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ON THE POLITICAL ECONOMY OF THE CHOICE OF A TRADE REGIME

AMIYA KUMAR BAGCHI

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AMIYA KUMAR BAGCHI

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Centre for Studies in Social Sciences, Calcutta
10, Lake Terrace,
Calcutta-700029.

ABSTRACT

Questions of laissez faire versus public regulation, and of free trade versus potection for domestic production and domestic techniques have been debated in Europe, followed by the rest of the world since at least the sixteenth century. Such choices, in real-life, seldom have been determined by abstract principles of economics, but have been based on an analysis of the different forces governing social and political behaviour, and on judgments about whether the country or society would derive a greater advantage from more or less public regulation, or from a greater or smaller degree of restriction placed on imports and exports. The pursuits of economic power and national affluence have gone hand in hand in such debates. Free trade doctrines have usually been favoured by countries enjoying dominance in the areas of international trade and finance. The doctrinal triumph of comparative advantage and free trade theories in mainstream economics, despite their poor record as explanatory bypotheses, has recently been challenged by new international trade theories that take increasing returns, technical progress and path-dependent development seriously. The socalled new political economy seeks to lay the blame for the poor performance of most less developed economies almost exclusively at the door of government interference in public life. In the process it misreads history and misses out on the complexity of analysis of society that was the hallmark of discussion regarding the relative roles of public regulation, free markets and protection in different areas of economic life in the days of Adam Smith predecessors and his immediate

followers. The policy prescriptions of new political economy sidetrack the inference derivable from new developmental trade theory and put the cart before the horse by seeking to make institutional change a mere handmaiden of mythic competitive markets rather than regarding markets as institutions that must be suitably supported by other institutions promoting economic growth and social equity.

1. Mercantilism, free trade and the old political economy

Free trade and laissez faire doctrines have enjoyed a claim to universalism since their magisterial formulation in Adam Smith's Wealth of Nations. By contrast, the opponents of free trade have been dubbed as particularist, protectionist, obstructionist and pleaders of particular interest groups. Adam Smith invented a whole doctrine of mercantilism in order to corral all his imagined opponents into a convenient ravine and bury them under a hail of contumely and ridicule. The latter-day descendants of Adam Smith have seen in the opponents of free trade advocates of authoritarian states, self-defeating Keynesianism and comforters and abettors of rent-seekers. 'Mercantilism' has become a term of abuse in the writings of most economists.

Since the days of Heckscher, mercantilism has been seen as a set of doctrines purporting to serve the pursuit of national economic power often at the cost of general economic welfare and plenty. They have also been seen to be quite ineffective even for the pursuit of economic power as the principal goal. By contrast, free trade has generally been seen as the proper policy regime for the promotion of economic welfare and plenty. One contention of this paper is that free trade, no less than mercantilism can be seen as the regime for the pursuit of national economic power provided the nation or economy enjoys certain advantages. Indeed, some of the most percipient advocates of free trade saw economic power as growing out of plenty or affluence. There are echoes of this line of thinking in a considerable body of contemporary international trade theory.

Another contention of this paper is that protectionist instruments can in fact be effective tools of defence or pursuit of power but that their degree of effectiveness depends, as they depended in the days of mercantilism, on the wider policy framework and not just on instruments of foreign trade regulation.

Economists and historians have generally accepted Adam Smith's version of mercantilism as the gospel truth and have not given enough credit to the 'mercantilists' for the effort they made to figure out the institutional changes needed for attaining high rates of economic growth and employment. Nor has it always been realized that in Europe during the sixteenth, seventeenth and eighteenth centuries, the instruments of national protection rather than local protection of industries, techniques and innovations were being forged with varying degrees of success. Many publicists in the most successful economy of the late eighteenth century, viz., Britain had a shrewd idea that laissez faire was not only their best policy from a liberterian point of view but that free trade in external commerce could benefit the already wealth economies. In this first section, we will summarize some of the most important arguments advanced by the advocates of free trade and of continued protection or regulation for important sectors of the economy in the eighteenth century. We will concentrate entirely on the views of Adam Smith, Josiah Tucker, David Hume and two of their most important latter-day interpreters, viz. Jacob Viner and Eli Heckscher. This summary, I hope, will convince many of our contemporaries that these debates can better

illuminate the terms of discourse in the choice of a trade regime in the modern world.

