

Calcutta Notebook

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COMMERCE MINISTER ANAND Sharma has called for countries across the globe not resorting to protectionism to solve their woes due to the ongoing economic slowdown. Mr Sharma is ignoring the growing worldwide backlash against globalization. White collar workers in industrial countries are losing their jobs to cheaper workers from India and China. Services such as research are now being outsourced because scientists in the developing countries are cheaper. On the other hand workers in the developing countries are finding that their wages are stagnant while inequality is rising.

The belief was that free trade leads to efficient production and also forces domestic government to reduce corruption. This provides relief to the people. The businessman has to pay money to the local thugs and politicians in a situation of bad governance to avoid trouble. The government officers have to be paid bribes to buy peace and avoid harassment. For example, a boiler inspector can shut down the plant for fifteen days on frivolous grounds if he is not appeased. The money paid to politicians and officers is added to the cost of production by the businessman and he has to sell the cloth at say Rs 25 a metre instead of Rs 20 a metre which it otherwise costs to produce.

The cost of production of similar cloth in other countries having good governance, however, remains low because they do not have to pay money to politicians and officers. The cost of other inputs such as cotton, machines and chemicals remains same in all countries because of free trade. Cloth produced in Bangladesh will conquer Indian markets if the cost of production in that 'clean' country is Rs 20 and is Rs 25 in 'corrupt' India. Textile mills in India will have to down their shutters. Ultimately, Indian politicians will have to reduce the money they extract from the businessmen failing which they will be killing the hen that gives golden eggs.

The same applies to inefficient businessmen. Say the Indian textile mill makes seven metres cloth from a kilo of cotton while the Bangladesh mill produces ten metres because the looms of the Indian mill are old. Globalization will force the Indian businessman to install latest looms in order to survive. This will provide good and cheap cloth to the Indian people. True Globalization begets clean governance and efficient production but the difficulty, however, is that free trade also works in the labour market. Say Bangladesh and India both have clean government and the cost of production of cloth in both countries is Rs 20 a metre. The wage rate in Bangladesh is Rs 150 per day. The Indian businessman will not be able to pay more than this rate to his workers otherwise his cost of production will increase and he will be ousted from the market. The country paying lowest wages wins in free trade. Free trade leads to equalization of wages rates to their global lowest levels. This decline in wages nullifies the benefits from good governance and efficient production.

No wonder workers in the industrial countries are opposing free trade and outsourcing. The software programmers are finding their wage rate declining as technology makes it possible to transfer huge amounts of data at the click of the mouse. The wage rates in most developing countries are also stagnant. Workers in East Asian countries are seeing their wage rates decline due to competition from less paid Chinese workers.

Free trade works as a two-edged sword. On the one hand it leads to clean governance and efficient production but on the other hand it leads to lowering of wage rates to their global minimum.

What is the solution to this problem? How can the benefits of free trade be secured while creating higher wages for the workers? Protectionism enables the domestic prices to remain higher than the global prices. These higher prices can be used to support corruption, inefficient production or higher wages. The solution comes from using protection not for corruption or inefficient production but for higher wages.

Suppose India was to impose an additional tax of Rs 5 per metre on cloth imported from other countries. The price of cloth in Indian markets will become Rs 25 instead of Rs 20 earlier. This margin can be taken away by corrupt politicians and officers; or it can be used to maintain inefficient production in obsolete mills; or it can be used to raise wages of the workers. The ability lays in avoiding the first two uses and promoting the third. If the government establishes, say, a spy system to trap corrupt politicians and officers; promotes domestic competition to avoid inefficient production; and implements policies that lead to higher wages, then this protectionism becomes pro-people.

Free trade is necessarily anti-people because it leads to low wages even if provides good governance and efficient production. Protectionism can possibly be pro-people if applied correctly.

What about exports, though? It is possible to prevent cheap imports from other countries by imposing import tariffs. But how will exports be made if the domestic wage rates are high? The solution is to use the receipts from import taxes to provide export subsidies to labour-intensive products. The higher cost due to high wages can be neutralized by the subsidies.

It is clear that free trade will not lead to the welfare of the people anywhere in the world. Protectionism makes it possible to secure people's welfare but only if applied correctly. But bad protectionism that supports corruption is worse than free trade. The challenge is to embrace good protectionism, Mr Sharma. □□□