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MERCANTILISM AND TRADE POLICIES IN THE 21ST CENTURY: DO THE TWAIN MEET?

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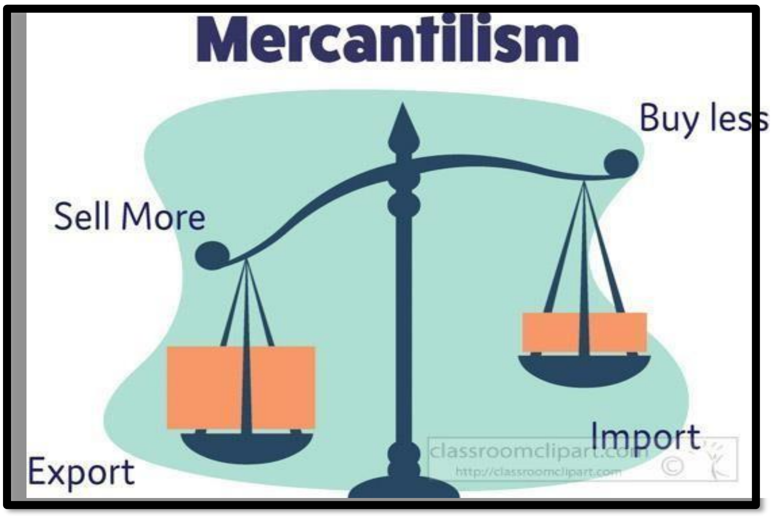
ABSTRACT

Mercantilism argues for government regulation in the economy (especially in trade) to make the nation more powerful at the expense of other nations. This economic theory was in vogue in Europe from the 15th-18th century after which it was replaced by the theory of free trade. But despite continuous efforts by supranational organizations like WTO to liberalize trade, countries still show a pro-export and anti-import attitude. This has been labeled as neo-mercantilism by economists and it is expected to increase further as countries recover from the covid-19 pandemic.



INTRODUCTION

The word "mercantile" means merchant or trader and mercantilism refers to the theory of international trade which advocates for regulation of trade via protectionist trade policies. Popular in Europe during the Age of Discovery (15th-18th Century), mercantilism was based on the belief that international trade follows a zero-sum game i.e. during trade, one country loses while another gains. Therefore, a nation should always try to minimize its exports and maximize its exports.

Mercantilism was based on the belief that the power of a nation is determined by its stock of wealth (i.e. gold, silver, and other precious metals). Gold was needed to maintain a large army for the expansion of the domestic empire and the lack of gold would inevitably lead to the nation's demise. The total stock of gold was assumed to be constant and countries followed the fixed-exchange-rate system. An excess of exports over imports led to net accumulation of wealth from the rest of the world while an excess of imports over exports meant sending wealth, and hence power, abroad. Therefore, mercantilists were in the favor of using government regulations to ensure a positive trade balance.

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Tariffs and quota restrictions were imposed to restrict imports and subsidies were given for promoting exports.

Moreover, a large population was considered necessary to maintain adequate labor supply, ensure a large domestic market and a huge army. More people meant a more prosperous nation and therefore emigration of skilled labor, capital, tools, etc was prohibited. Colonization was another way in which mercantilism was practiced. Cheap raw material acquired from colonies was converted into final goods by colonialists and was then sold back to the colonies at a profit.

Mercantilists believed in the need of government action to promote the development of the capitalist system. Hence state monopoly was granted to the firms associated with shipping and trade. To increase the efficiency of the domestic industries, government invested heavily in research and development and allowed copyright/ intellectual theft from foreign companies.

Thus mercantilism, which became popular with the advent of industrialization and capitalism, was a sort of economic nationalism in which government and merchants worked together to generate a trade surplus. Merchants needed the support of the national government to beat foreign competition and when domestic businesses dominated the global market, the government benefitted from the increased tax collection and a current account surplus.

Mercantilism, therefore, was very different from the agricultural system of Physiocrats which it had replaced, and the system of laissez-faire which replaced it.