Adam Smith's anathema against what he dubbed as the mercantile system (Smith, 1776, Book IV, chapters I-VIII) was reiterated and given a new force of moral opprobrium in the monumental Mercantilism of Eli Heckscher (1935, 1955). Heckscher constructed a system out of three centuries of debates on doctrines and policies in western and southern Europe including Britain, France, Germany, the Netherlands, Spain and Italy. According to him, the statesmen of Europe between the sixteenth and the middle of the eighteenth centuries strove especially 'towards the unification of the territory of the state economically and the use of resources of their countries in the interests of the political power of the state' (Heckscher, 1936, p.20). Heckscher was himself a convinced free trader - he was after all the originator of the Heckscher - Ohlin theory of comparative advantage - and regarded the mercantilists' pursuit of power to the neglect of plenty as fundamentally flawed from a moral point of view. But he was not wholly consistent in his excoriation of the ends of the mercantilist writers. For he conceded that the latter's conception of society was in 'fundamental accord with that of laissez faire' (Heckscher, 1936, p.31). Yet he thought that 'the humanitarian outlook' was entirely alien to the pre-Smithian writers - an outlook that he found explicated in the writings of 'Adam Smith, Malthus, Bentham, Romilly and Wilberforce' (Heckscher, 1936, p.33).

Heckscher never made clear what he meant by society in this particular context : this failure to deal with society as an entity, incidentally, is shared by the majority of latter-day free traders. The assignment of priority to power rather than plenty as the alleged end of mercantilist writers was criticised by Jacob Viner (1935) in his review of Heckscher (1935), and the criticism was spelled out by him in more detail later on (Viner, 1948).

The systematization of mercantilist policies and theories into a body of doctrines in the hands of Adam Smith and his successors - the admirers of mercantilism such as Roscher and Schmoller in Germany, Cunningham and to a lesser extent, Ashley and Lipson in Britain, and critics such as Heckscher and Viner among modern theorists and historians of economic thought - has been echoed in the work of Michel Foucault, who has discerned the play of power in the construction of all bodies of knowledge - especially those concerned with the human sciences (Foucault, 1970, especially Part I, chapter 6; and Foucault, 1972). While Heckscher thought the pursuit of power to the detriment of human welfare was peculiarly characteristic of the aims of mercantilist writers, and free trade policies embodied a universalistic humanitarianism, Foucault has condemned political economy as yet another system for achieving and perpetuating the dominance of man over man. Pace Heckscher, all advocates of free trade were not equally indifferent to the possibility of attaining both plenty and dominance through their preferred polity. On the other side, advocates of specific mercantilist policies were at the same time proponents of laissez faire and republicanism. Hence it is wrong to see the triumph of free trade

doctrines as necessarily the triumph of the ideology of freedom, except in a narrow libertarian sense (as for example, Appleby, 1978 and 1984 seems to have done). Many advocates of mercantilist and free trade policies may have had common goals but differed in respect of instruments because they perceived their circumstances to be different (Hont, 1990, Pocock, 1975, 1990 and Winch, 1985).

Heckscher was a historian of economic theory but he was contemptuous of attempts to relate particular economic conditions to the ways in which contemporary advocates of particular policies systematised their thinking. As Coleman pointed out in his editor's introduction to Revisions in Mercantilism, in Heckscher's account, 'the common element in formulating policy is always assumed to be the common "system" of thought called mercantilism; what is specifically ruled out is that the policy may have been the outcome, even in part, of the existence of common elements in the economic situation, in the circumstances of economic life'. Moreover, 'the emphasis upon a "common European problem", in combination with the classical economists' approach, i.e. isolating economic variables from others, means that inadequate regard is paid to the elements that are not common, in space or in time; variations by country or region, variations according to secular or short-term movements in the economic situation' (Coleman, 1969, pp. 9-10).

