

# FACULTY OF JURIDICAL SCIENCES

# Lecture-5



# The Rise of Neomercantilism

World War II's devastation scared Allied nations into desiring global cooperation. They created the World Bank, the United Nations, and the World Trade Organization. They saw mercantilism as dangerous and globalization as its salvation

But other nations didn't agree. The Soviet Union and China continued to promote a form of mercantilism. The main difference was that most of their businesses were state-owned. Over time, they sold many state-owned companies to private owners. This shift made those countries even more mercantilist. Neomercantilism fits in well with their communist governments

They relied on a centrally planned command economy. It allowed them to regulate foreign trade. They also controlled their balance of payments and foreign reserves. Their leaders selected which industries to promote. They engaged in currency wars to give their exports lower pricing power. For example, China bought U.S. Treasury's to fuel its trade with the United States. As a result, China became one of the largest foreign owners of U.S. debt.

## Modern Mercantilism

In the modern world, mercantilism is sometimes associated with policies, such as:

- Under valuation of currency government buying foreign currency assets to keep the exchange rate undervalued and make exports more competitive. A criticism often leveled at China.
- Government subsidy of an industry for unfair advantage. Again China has been accused of offering state-supported subsidies for industry, leading to oversupply of industries such as steel – meaning other countries struggle to compete.
- A surge of protectionist sentiment, e.g. US tariffs on Chinese imports, and US policies to 'Buy American.'
- Copyright theft

# Criticisms of Mercantilism

At the heart of mercantilism is the idea that wealth is centered on the accumulation of gold and other precious metals. Today, we consider the wealth of a nation to derive from its GDP, or economic output. This is because true wealth is based on what the land and labor are producing – not how much gold it has. Gold is unable to cure hunger unless it is exchanged for food. However, mercantilists prefer to be self-sufficient and refuse to import. Yet some nations are unable to grow enough to feed themselves, which is exactly what happened in Spain. Although it had a high level of gold, the majority of its population went hungry.

A nation that is unable to provide basic necessities for it can hardly be considered wealthy. At the same time, the monopolies that the state granted prevented domestic firms from competition. By placing high tariffs and restrictions on imports, domestic firms are largely insulated from competitive pressures. These pressures would create an incentive for firms to improve the efficiency of production in order to produce at a lower price.

The attack against imports was based on the principle that wealth is set and cannot increase. In other words, one nation's loss is another's gain. Yet this assumption is false. The reason was highlighted by Adam Smith in his book 'A Wealth of Nations'. In this book, Smith identifies 'comparative advantage' – whereby one nation is comparatively more efficient at making Product A, whilst another country is better at making Product B. By focusing on the product which the nation is most efficient at making – both nations will obtain a higher output, and therefore wealth.

- Adam Smith's "The Wealth of Nations" (1776) – argued for benefits of free trade and criticized the inefficiency of monopoly.
- Theory of comparative advantage (David Ricardo)
- Mercantilism is a philosophy of a zero-sum game – where people benefit at the expense of others. It is not a philosophy for increasing global growth and reducing global problems. Trying to impoverish other countries will harm our own growth and prosperity. By contrast, if we avoid zero-sum game of mercantilism increasing the wealth of other countries can lead to selfish benefits, e.g. growth of Japan and Germany led to increased export markets for UK and US.
- Mercantilism which stresses government regulation and monopoly often lead to inefficiency and corruption.

- Mercantilism justified Empire building and the poverty of colonies to enrich the Empire country.
- Mercantilism leads to tit for tat policies – high tariffs on imports leads to retaliation.
- The growth of globalization and free trade during the post-war period showed possibilities from opening markets and respecting other countries as equal players.
- Economies of scale from specialization possible under free trade.