ECONOMIC POLICY FOR A STABLE WORLD ORDER

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Introduction

It happens often that you prepare a paper or a talk for a conference and before you get to deliver it, all your main topics and even particular ideas have already been discussed. Normally it is not so much infuriating perhaps as saddening, an incontrovertible proof of your own lack of originality. Today, however, I derive only satisfaction from it. Planning this talk, I decided to elaborate several ideas I retained from a brief discussion with Bob Weintraub at the last conference he attended, in Geneva, last summer. So it is pleasing to see to what extent this has become truly his conference, with his last intellectual concerns on the minds of us all.

The conversation I referred to had been about the responsibility of a few large countries for an international economic order in which numerous small countries must try to succeed. He and I talked about how badly the large countries were discharging this responsibility. Today we are seeking a solution to the debt problem in an international system that is about to give out at the seams because the large countries have not been good guardians of it. The debt problem is only one symptom of this failure, but it may be the culmination of an acute systemic crisis.

From an institutional perspective, an international economic order consists of little more than two sets of arrangements—or better, com-

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mitments *exchanged among governments—concerning* the national conduct of monetary and trade policies. These two national economic policies have direct and obvious repercussions abroad. They are also the two policies that governments will find it most difficult to pursue in the interest of their societies at large; since governments will be continuously pressed and tempted to act on behalf of organized special interest groups. The monetary commitments and rules focus on maintaining currency convertibility, while trade policy rules typically aim at ensuring stability of trading conditions. Their main task is to limit protection to tariffs which can be bound against unilateral (unnegotiated) increases. The two sets of policy rules must be carefully dovetailed, because over a broad range of situations restrictions on payments and on trade are close substitutes.

When rules of this kind are in force and observed in at least several of the large economies—so that currency convertibility coexists with price level stability in these economies, and exporters in all countries have equal and stable access to at least these few large national markets—an efficient world market (an international price system) can be said to exist. The relative prices formed in this market will promptly transmit information about incipient scarcities and surpluses anywhere in the world economy. This information is indispensable for timely adjustments in the structure of national economies. The world price system thus allows major economic changes to be anticipated in all societies. The future does not have to arrive in the form of surprises and upheavals.

It is the erosion of this world market order, in its most fundamental functions, that I want to emphasize. The difficulties experienced on the monetary side of it—inflation and highly variable interest and exchange rates—are the main topic of this conference. Clearly, the origin of the debt problem lies in this conference. Clearly, the origin of the debt problem lies in this nexus of inflation, interest and exchange rates. The story can be told in different ways depending on the predilections of the teller. I personally side with those who emphasize the recent history of the dollar exchange rate. But the picture is incomplete without bringing trade into it, the "real" side, as economists call it, of the world economy.

It is not a reproach to my colleagues specializing in monetary analysis to note that the theorizing about inflation, interest and exchange rates proceeds, and cannot but proceed, on the assumption of a reasonably competitive world economy, in which disturbance and uncertainty arise mainly from monetary policy. If such a competitive system did exist, I am convinced that real exchange rates would be, not perhaps perfectly stable, but certainly much more so

than they have been in the last decade. To explain their observed instability, we have to take into account the systemic impairments on the real side of the economy—the great *recent* deviation of reality from our competitive model.

What Remains of the Price System?

It is trade that connects the national price systems into an international one. The most important information processed by the national price systems is about developments abroad. When, therefore, I talk about protection and the growing inhibition of trade, I am only secondarily concerned with the direct contribution of trade to GNP (for example, the employment effect of exports, specialization, productivity, etc.). Primarily I have in mind the essential role of trade in creating and maintaining an international price system. For that reason, too, I find it difficult to work up much interest in tariffs, which both history and theory show to be quite innocuous protective devices, at least when stabilized. Once in place, they do not interfere with changes in relative prices. My main concern is with quantitative restrictions, which have the effect of paralyzing the price system in their area of application.