In his chapters on the actual economic policies pursued under mercantilism, Heckscher clearly differentiated between different countries and the different packages of policies they followed, with different degrees of success (Heckscher, 1955,

Vol.1, chapters II-VII). At the risk of some degree of over-simplification, it may be argued that the degree of success of the balance of payments or export trade objectives of the policymakers during the mercantilist age depended very largely on the extent to which internal markets had been truly unified on a national basis. The unification of the internal market in turn depended on the extent to which the national state had triumphed, the economic and judicial privileges of feudal lords and corporate bodies such as guilds and municipalities had been curbed and internal transport and exchange mechanism had managed to connect all internal markets into a national network. Judged by such criteria, of the three western European countries specifically taken up by Heckscher, viz., Germany, France and England, Germany performed very poorly in respect of political unification, abolition of privilages of feudal lords and corporate bodies and unification of exchange mechanisms including the currencies of the realms. France performed well in respect of political unification but poorly in respect of abolition of feudal and corporate privileges and a proper interweaving of the national exchange network. England did best by all the three criteria. This superiority was one major factor in her ability to outbid France and Germany in terms of development of machine-based large-scale industry by the end of the eighteenth century (see, especially Heckscher, 1955, vol.1, pp.184-203). The unsatisfactory outcome of the promotion of inventions and luxury manufactures under royal or more generally state patronage in France which Mantoux (1961, pp. 28-33) had already commented upon in the beginning of this century was at least partly due to the weight of the other factors constraining industrial

growth in that country as compared with England. It is possible to argue that the same cluster of advantages also enabled England to outdistance the Netherlands, her arch-rival in finance, transoceanic trade and shipping until the end of the seventeenth century. A study of the history of these four countries in the two centuries preceding Adam Smith's pronunciation of anathema against the mercantile system would thus lead us to conclude that the success or failure of policies of protection of domestic industry (and agriculture) against foreign competition largely depended on the way the internal economy and society were being moulded to promote competition internally, even while it was to be sought to be restricted as far as the entry of foreign commodities was concerned. Although Heckscher describes these variations when he comes to pass his judgement on the protectionist policies characteristic of the age of mercantilism, he is curiously reticent about the differential advantages of mercantilist policies in different social and political settings.

The same kind of insensitivity to local conditions, including local social variations, characterizes much of the advocacy of free trade in the modern world. Most often, the advocacy of state regulation, patronage or fostering is simply dismissed as ideologically motivated, or worse, as motivated by interests of sectional groups. In this again they are following Adam Smith[1] : but unlike his latter-day followers, Adam Smith knew the economic dynamics of the country he was keenest to convert, viz., the United Kingdom. He had been preceded in some of his essential assumptions by David Hume,

and Josiah Tucker, and he was a better reader than his immediate predecessor, Sir James Steuart, of the relative prospects of Scotsmen (and Englishmen) in a unified free-trading Britain compared with a protectionist, Colbertian kingdom of regulated regionalism.[2]

A key element in the classical construction of the doctrine of free trade was David Hume's formulation of the socalled 'specie-flow price mechanism', or the theory of the automatic adjustment of price levels to inflows and outflows of gold and silver (Hume, 1752). Hume held that it was irrational for any country, including Great Britain, to prohibit or restrict the export of precious metals for fear that in the event of a lack of balance of trade between that country and the rest of the world, the precious metals would leave it and render it poorer. The essence of Hume's mechanism is captured in the following passage (Hume, 1752, p.27) :

> Suppose four-fifths of all the money in Great Britain to be annihilated, and the nation reduced to the same condition, with regard to specie, as in the reigns of the Harrys and Edwards, what would be the consequence ? Must not the price of all labour and commodities sink in proportion, and everything be sold as cheap as they were in those ages ? What nation could then dispute with us in any foreign market, or pretend to navigate or to sell manufactures at the same price, which to us would afford sufficient profit ? In how little time, therefore, must this bring back the money which we had lost, and raise us to the level of all the neighbouring nations ? Where, after we have arrived, we immediately lose the advantage of the cheapness of labour and commodities; and the farther flowing in of money is stopped by our fulness and repletion.

