The new Mercantilism

by Michael Henderson

Despite themselves the governments of the advanced market economy countries (AMECs) are becoming ever more deeply involved in the active management of the world economy. This has occurred despite the propensity, during what we might call the Reagan-Thatcher years, for governments increasingly to let market mechanisms decide matters economic. In national economic affairs there has been a strong emphasis on privatization and deregulation, and conscious attempts have been made to decrease the role of governments. Paradoxically there has been a tremendous increase during the same period in the degree of state management of international economic affairs reminiscent in many ways of 17th-century Mercantilism.

Two well documented developments illustrate this trend. Since the conclusion of the Plaza Accord on September 22, 1985, the Members of G5/G7 have consistently intervened both directly and indirectly in foreign currency markets in order to affect the relative value of their national currencies. Their expressed purpose has been to try to rectify, through coordinated monetary and financial policies, serious trade and balance of payments disequilibria. Moreover, there has been a significant increase in "managed trade," or government interference of a non-tariff nature with free market forces, in order to affect the volume and direction of trade. The late Jan Timlur, former Director of Research at GATT, estimated that by 1985 managed trade accounted for 40-45 percent of total world trade.

Ideology versus reality

How do we explain this contradiction between ideological predisposition on one hand and government actions in international economic affairs on the other? The answer seems to be that the governments of the AMECs are trying to cope with numerous practical problems arising out of a conjunction of political and economic events which have made, and doubtless will continue to make, a massive expansion of the role of governments in the management of their countries' international economic affairs seem imperative. These factors include: (1) the rapid relative decline of US economic power in the last decade; (2) the logic of dealing with an increasing economic interdependence; (3) a quantum leap in global productive capacities; and (4) the consequences of the increasing interface between the market and the command economies (managed economies). Let us briefly consider how each development has contributed to great state involvement in the world economy.

US no longer alone at top

There is no need to enter the largely semantic debate as to whether the United States remains the hegemonic or dominant power in the world market economy. Analysts do agree on two points: first, the US remains far and away the strongest economic actor in the global market economy; and second, there has been a tremendous decline in US economic power relative to Japan and the rapidly expanding European Communities (EC). A greater pluralism in economic power means that the US can no longer be rule-maker, rule-enforcer, and even rule-breaker, in the world market economy system. The loss of one power dominance means that US leadership on economic issues no longer leads to automatic compliance. The three so-called Triad Powers — the US, Japan, and the EC — now have serious disagreements, which are at times made public, over macro-economic questions such as appropriate currency levels, appropriate demand management policies, and appropriate national fiscal policies. Protracted frictions, particularly on bilateral trade matters, are now common.

This new economic pluralism necessitates more process in inter-governmental affairs. For example, if the US government wants the West German government to stimulate domestic demand at a greater rate, it must make its views known not only through bilateral contacts, but press its case in international economic forums such as the IMF and the OECD. Bilateral persuasion and even bilateral pressures need to be buttressed by informal alliances of convenience with the governments of other AMECs on the issue, and, if possible, by the favorable prescriptive opinions of international experts. Such action requires a great deal of inter-governmental information sharing, consultation, negotiation, and the monitoring of events and policies. Such "process" activity is an essential pragmatic response to changed conditions.

Growing interdependence

This need for closer inter-governmental cooperation on economic matters is heightened by the acknowledged fact that economic interdependence among the AMECs has increased dramatically. All governments have become more sensitive, if not more vulnerable, to external policy initiatives. Given this new reality, both games theory and complex econometric models have demonstrated that in an economically interdependent world maximizing behavior demands the coordination of international economic policy.

State managers, however, are naturally more impressed by events than by theory. On this count, the financial crisis of October 19, 1987, provided them with an invaluable lesson. The crisis demonstrated how a relatively minor unilateral government action could destabilize the total financial system. On October 18, US Treasury Secretary James Baker in an informal aside to the press criticized the West German government for unilaterally raising its interest rates. The next day the Dow Jones Industrial Index experienced a massive 508 point decline, which in turn triggered huge losses on the Tokyo, London and Frankfurt exchanges. Mr. Baker's implication that the West German government had reneged on the Louvre Accord of February 1987, had undermined the confidence of the international finan-

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