SOME EXAMPLES OF MERCANTILIST TRADE POLICIES

Mercantilism was practiced from the 15th-18th century in the form of protectionist trade policies and colonialism. It became very popular in European countries like Britain, France, Spain, Portugal, etc which were the economic and military superpowers at that time. Some examples of mercantilist trade policies are:

- **British Navigation Act, 1651 -** Only British ships (with a British owner and British crew) could be used for carrying the goods which were traded between England and its colonies. Foreign vessels were not allowed to engage in coastal trade in England. **Staple Act, 1663** further mandated that all colonial exports to Europe had to land at an England port first and only could then they could be re-exported to Europe.
- **Corn Laws (1815-1846) –** Heavy duties were imposed on the import of corn in UK to protect the domestic producers.
- **British East India Company (BEIC) –** British Parliament granted the monopoly of the right to trade with India to the BEIC. The BEIC eventually defeated the Indian princes with support from the British army.
- **Colbert-ism –** It refers to the mercantilist policies implemented in France in the 17th Century. E.g. Introduction of tariffs, increase in public works programmes, setting up of French merchant navy to boost exports, etc.
- **Colonialism –** Mercantilism led to a scramble for colonies in Africa, colonialism of India under the British, etc. E.g. under the British rule, India was not allowed to manufacture salt and had to import it from UK which later led to Dandi March by Gandhi ji.
- **The Great Depression, 1929 –** Protectionist trade policies resurfaced post the Great

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Depression as countries tried to reduce the value of their domestic currency to make exports more competitive. For example, when U.S.A. increased tariff on 20,000 goods under the Smoot-Hawley Act, 1930, other countries retaliated. As a result, global trade shrunk by 66% by 1933.

THE END OF MERCANTILISM

Mercantilism was replaced by the Classical school of thought with Adam Smith's "The Wealth of Nations" (1776). In contrast to mercantilism, classical economists emphasized that the wealth of a nation is determined by real factors like the stock of labor, the stock of capital, and the state of technology; and not by the finite stock of precious metals. Smith and Ricardo further argued that free trade is a positive-sum game. Foreign trade is mutually beneficial when each country specializes in the production of that good in which it has a comparative advantage. Classical economics also stresses the optimizing tendency of a free market in the absence of state control. Government regulations and monopolies benefit only the government and the capitalists, ultimately leading to corruption and inefficiency in the economy while a free market or laissez-faire system benefits the whole population.

Therefore, a new world order of multilateral free trade came into being with the signing of GATT (General Agreement on Tariffs and Trade) in 1947. Since then, eight rounds of multilateral trade negotiations have led to significant trade liberalization with the setting up of the World Trade Organization (WTO) in 1995 further accelerating the process.

MERCANTILISM IN THE 21ST CENTURY (NEO-MERCANTILISM)

Though basic principles governing the mercantilist ideology are considered outdated now and countries today follow the comparative advantage model, but traces of mercantilism can still be found in the new world order. Mercantilism constitutes the foundation of protectionism and nationalism practiced in today's era of growing discontentment over the distributional impacts of globalization. Economists have labeled the modern anti- import; pro-export attitude of countries as "neo-mercantilism".

Today's premier economic policies like a floating exchange rate system, antidumping actions, countervailing duties, and regulation of trade in agricultural goods, textiles, steel, shoes, etc. to protect domestic employment are all examples of modern mercantilism. Despite the efforts of supranational organizations like the World Trade Organization, non-tariff barriers continue to exist. Developed countries often restrict imports from developing countries on the pretext of poor packaging standards, use of child labor to make a product, etc while the developing countries retaliate by arguing that economics should be kept separate from social issues. Some country-specific examples of neo-mercantilism are:

CHINA

- **Under-valued Exchange Rate** - China has been following the model of export-led growth by keeping its exchange rate undervalued (which makes exports more competitive) by buying foreign currency assets.
- **Subsidies to Industries** – China gives a state-sponsored subsidy to various industries (lie Steel industry) which has led to a glut in the supply of steel thus lowering its price. In retaliation, other countries have imposed a tariff on the import of Chinese steel to protect domestic producers from unfair competition.
- **Copyright theft –** It is rampant in China.