Hume then supposed the contrary and showed that a sudden 'fulness' of specie would raise prices in such a fashion as to bring down the bullion rich country back to the level of its neighbours through an excess of imports over exports and a consequent outflow of specie in response to the lower prices prevalent in the nations with which the home country trades. This is the basic adjustment process which then became ensconced as an unchallenged orthodoxy until empirical testing of the specie-flow mechanism by J.W. Angell, Jacob Viner and J.H. Williams, and the implications of the Keynesian revolution brought the apparent simplicity, automaticity and effectivity of the mechanism into question.[3]

Underlying Hume's formulation, there was a basic assumption that the trading country concerned, through all the upheavels of the adjustment process, should retain its 'people and industry' (Hume, 1752, p.26). Hume did not believe that the activity of people or industry was constant for all time. For, he also advocated banking and paper credit as instruments for economizing on specie and encouraging economic activity. Indeed, without the latter, mere expansion of paper credit might lead to trouble. Differing views regarding the impact of expansion of paper credit on prices and output could indeed be said to lie at the heart of the debate between the supporters and opponents of the English Bullion Report of 1810 (Viner, 1937, chapters III and IV).

While Hume regarded the fear of loss of specie through free trade to be unfounded, he did believe that a rich country could ultimately become impoverished through the

permanent loss of a part of its stock of precious metals to a poorer country. The wages of the latter would, through the mechanism of trade, come up to the level of the rich country, so that eventually the rich and the poor countries might meet somewhere in the middle, with the rich being less rich and the poor being less poor.[4] This part of his analysis was subjected to a strong critique by Josiah Tucker, the Dean of Gloucester. Tucker distinguished carefully between the effects of a sudden acquisition of wealth in the shape of mines and those of acquisition of riches 'in the way of general industry' (Tucker, 1774, p.20, as quoted in Semmel, 1970, p.16).

Tucker seems to have anticipated virtually all the later arguments suggesting that a rich country, with a high level of labour productivity, a long history of learning by doing in manufactures, a large endowment of skills, capital and knowledge, a highly developed infrastructure, and a large home market, will have a dynamic advantage in relation to a poor country which ranks low in respect of all the attributes described above. Tucker seems to have even recognized that the rich country would be better able than the poorer ones to undertake projects with long gestation periods, and to make experiments - that in effect, it would have a high rate of endogenous technical progress (Semmel, 1970, p.16). He seems also to have appreciated the dual function of capital in a dynamic economy, viz., its role as a fund for setting capital projects into motion and its function as equipment and working environment fostering productivity growth through learning by doing, and introduction of innovations. A rich

country would have an advantage in productive investment because of the high rate of capital formation and it would have an advantage in productivity raising improvement, because of its superior endowment of skills, more intense division of labour and higher endowment of appropriate capital equipment.

Tucker, therefore, thought that it was incorrect to expect the rich country to lose out to the poor in the process of trade, because of lower wages prevailing in the latter. In fact, he formulated a law which can be said to have anticipated much of the nineteenth century theory of international division of labour and which can be used to set the stage for the elaboration of the Prebisch - Singer - Lewis - Emmanuel theories of unequal exchange and deteriorating terms of trade as between rich manufacturing nations and poor primary producers. The law ran thus : 'That operose, or complicated Manufactures are cheaper in rich countries : - and raw Materials in poor ones : And therefore in Proportion as any commodity approaches to one, or other of these Extremes, in that proportion it will be found to be cheaper, or dearer in a rich, or a poor country' (Tucker, 1774, p.28, as quoted in Semmel, 1970, p.16). Timber, for example, would be cheaper in a poor country, but cabinet-work in the richer nation.