Most of you are aware of, and I dare say worried about, the recent growth of protectionism. But I dare say, too, that most of you still consider protection to be more of an exception than the rule. To be sure, it is very difficult to come up with any reliable quantitative indications in this area.[1] Nonetheless, there exist several independent estimates of the proportion of world trade that encounters obstacles of a more severe kind than just tariffs. François David (1983, p. 225), a senior official of the French Ministry of Trade, estimates that between 55 and 60 percent of world trade is subject to nontariff restrictions. Sheila A. B. Page (1981, p. 29), of the National Institute for Economic and Social Research in London, has come up with a figure of 48 percent. My own research indicates between 40 and 45

[1]The main obstacle is posed by the unavoidable task of averaging. There is a large number of protective devices in use, secret bilateral agreements being increasingly preferred. But even if we had information on all the restrictive devices in use, for a meaningful average we would also have to know their *degree of restrictiveness*. Thus in averaging, each item in the array of devices would have to be weighted by the amount of imports *it keeps out*, an unobtainable measure. Furthermore, indicating the extent of protection by the proportion of world trade under restrictions more severe than tariffs is a misleading measure because when world trade grows and the restrictions measured are indeed restrictive, the proportion of trade under them will be declining from year to year.

percent of total trade, and between a fifth and a quarter of world trade in manufactured products, to be similarly restrained in 1982.

Trying to estimate the extent of protection leads to endless disputes, methodological as well as political. We can avoid them by pointing out that, in the present context, we are interested not in protection as such, but in the degree to which it impairs the price system; that is, the degree to which it reduces the amount and value of the information the international price system is allowed to transmit. In this respect, it can be shown that the above estimates substantially *underestimate* the damage. First, all of the above estimates of protection disregard subsidies. Subsidization, however, has become in the last decade another major cause of distortion in international prices. Second, it is seldom that all trade in a particular product will be controlled by quantitative restrictions. But even if only the trade flows from the lowest-cost sources are so controlled, the rest of international trade in that product, which is not included in the estimates (and which may be by far the larger part of international exchanges in that product category), will be transacted at distorted prices.

If the magnitude of the estimates of nontariff restrictions seems fantastic to you—and I would not be surprised by that reaction—try a mental experiment. Try to enumerate all the industries in which pricing is determined or at least strongly influenced by deliberate policy rather than by the market. The list would begin with crude oil, the price of which is the main determinant of all energy prices; it would include almost all of the temperate zone's agricultural products, and those products of tropical agriculture that are subject to commodity agreements; it would also include textiles and clothing, an industry which is fiercely competitive in every nation but in which prices in the industrial countries are effectively shielded from the competition of low-cost producers in developing countries; iron and steel, an industry which is highly concentrated on national levels and, for the time being, also effectively cartelized internationally. In automobiles, Western industries are securely protected by quantitative restrictions against the world's most efficient producer, Japan. Large segments of the petrochemical industry are cartelized, and quantitative restrictions also proliferate in such minor areas as TV sets and tubes, ball bearings, batteries, and computer hardware. In addition, acrimonious negotiations and outright power plays continue as to where the most promising new products are to be manufactured. One is thus justified in asking: What remains of the price system?

When the price system is paralyzed or distorted to this extent, when so many prices are prevented from finding their own proper

levels but the exchange rates are free, is it surprising that the latter move erratically? With the price system so extensively impaired, there simply is not enough information to make possible a smooth adjustment of exchange rates to purchasing power parities.

Indeed the difficulty for the economist may now lie in explaining why the world economy still functions at all, however dissatisfied we may be with its functioning. The answer is, of course, that there is a lot of ruin in any economy with a modicum of freedom. I am sometimes unsure whether it is actually an advantage of the capitalist system that it can take such an enormous amount of beating. If it were in the habit of collapsing more frequently, we would perhaps govern ourselves more prudently (and more cheaply to boot). But that is neither here nor there. We want to see how the guardians of the system, the governments of the large countries, react to its deepening crisis.