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- **China-Australia Trade War** - China recently imposed high tariffs on the import of beef, barley, wine, etc. from Australia in response to Australia's demand for an independent inquiry into the origin of Covid-19.

USA

- **Restrictive Immigration Policies** - Mercantilism is against immigration as immigrants take away the jobs meant for domestic workers. Trump's anti- immigration policies like a decline in the grant of H1-B visas to highly skilled foreign nationals and renegotiation of NAFTA to increase immigration restrictions, etc were all based on the same argument.
- **USA's Exit from the Trans-Pacific Partnership** (a trade alliance of Asian nations) – Trump's preference for bilateral trade agreements over multilateral trade agreements and his preference towards expansionary fiscal policies (like tax cuts to support businesses) were all signs of mercantilism.
- **US-China Trade War, 2018 –** USA under Trump imposed tariffs on imports from China citing concerns over slave labor. China retaliated by imposing tariffs on US imports. China wants technology transfer from USA before opening its domestic markets to US firms.

INDIA

- **India's 'Aatmanirbhar Bharat' Plan –** While recovering from the Covid pandemic, India is also aiming to become self- reliant by following an import substitution strategy to reduce its dependence on foreign countries. Focus is also on promoting Indian brands by becoming 'Vocal for Local'.
- **Ban on Chinese Apps** - India banned around 177 Chinese Apps in 2020 after increased tensions on border citing concerns related to India's security and sovereignty.
- **India's Exit from Regional Comprehensive Economic Partnership** – India opted out of RCEP to protect the interests of its domestic producers.
- **Mounting Foreign Exchange Reserves** – India's foreign exchange reserves are at an all-time high thus showcasing a pattern similar to that of China's neo-mercantilist strategies.

EUROPEAN UNION

- **Airbus Subsidies** –European Union was giving subsidies to Airbus that were hurting USA's aerospace industry. WTO allowed USA to impose counter-measures in retaliation.
- **Agricultural Subsidies –** Subsidies given by European Economic Community lead to the over-production of cereals, sugar, etc which are then dumped in the international market. This drives down the market price of key commodities and hurts the farmers in developing countries.

A MERCANTILIST WORLD ORDER POST THE COVID CRISIS

The Covid-19 pandemic is paving the way for a new mercantilist world order characterized by protectionism and de-globalization. Four major shifts are likely to shape the international trade:

1. **Shift from Market to State** - Government regulations which are biased towards domestic production are likely to increase. Subsidies introduced to recover from the crisis will have trade-discriminating effects and will be tough to reverse. Restrictions on cross-border movement of workers are likely to increase and the list of strategic sectors (which have to be protected from foreign competition due to national security concerns) will likely expand.
2. **National Unilateralism** – Countries might start acting against each other thus increasing the chances of copy-catting protectionism and tit-for-tat retaliation which will make global policy cooperation tough.
3. **Re-orientation of Global Value Chains -** MNCs are relocating their firms from China to elsewhere due to increased political risk and security concerns. The overall effect of this on-shoring/near-shoring/regionalization of value chains will be increased costs to both consumers and producers.
4. **Unstable Geopolitics –** International trade may suffer due to an unstable geopolitical environment centered on the US-China trade rivalry, an inward-looking and divided EU, etc.

CONCLUSION

Mercantilism is the use of state power to control domestic and international markets. The theory of mercantilism might be outdated but the economic policies of the 21st century still carry the undertone of mercantilism. Despite many limitations, mercantilist policies (which restrict free trade) are justified in the following cases:

- **Tariff in Retaliation to State Subsidy** - It is fair to impose a tariff to protect domestic producers from unfair foreign competition. E.g. tariff on the import of subsidized steel from China, subsidized Airbus from Europe, etc. is necessary and fair.
- **Protection Against Dumping** - Dumping occurs when firms sell their products at artificially low prices in a foreign market thus hurting domestic producers. Protectionism is justified in this case. E.g. dumping of agricultural commodities by the European Economic Community, dumping of steel by China, etc.
- **Infant Industry Argument –** Imposition of tariffs etc. is justifiable when the domestic industry is at a nascent stage and hence can't survive foreign competition. When the industry has developed and can accrue benefits of economies of scale, protectionist policies should be removed.

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