Tucker did not believe that poor countries were predestined to do badly in the long run. Two different kinds of hope were held out to them. The first was that the richer country would lend its capital and technical assistance to the

poorer country and thus raise its productivity (Semmel, 1970, p.16). Secondly, the poor country could adopt protectionist measures and try to develop skills and knowledge so as to come up to the level of the rich countries. The poorer country would also utilize its specific endowments of climate, soil and the natural turn and peculiar genius of its people to try and forge ahead in the arts of manufacture (Semmel, 1970, pp. 17-18).

Some of Tucker's arguments were developed later on by Adam Smith, Allyn Young, and Nicholas Kaldor. The arguments about economies of scale, learning by doing, and differential rates of endogenous technical progress have been used in recent times to produce models of trade under which some nations with particular advantages would dominate international trade, and there was little the other countries could do except to adapt passively to the state of dynamic comparative advantage created by these dominant nations.

Tucker brings us closer to one strand of thinking about economic policy-making and its relation to the choice of an appropriate trade regime that has been strangely neglected in mainstream economics. This is the concern about effecting profitable technical change in all branches of economic activity but especially in manufacturing. Capitalist societies evolved various devices for encouraging the making of inventions or the import of useful inventions. The first patent law is credited to the Venetian Senate which in 1474 provided for the registration of inventions and their protection for ten years (Lane, 1973, p.320 and McLeod, 1988, p.11). This

procedure was imitated, with many variations, by other European states. The early beneficiaries of the system were often Italian immigrant craftsmen, since they tended to be the most advanced in the dynamic fields of 'manufacture or craft-work. In England a patent was granted for glass-making in 1552, 'apparently to an Englishman, Smyth, the next in 1561 to two immigrants for making Castile soap' (McLeod, 1988, p.11). 'Acquisition of superior Continental technology was the predominant motive for the issue of patents under the guidance of Elizabeth I's chief minister, William Cecil, later Lord Burghley. The shaping of patents to serve his policy of importing and improving technology left a lasting imprint.....' (McLeod, 1988, p.1).

Thus protection of infant technologies was often as pressing a concern of the policy-makers in the Europe of the sixteenth to eighteenth centuries as the protection of particular trades. The Statute of Monopolies passed by the British Parliament in 1624 specifically exempted inventions from the prohibition against the granting of monopolies through letters patent by the Crown. This does not mean that the introduction of new inventions - especially those that threatened to disrupt an existing craft and cause unemployment - was unproblematic during this period. Especially under the Stuarts, the Crown tried to outlaw the introduction of several such inventions. But by and large, most profitable inventions were eventually introduced and managed to enjoy protection from the state (Clark, 1936). In England, the power of guilds had already broken down by the beginning of the eighteenth century, especially in new areas of growth such as the countryside

/1931; and Heckscher, around Manchester and Liverpool (Wadsworth and Mann,/1955, chapter VI), and the acceleration of economic and demographic growth from the late seventeenth century produced an atmosphere of creative innovation and destruction, especially in many relatively new industries such as cotton-spinning and iron work.

If we examine Adam Smith's work in the light of our knowledge of how economic policy-making was shaped in the tradition which was the particular target of his attack, we notice how cleverly he lumped together different kinds of pressures for regulation or restriction under the generic name of 'monopolies'. He also had the foresight to realize that, although in his view, free trade policies would benefit manufactures and traders immensely, traders or manufacturers were themselves the enemies of those policies. So he appealed over their heads to others who mattered and he appealed perhaps to the long-term pursuit of self-interest by manufacturers and traders as a class. His sense of political economy was doubly apt; he not only perceived the basic division of the society of his time into landlords, capitalists and wage-earners, he also knew that effective political power lay with the landlords. Did he not also argue that in respect of public attention and government patronage agriculture in Europe suffered in comparison with the other sectors of the economy ?

In spite of Adam Smith's persuasiveness, laissez faire policies did not triumph in the arena of British external trade until more than sixty years after the publication of the Wealth of Nations. (Adam Smith had not in any case expected free trade principles to triumph in England for many, many years).

