capital is also internationalised, the scope for asynchronous economic cycles will be limited, since international liquidity can be flashed from one point to another in a matter of seconds in order to take advantage of yield differences and expected exchange rate changes. The differences that make the locomotive effect possible are ironed out by the workings of the world *money* market or their effectiveness is reduced. Given the near-absolute internationalisation of the credit system, it is therefore a sign of theoretical and practical helplessness that countries such as Japan and Germany are being exhorted to assume the role of locomotive in the world economy *without at the same time* considering whether and how the international credit system can be brought under political control in order to prevent offsetting capital flows ("capital flight" from countries with low interest rates).

Summary

The much-discussed protectionist malaise in industrialised and developing countries is therefore associated both with a trend towards stagnation in the world economy and with the erosion of a system for the political regulation and protection of free trade by the dominant power, the USA. The chances of restoring a hegemonical order are not very high at present. The financial instabilities that persist in the form of the Third World debt crisis and which erupted in the stock exchange crash of October 1987 – an event that could be repeated at any time – cannot be combated until the USA significantly reduces its budget and current account deficits. Paradoxically, however, the deflationary effect of eliminating the budget deficit would initially exacerbate the situation. It would appear that Sweezy and Magdoff are right, when they state that, "Today's capitalism . . . can't live without the deficits and it can't live with them".[49]

Eliminating the trade deficit – an essential step if the USA is to finance the servicing of its external liabilities with its own resources rather than with yet more foreign loans – raises still greater problems. Apart from the domestic structural shifts in demand (from consumption to saving) and production (to improve the country's "competitiveness"), the switch from a trade deficit to a trade surplus would force the rest of the world to import a massive volume of US goods instead of exporting to the USA. The ability of Third World countries to service their debts would be permanently undermined. The consequences for US banks, which hold large portfolios of claims on debtors from the Third World, are easy to imagine. The reversal of world trade flows would in all probability accentuate the tendency for the world economy to stagnate, to the point of inducing a depression. "Dirty protectionism" could then escalate into a new trade war.

It therefore appears that the two deficits, however destabilising they may be, can be eliminated only at the cost of bringing the incipient global crisis to a head. This danger could be averted only by establishing a new international economic order and a new hegemony. It is rather unrealistic at present to suppose that nation states will combine in a co-operative project comparable with the Bretton Woods system after the second world war. However, the seemingly obvious notion that the approaching crisis can be avoided by resorting to the national options of offensive and defensive protectionism and constantly dealing oneself the best cards in a zero-sum game is even less realistic.

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[47] Ibid., p. 321.

[48] Roland Czada: The Impact of Interest Politics on Flexible Adjustment Policies, in: Keman, Paloheimo, Whiteley (eds.): Coping with the Economic Crisis, London, Newbury Park, Beverly Hills, New Delhi 1987, pp. 30 ff.

[49] Paul M. Sweezy, Harry Magdoff: The Federal Deficit: The Real Issue, in: Monthly Review, April 1984.