Pitfalls of the Negotiations Approach to Trade Liberalization

Important statesmen are issuing calls for a "new Bretton Woods" conference and for a new round of multilateral trade negotiations, which suggests that they are aware of the existence of a crisis. Do they really imagine that it can be resolved by a negotiated agreement, some 90 to 120 governments achieving unanimity in some vast conference room in New York or Geneva on what has been wrong with the world? Perceptions of national interest now differ so much that the conclusion most likely to be agreed upon would be, in the words of Henry Simons, that "nothing should be done about anything until everything has been done about everything else" (1948, p. 325).

A very small number of large countries accounts for the bulk of international trade and a smaller number still for the bulk of international lending. True, there are benefits from expanding the number of countries willing to abide by agreed policy rules, but these benefits decline at the margin and beyond perhaps 10 or 15 countries they begin to fall off sharply. You get to the very small countries rather quickly. At the same time, the costs of expanding membership rise no less steeply. These costs are counted in terms of the growing difficulty of agreement and the growing vacuousness of the rules, as they are eroded by diplomacy. Universal membership systems invariably tend either toward the lowest common denominator in matters of principles and rules or to an untenable arrangement between groups of countries with different rights and obligations, some having more rights than obligations and conversely for others. In particular,

the tendency will be strong to build into universal membership systems mechanisms for international redistribution of income and wealth, and this is certain to interfere with the regular exercise of rights and the performance of duties required by a stable international order.

It is therefore difficult to consider these calls for reforming the world by a common effort to be an exercise of international responsibility. I am rather inclined to consider them a flight from responsibility. "Let us call a world reform conference and if it fails, as it most likely will, we shall have demonstrated not only our concern and our will to reform, but also that a real reform is impossible." Take the debt crisis as an example. The creditor countries are hiding behind the International Monetary Fund and are urging the Fund to use its leverage to press the debtor countries to liberalize their imports, or at least to restrain them from imposing further import restrictions. This is not a bad idea in itself, but I fear that the Fund will not be able to support the overload of hopes placed upon it. For what is expected from it is, in short, that it will make good debtors out of bad ones singlehandedly—without the creditors having to change their own policies one bit. (Except, perhaps, for creating more money through enlarged IMF quotas, as if they did not have enough of an inflation problem.)

There is no doubt in my mind that the debtor countries should, for their own good, liberalize their import policy along with other domestic policies. What astonishes me is the political naiveté, and the shortsighted selfishness, of putting this advice in the form of a demand or a condition. To state my thoughts on the issue more precisely, a resolution of the debt problem which is satisfactory to both sides—or at least minimizes the risk of some form of an open crisis—requires some combination of two general policy approaches on the part of the debtor countries: macroeconomic tightening and microeconomic liberalization.

Policy Requirements

Macroeconomic tightening is required because a credit crisis is, as the word *credit* itself suggests, a crisis of confidence. When the ability to service the debt has been demonstrated, confidence returns and credit becomes available again. How long the demonstration takes—that is, how long the debtor countries have to show a current account surplus or at least go without a deficit—nobody can say at the moment. But we can say with some confidence that the domestic effects of the macroeconomic tightening necessary for the demonstration will

depend on the extent of the simultaneous microeconomic liberalization. In particular, the level of unemployment prevailing during the austerity period will be inversely related to the extent of liberalization.

Politically speaking, spontaneous liberalization on the part of the debtor countries is nowhere in sight. This is an unpropitious time to preach unilateral *aperatura* policies to Latin America. They were tried and, despite considerable initial success, ended badly—sunk, so to speak, in the exchange rate waves made by the large countries. But it is too late for sermons for other reasons as well.

When international trade discipline collapses, and almost any industry in any country can obtain additional protection practically for the asking, producing for export becomes singularly unattractive. An instance of getting protection for the asking was the widely publicized cave-in of the Reagan administration before the textile lobby last November.[2] The industry obtained more than it had even dared to hope for, and is now on its way to realizing its old dream, a guaranteed share of the national market. This is just the most recent example—an all too typical Washington confrontation, with all the drama of a resistible force meeting a movable object.