Looking back, we could attribute this to the interruption of the policies embodied in the Anglo-French (Eden) treaty of 1786 by the wars of the French Revolution and the Nepoleonic Wars, to the strength of the particularistic interests, or to the new interest of landlords in protectionism kindled by the influx of grain supplies from countries blessed with lower wages or more abundant land. But the evidence could also be read as a demonstration that laissez faire policies in international trade are adopted by a country voluntarily only when it has achieved assured dominance in areas of critical importance. In the case of Britain, international economic dominance comprised not only unquestioned leadership in the new machine-based manufactures, but in shipping and ship-building and in a newly invigorated international capital market.

The contemporary history and the sense of political setting that render Adam Smith's magnum opus so compulsively readable even today virtually disappeared from the work of the classical economists and of their successors in orthodoxy, viz., the neoclassical economists. But that did not prevent the static comparative cost theory constructed by David Ricardo from claiming the foreground in all later theories of international trade.[5] The specie-flow-price mechanism, comparative cost theory and the theory of reciprocal demand of John Stuart Mill were all challenged by J.H. Williams, Frank Graham, Mihail Manoilesco and a host of post-Keyanesian theorists who found the assumptions of full employment and full utilization of resources underlying the work of Ricardo, Mill and Marshall (though not of Adam Smith, or of course, Karl Marx) too glaring in inconsistency with the real world to be absorbed into their

conceptual framework. Theories of imperfect and monopolistic competition remained for long foreign bodies which could not be absorbed into a general equilibrium framework. Since the mainstream theories of international trade remained wedded to the latter, trade theorists went on merrily waltzing in a world of perfect certainty and perfectly competitive markets fully furnished with the necessary complements of trading in future in all goods and services. The very difficulty of incorporating real world phenomena assured the victory of theory over reality.

Attempts were made to produce sophisticated versions of Heckscher-Ohlin theory and to dynamize the Ricardian theory by taking circulating capital and intermediate inputs into account, and then test these against trade patterns in the real world. By and large, however, even sophisticated tests such as those performed by Leamer (1984) lacked historical depth. In most cases, the theories performed better in explaining trade flows between the poor, primary product-exporting developing countries and the affluent, manufacturing nations than those between developed market economies. Moreover, the dynamic factor$ such as investment rates or patterns and speeds of technical change are largely treated as exogenous actors in these extensions. Thus, the task of linking trade and growth by developing traditional Ricardian or Heckscher-Ohlin theories has been imperfectly accomplished even by the best practitioners (for a competent and interesting summary of these developments, see Evans, 1988, chapters 6 and 9).

In the meantime, as pointed out earlier, other theorists were trying to incorporate dynamic returns to scale and technical change in new theories of growth (Kaldor, 1957, Arrow 1962; and Kaldor and Mirrlees, 1962), conceptualize 'local' technical change and the fruitfulness of localized R & D (Atkinson and Stglitz, 1969) and absorb monopolistic competition into the mainstream theory of international trade (Dixit and Norman, 1980). On the other side, evidence accumulated of the formidable emergence of Japan as a new industrial giant to reckon with and the effective use by that country of a wide array of measures of governmental guidance, regulation and support. A little later, evidence mounted of the success of intervention by government in the economic life of South Korea and the Taiwan Province of China, two medium-sized economies which outperformed most other runners in the league of the socalled newly industrializing countries.[6] Evidence also accumulated of how, while the mainstream theorists based in the U.S.A., Britain and other European countries advocated free trade, the governments of those countries continued to pursue protectionist, and in some cases, etatist policies with a view to arresting the decline of sunset industries and for fostering sunrise industries. Despite this kind of evidence, 'vulgar' neoclassical economics decked out with some dubious sociology and even more dubious history and calling itself 'new political economy', launched a new assault on all public attempts to improve the conditions of living of ordinary people in developed as well as underdeveloped countries.[7]

In the next section I will refer to some results of the new theory of international trade and consider their implications for the possibility of public intervention in trade and industy.

In the final section I will critically examine some propositions advanced by leading protagonists of the new political economy, and look at the real reasons for the current triumph of the new political economy in the underdeveloped world.

