# The Pitfalls of Growth Under Unrestricted Trade*

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The French economist J B Say had believed that there could never be a problem of aggregate demand in any economy, that whatever was produced was ipso facto demanded. There could of course be too many safety-pins and too few blades, but other than such micro mismatches, there could never be too little demand for the aggregate output as a whole. This assertion which is called "Say's Law" in economics is obviously an absurdity, because if it were true then there could never be an over-production crisis. Marx had pilloried Say's Law, and in the 1930s J M Keynes and Michal Kalecki, separately and almost simultaneously, also showed its logical infirmity. Bourgeois economics however, unwilling to concede any flaws in the working of capitalism, has sought assiduously to re-establish Say's Law through all kinds of dubious theoretical stratagems lacking any scientific merit.

The reason for recalling all this here is that every argument for free trade assumes the validity of Say's Law. In fact by assuming Say's Law implicitly if not explicitly, the "free trade" argument assumes that all economies experience full employment both before and after trade; all that trade does is that while keeping all resources fully employed in every country, it increases the total world output (since each country specializes in a sphere where it has a "comparative advantage"), whence it follows that free trade is beneficial for all countries.

But this proposition is obviously invalid, among other reasons because Say's Law is invalid. Capitalist countries generally do not experience full utilisation of resources, because of a shortage of domestic demand; and this is certainly true for the world economy as a whole. If the overall world economy is demand-constrained, then it follows that if one economy increases its level of output and employment through trade, then some other country must be witnessing a reduction in its output and employment, as a counterpart of this increase by the first country. It follows then that free trade, instead of being beneficial for all, entails a "rat race" among countries, where each tries to sell at the other's expense.

The growth strategy that neo-liberalism entails is therefore fundamentally ethically unacceptable; it forces third world countries to fight against one another, which is essentially a bourgeois strategy. Just as capitalism forces workers to compete against one another (until they combine in trade unions against the wishes of the capitalists, and even then the competition between the employed and the unemployed never ceases), likewise neo-liberal capitalism forces third world countries to compete against one another. For countries that had developed a sense of unity and solidarity during their respective anti-colonial struggles, and that still need to maintain solidarity amongst themselves in confronting imperialism even today – quite apart from the fundamental fact that mankind needs cooperation rather than competition for its survival and flourishing – this pressure exerted by neo-liberal capitalism in the very opposite direction, is ethically objectionable.

There is an additional reason why the growth strategy based on free or unrestricted trade becomes ethically objectionable. We know from our experience of neo-liberalism that a removal of restrictions on trade is necessarily associated with a removal of restrictions on capital flowsas well; otherwise financing current account deficits will become impossible for many countries. But this removal makes the country open to the vortex of global financial flows, and hence enfeebles its state, making it utterly incapable of intervention for raising the level of employment and output.

The people's living standards therefore become dependent upon impersonal forces beyond their control, that determine in the aggregate the level of world demand. The promise of the anti-colonial struggle had been that after decolonisation people would control their own economic destiny through a democratically-elected government that would reflect their wishes. But if the economy is governed impersonally by its own immanent tendencies, and if people cannot affect their economic lives through politics over which they have some control, then that constitutes a continuation of their unfreedom as in colonial times. What is more, this whole arrangement reduces them to the status of mere "objects" at the mercy of markets, rather than of "subjects" who control their own destinies, which itself is highly ethically objectionable.

But the invalidity of Say's Law means even more. Even at the economic level, leaving aside all ethical objections, a growth strategy based on unrestricted trade is distinctly inferior to one based on expanding the home market. If the world economy is demand-constrained, then this must be because individual economies within it (not necessarily all of them) must be demand-constrained; and it is generally the case that the third world as a whole is constrained by an inadequacy of aggregate demand within a neo-liberal dispensation. It follows therefore that state intervention in boosting aggregate demand can make the third world as a whole better off in the sense of having a higher time-profile of employment and output than along a growth path characterised by unrestricted trade.

Three caveats are needed here. First, we have talked of the third world as a whole; no doubt within the third world there may be countries that are so successful in their export drive, and hence the time-profile of their employment and output is already so high that there is no further scope for boosting aggregate demand within them by the State without causing inflation. But their success should not hide the failure of others; and it also cannot be replicated in the rest of the third world as bourgeois economics invariably pretends, any more than one person's win in a lottery can be replicated for all persons participating in it.

Second, these "success stories" within the third world are typically the result of State intervention not in boosting aggregate demand but in boosting export performance. From this many have argued that third world States should intervene to boost the export performance of their economies instead of simply leaving things to the operation of "free trade". They argue in other words not for a neo-liberal but for a neo-mercantilist strategy. But with the world economy being demand-constrained, even the success of one country in boosting exports through a neo-mercantilist drive, is also necessarily achieved at the expense of some other country. Even this advice to the third world therefore is both ethically objectionable and economically impossible to achieve for all of them together.

Third, many third world countries have outputs well below their potential output, if all resources were used up; but in their case if the State intervened to raise the level of aggregate demand and hence the level of employment and output, then there will be a foreign exchange shortage. There is, it would appear therefore, no alternative to the strategy of boosting exports; simply raising domestic demand will not do. The typical means of boosting exports within a neo-liberal setting is through an exchange rate depreciation. But an exchange rate depreciation raises the domestic prices of imported inputs including of such essential inputs as oil; and if these increases are “passed on” to the final price, then there would be inflation; what typically happens under neo-liberalism therefore is that inflation is controlled even in the face of an exchange rate depreciation, by reducing the money wage rate of workers (or preventing its rise in tandem with labour productivity). But attacking the workers is not just unacceptable; it is unnecessary as well if the State manages to impose import controls on a variety of luxury consumption goods that are consumed by the rich.

It is perfectly possible therefore to increase employment and output by making the State intervene in boosting aggregate demand at home and to overcome any foreign exchange shortage that may arise in the process by imposing trade controls (apart of course from capital controls). This logic can be carried even to the case of countries stressed by the burden of external debt. They have to prioritise certain debts over others and instead of trying to have a general agreement for relief among all creditors, first pay off some before coming to others.

Such a strategy of looking “inwards” however would be opposed by globalised finance capital and by the dominant powers that stand behind it. But we have seen that their entire “theory” and the apparently benign advice they give on the basis of this “theory” is completely flawed, because the world economy is not what they imagine it to be. Say’s Law does not hold and the world economy is demand-constrained. The priority of all States in the third world, whether singly or in collaboration with one another, must be to overcome this demand constraint, so that employment and output are increased, while rationing the use of foreign exchange.

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