Under these conditions, uncertainty itself becomes a highly effective trade restraint, even in markets which are technically still open. It obviously takes a much greater degree of macroeconomic pressure to push exports in such a situation than under conditions of guaranteed market access. Let us not forget, either, that the private sector is now the minority sector in all the most indebted economies (which goes a long way toward explaining their debt problem), and that the public sector is notorious for its capacity to evade macroeconomic cutbacks. The private sector thus has to bear the brunt of the monetary and financial tightening and, notwithstanding what I have said about its capacity to take a beating, there are limits to everything.

Finally, consider the purely political effects of the contrast between the policies demanded of the debtor and those in force in the creditor countries. Preaching free trade to unresponsive listeners, I am reduced to envy thinking of the vast and impassioned audiences which the marxist preachers of all kinds of financial conspiracy theories are enjoying in the debtor countries—whose governments are being urged to liberalize while their creditors are increasing protection! Politically this means that the creditor governments are not alone in

[2]See Pine (1983a, 1983b, 1983c, and 1984) for a discussion of current changes in U.S. textile policy.

thinking along mercantilist lines. The debtors think that way too, only more so.

If there is to be a liberalization of import as well as domestic economic policies, to provide the dynamic impulses capable of offsetting the employment effects of the unavoidable austerity, the creditor must meet the debtor countries half way. This would do more than merely help the latter to service their debt because, apart from the outstanding IOUs, the economic-political problem is much the same on both sides. The creditor countries, too, face the necessity of fiscal and monetary restraint—and they, too, are looking for ways to offset the temporary effects of the tightening. Basically they know already that the only way to stabilize their own economies is to allow the market to play a larger role, to restore the international price system, and to shrink the public sector relative to the private sector. Their only problem is how to do it, how to get there.

The governments of all Western democracies know that the conception of economic policy, of the government's role in the economy, that guided them through the 1960s and a good part of the 1970s is dead. Under that conception, unemployment was considered worse than inflation; the government viewed itself as the vanguard of progress, leading the private society into the future; and consumers, businessmen, and financial agents were regarded as a pack of Pavlov's dogs duly salivating and otherwise appropriately reacting to the signals of the scientific policy maker at the center.

Economics as a professional discipline has been recovering from this intellectual blight for some two decades. It is now becoming generally accepted in the profession that the only policies whose consequences an economist can hope to predict are policies generated by relatively permanent and widely understood rules. On what may result from policy improvisation which changes from quarter to quarter, the economist can speak with no more authority than the average chatty drinker in your neighborhood bar.

For governments, abandoning long-held fallacies is difficult even when they have been perceived as such. Governments embody social authority and whatever they do is a precedent, binding or at least influencing their future actions. Involved as they have become in the impossible responsiblity of guiding large, complex and still largely free economies into the future, they can only zigzag. Can one be surprised if, forced to zigzag, they also try to cut corners? As international economic policy conflicts multiply, their settlements are improvised under pressure and often in ways that raise legal doubts. It is no exaggeration to say that the increasingly conflictual nature of

international economic relations has begun to erode the integrity of national legal systems.

It is on the background of these developments that the need for a serious trade liberalization may be fully understood. A speedy agreement on trade liberalization can only be achieved among a limited number of countries. Why not among the major creditor and debtor countries, who have the most at stake here? The results of their agreement could then be generalized to all other countries by the unconditional most-favored-nation clause, and additional countries could join the negotiation later. A reduction of obstacles to trade and a more rapid expansion of international exchanges, of course, would contribute to financial stabilization. Yet even at this stage these financial effects must be considered only secondary benefits. On the face of it, trade restrictions protect particular industries and interest groups. In the last respect, however, they protect a particular conception of economic policy, of the government's role in the economy, and a particular form of politics, all of which are at variance with constitutional prescriptions.

The Threat to Democratic Constitutions

We can no longer overlook the threat to democratic constitutions from an excess of government's "responsibility" for the economy of its people. Democracy is, after all, only a political method of accommodating change without a revolution. It must therefore rely mainly on procedural rules and have only a minimum of substantive and discretionary content. When the state comes to be so involved in the processes of society that it becomes the necessary support of the existing economic and social structures, it has become identified with the *status quo*. Then, of course, the basic function of democracy—change without upheaval—has become undischargeable.

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