2. The new theories of international trade and the possibility of public intervention

The work done in recent years by a host of economists led by Avinash Dixit, Paul Krugman, Wilfred Ethier, Elhanan Helpman, James Brander and Barbara Spencer in the area of international trade and investment, by B.C. Eaton and R.G. Lipsey in the field of product differentiation and by Robert Lucas and Paul Romer[8] in the area of economic growth has its antecedents in the theories and descriptions proposed by Frank Graham (1923), Allyn Young (1928), Nicholas Kaldor (1957 and 1972), S.B. Linder (1962), Michael Posner (1961), Kenneth Arrow (1962) and Raymond Vernon (1966). What the new group of theorists have done is to make increasing returns, technical progress, learning by doing, external economies and monopolistic and strategic behaviour integral elements of their theories rather than introduce them mainly as critiques of the neoclassical orthodoxy. The same elements have also been systematized to provide the basis of a different genre of stories of economic growth. Recent work of core-periphery relations, or the agglomeration effects of increasing returns and external economies harp back to themes introduced earlier by Francois Perroux, Gunnar Myrdal, Paul Baran, Raul Prebisch, Hans Singer, Oswaldo Sunkel, Celso Furtado, Andre Gunder Frank, Samir Amin, Immanuel Wallerstein and other writers,

many of whom are aligned with the dependency, world-system or Marxian schools.[9]

The recent theories of trade and growth adopt different sets of assumptions for setting out the basic framework, and arrive at different specific conclusions. But all of them depart from the usual neoclassical assumptions of constant returns, pure competition and perfect information. In their different versions they lay special stress on the importance of initial conditions and first-mover advantages, increasing returns, technical progress brought about by deliberate R & D expenditure, learning by doing or learning by using, and the possibility of strategic manipulation, preemptive action, and make room for the use of various types of public intervention in order to achieve dominance in international trade or counter strategic behaviour by firms and governments of other countries.

I will not here try to summarize the results of even the most prominent of these theories. Instead I will try to indicate the flavour of their reasoning, and cite a few real life situations for which neoclassical theory had no explanation but which are well explained by particular variants of these new theories. I will also then try to indicate that the attempt to restore confidence in free trade and minimal government, especially for a country which does not enjoy dominance in any sector of international trade, has nothing but an irrefragable ideological bias to recommend it.

Let us suppose that there is an industry which is characterized by economies of scale that are not exhausted with the size of a particular economy (say, Country A). It is also assumed that there are other firms in the world economy which are already exploiting the economies of scale fully. If the government does not offer some protection against external competition, then no investment will occur in that industry in that country. For, at the prevailing world prices, taking into account the risk of the investment not being as profitable ex post as it appeared ex ante, the potential investor's expected rate of return will be less than the prevailing rate of return in the country (for in the fully riskless situation, the investor can just about recover costs including the cost of capital). The government may decide to offer protection or a subsidy to a potential investor : the latter may then be required to start exporting abroad as a test of the efficiency of investment. Of course, with growth of the internal market, the investing firm may find it possible to sell a large fraction of its output at home. In this sequence it is difficult to separate out inward - and out ward - directed strategies. But what comes out is a case for public intervention in support of domestic investment (cf. Graham, 1923 and Ethier, 1982).

The case for protection against external competition need not be dependent only on the existence of static economies of scale. One situation in which the government may offer tariff protection is when there is a potential for development of a particular industry so that it would eventually be internationally competitive but which is not being developed

because foreign competition - often of a predatory and pre-emptive nature - prevails in the domestic market. An import tariff or quota restriction may then induce investors to invest in the industry : the investment response may be so vigorous that the capacity of the industry soon exceeds the size of the domestic market and the price of the commodity comes down to international levels or goes down even further. Such a policy may be especially justified when investment is expected to come out of potential saving of the upper classes and instead of crowding out other, more socially profitable investment, pushes up effective demand and reduces unemployment. The raising of the import tariff on sugar by the Indian government had such an effect in the 1930s (Bagchi, 1963, chapter 2; and Bagchi, 1972, chapters 1 and 12), although that was hardly the intention behind the step taken.

