Prof. Bhagwati has Got it Wrong*

Rohit

Prof. Jagdish Bhagwati has written an invited article on the front page of Economic Times on January 9. He has made a strong case for Narendra Modi's Make in India (and sell abroad) campaign and has urged the Prime Minister to overcome the 'populist' anti-reformers both politically and intellectually. His is an attempt, self-confessedly, of providing the latter and in the process, he derides all those critical of export-oriented growth as paper tigers. Mine is obviously a 'paper-tigerly' response to his arguments.

One, there is a fallacy of composition in the strategy of export-oriented growth as a panacea for growth of all the economies. All countries cannot be export-oriented at the same time as they cannot all be exporting to Mars. Obviously some of them would have to be import-oriented to be able to accommodate others' export-oriented growth. And if there are limited markets abroad to compete for, more difficult will be the export-oriented strategy more are the number of players. Moreover, there is a first mover's advantage.

Two, this strategy has to be in contradiction with a domestic demand driven approach. This is so because it requires a continuous decline in the cost of production, a significant proportion of which is the wage cost, to outcompete the rivals. Two ways in which you can keep the relative wage costs down is by depressing the wages and/or increasing the productivity of labour relative to the competitors. Both these involve a fall in the share of wages in the economy (as has been the case with the Chinese or other such experiments). This squeezes the domestic demand in the economy in the long run either through a fall in incomes (wage fall) or unemployment (through labour displacing technological expansion). This contradiction is clearly visible with the Chinese today, who are finding it difficult to move from an export-oriented strategy towards a domestic demand driven strategy. And in this race to the bottom, if you don't win, you end up losing on both ends, neither will there be an external market created nor a domestic market remaining.

Three, the other part of the cost, raw materials, requires the corporates to be given a free-hand in terms of exploiting the natural resources. Corporate scams across the Third World today are mere reflection of how desperate they are to grab the resources without paying for the same, all in the name of outcompeting the 'external' rivals in this race. The extent of environmental degradation domestically coupled with exploitation of the resource-rich-but-politically-weak countries abroad surely should be a matter of concern even for these export enthusiasts.

Four, even if we assume that growth is delivered, it will surely be inequitable for the working masses in general for the second reason. What Prof. Bhagwati misses is that he equates the interests of the corporates who surely benefit from such a strategy with the majority of the population. His argument is so unabashedly anti-working class that he says that the mistake Clinton made in the 1990s was that he didn't crush the labour unions once and for all so that they could never raise their ugly head again finding voices through some of the democrats elected during Obama's time!

Five, his argument that growth is a radical pull up because it generates resources for social spending for those left-behind is also flawed because these policies also come with a baggage of controlling government deficit (broadly tax income less expenditure). If this is coupled with concessions in taxes for the corporate sector (in the name of incentivising production), there is a twin attack on fiscal expenditure. Add to this a downward inflexibility in military expenditure in the name of 'nationalism', the axe invariably falls on the social sector spending itself.

Last but not the least, all this growth, if delivered, would still be in control of the importing nations. If for some reason, they hit a roadblock in terms of providing a market, as is happening today, it will have a cascading effect on the export-oriented economies who would have lost the fall back options in the very process. Chinese talk of a 'new normal' and difficulties in achieving it is merely a recognition of this problem.

Here I have not even discussed the implications of 'parking' of funds by the foreign institutional investors in the capital markets in the emerging economies. I have kept the focus purely on the trade side of it as Prof. Bhagwati has. I am sure these are yet again paper tigers for him but such economists need to be told every now and then that they should be upfront and say that they are talking on behalf of the rich and the elite instead of calling names to those who stand with the working people.

PS: His anger against Prof. Sen (the only Nobel Laureate in Economics from India) is quite intriguing though!

*** This article was originally published in Rohit Azad's Blog on January 9, 2015.**