

End of Globalization?

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Soft Banking Regulations are being blamed for the present American economic crisis. Treasury Secretary Henry Paulson and both candidates in the presidential race-Democratic Barak Obama and Republican John McCain have demanded stricter regulation of banks. Belief is that stricter regulation would have prevented banks from lending to sub-prime borrowers of doubtful credit and saved America from the present woes. This is a hollow argument. The fact is that the US Federal Reserve Board had encouraged banks to extend housing loans in a big way. Banks were merely following the guidance. The manufacturing and services sectors were slowing down about five years ago. The Fed tried to generate demand by adopting an easy housing loan policy. Banks lent heavily to sub-prime borrowers in absence of prime borrowers.

This much is correct that stricter regulation would have prevented giving out of these sub-prime loans. But that would have nevertheless led to a crisis in the American economy. Only the form would be different. Less housing loans would result in less demand for goods and services and America would have entered a recession much earlier.

Anyway the American banking system is in a crisis. The Government has made a huge \$700 billion package to buy out loans of doubtful quality. Such a bailout will not lead to a solution to the present crisis. It will only involve transfer the present problem to future. It is more like changing the hats. The loss being presently incurred by the banks today will now be spread over the entire economy in future. The American people will have to pay higher taxes to provide the money spent in the bailout. This will only worsen the recession in future because consumers will face a heavier tax burden and will have less money left to buy goods from the market.

The question that must be asked is this: Why did the manufacturing and service sectors show signs of recession in the first place? The culprit is globalization which has made China and India develop a winning combination of advanced technologies and cheap labour. Globalization has encouraged American companies to transfer advanced technologies to these countries. Take the case of hybrid cars. The energy lost during application of brakes is conserved in batteries and used later to run the car. America could have lowered its cost of production had this technology been its sole preserve. The production of a T-Shirt requires two inputs-hybrid car and labour-both valued at Rs 10 each. Now the use of hybrid technology leads to reduction of cost from Rs 10 to Rs 6. Then American companies can pay Rs 14 to their workers making T-Shirts and still sell the T-Shirt at Rs 20 and remain competitive against India. The gains from advanced technologies can compensate American companies for the higher wages paid to the workers without affecting their global competitiveness. But hybrid technology is transferred to India, courtesy globalization. The cost of making a T-Shirt in India is, therefore, Rs 12-Rs 6 for hybrid truck and Rs 6 for wages. In the result American manufacturer cannot withstand competition from an Indian competitor. This is the main cause America facing recessionary tendencies few years ago.

The Fed adopted the policy of easy housing loans to deal with this problem and landed the US into the present banking crisis. Now the US Government is making a huge package to bailout the ailing banks. This is contra the principle of free market that was espoused by that country till recently. Thus commentators are saying it marks the end of free-market capitalism and start of a new era of state intervention in economy.

No doubt market will continue to rule because it is helpful in securing efficient production. The problem is that a global market leads to low wages equal to the global minimum. Reduction in wages of American workers is leading to less demand in the American market and causing onset of a recession. This problem cannot be solved within a global market. The first proposal is to raise statutory minimum wages. Higher wages in America will lead to higher cost of production and American companies will be priced out of the global market. It will be possible to produce the same T-Shirt with cheaper labour in Mexico and India and import it into the United States because globalization allows nearly duty-free import of goods. Second suggestion is for the US Government to increase incomes of American people by welfare programmes like Food Stamps in America or India's Employment Guarantee Programme. But raising revenues for such programmes will necessitate imposition of higher taxes on American companies and place them

at a disadvantage vis-a-vis foreign players in India, for example. Third suggestion is that restrictions may be imposed on outsourcing of services by American companies. This will result in American companies employing expensive American workers to provide these services, it will lead to an increase in their cost of production and price them out of the global marketplace. There is no happiness for America within globalization.

The demand for abandoning globalization and embracing protectionism will soon start making waves in America. Then it will become possible for the US Government to secure an increase in incomes of the American workers. The Government can raise minimum wages in a protectionist environment. The resulting increase in cost of T-Shirt will be borne by the American consumer because cheaper T-Shirts produced in Mexico will not be allowed entry. The US Government will then also be able to impose higher taxes on US companies and use the revenues to run welfare programmes. American companies will be able to pass the burden of higher taxes to the consumers because they will not be facing competition from companies located abroad in low-tax areas. Restrictions on outsourcing will also bear results. American companies will be able to pass the higher costs to the consumers. The present crisis will, therefore, ultimately lead to adoption of a protectionist stance.

Globalization necessarily involves global equalization of wages to the global minimum. Till recently this tendency was counteracted by the development of advanced technologies in the US. Globalization has taken away this technological advantage from the American economy even if it remains with American companies. Thus wages of American workers have to decline in a global economy. The only way to prevent this is for America to embrace protectionism. Incidentally the same applies to India. Raising wages in India will require restricting imports from low-wage countries like Bangladesh. □□□