In yet other situations only some kind of public support or cooperative action can stimulate the development of an industry and allow even a country trying to install the particular technology for the first time to reap the full benefits of the transfer. The industrial advances made by Japan since the second World War are dotted with examples where she managed to imitate and then improve the technology. This goes for the Linz-Donawitz process for the making of steel (Lynn, 1984), and for the use of the semiconductor for the making of radio sets and other electronic equipment (Morita, Reingold and Shimomura, 1986) - successes which allowed Japan to assume leadership in those sectors from the 1960s. There is an assumption in most of the conventional theory of international technology transfer that when an

economically more backward or lower-wage country imports sophisticated technology from an advanced economy it has to follow the specification prevailing in the latter. Again there are numerous examples to the contrary. A case in point is that of the adaptation of a component of a Cummins diesel engine by Tsuzuki, a small Japanese firm. The latter succeeded in producing it in small quantities but with a quality that was comparable with that of the products of the US firm. 'The task was accomplished by substituting 22 labour intensive processing stages for an automated transfer line' (Odaka, Ono and Adachi, 1988, p.13).

The Japanese victory in the race for parity with the U.S.A. in semi-conductor technology has been unambiguously ascribed to public regulation and support (Borrus, Tyson and Zysman, 1986; Sigurdson, 1983 and Okimoto, Sugano and Weinstein, 1984). Japanese success in importing technology and improving it and then beating the original developers in international competition has been replicated by other East Asian countries. As late as 1984, two major books on the semiconductor industry, one concerned with the general contours of development of the technology (Dosi, 1984) and the other devoted to the nature of competition between the U.S.A. and Japan (Okimoto, Sugano and Weinstein, 1984), the two global leaders of the industry, did not even mention South Korea and Taiwan. By 1987, both these regions were emerging as challengers of the two global leaders (Saghafi and Davidson, 1989). Unlike in the cases of mere assemblers of semiconductors such as Malaysia, Philippines and Mexico, South Korea, followed by Taiwan, had started full-time production of semiconductor chips, which were competitive

in the international market. The strategies followed by South Korea and Taiwan were different, the former depending on conglomerates for commercializing production, the latter developing a joint-venture company, with the government as the chief shareholder for producing semiconductor chips and supplying private sector companies. But the success of both these regions has again shown how quickly patterns of comparative advantage even in trade in sophisticated manufactures can change.

Even though the government of South Korea and Taiwan have pursued very similar strategies with respect to the import of foreign technology, the development of indigenous capability, and the simultaneous or phased exploitation of domestic and export markets, there are also some major differences with regard to the structure of control of private industry. On the whole, Taiwan's industrial plants have been more regionally dispersed than those of South Korea (Amsden, 1991). Moreover, the South Korean government has actively aided the growth of huge conglomerates (the chaebol), whereas Taiwan has relied far more on medium and small-sized firms. These differences have also been reflected in the different patterns of development of the electronics industry in the two regions (Mody, 1990). The cases of Japan, South Korea and Taiwan illstrate the proposition that in suitable socio-economic settings and appropriate government and business strategies, even latecomers can make rapid advances in technology absorption and quickly overtake some of their erstwhile mentors.

On the other side, the general impression often conveyed in many parables of the growth of modern industry and international trade that the pioneers of the industrial revolution in western Europe were model playgrounds of competitive games and development or absorption of technologies is also highly msileading. For example, Britain had highly imperfect capital and labour markets throughout the late eighteenth and most of the nineteenth century (Kennedy, 1987; Williamson, 1989). The upper classes of Britain also indulged extensively in 'rent-seeking behaviour' much derided in recent literature, besides, of course, deriving a vast amount of rent from land during the whole period of her transition to an industrialized economy (Rubinstein, 1983). To cap it all, all through the great age of technical invention, British businessmen made heavy weather of absorbing the silk-spinning and silk-weaving technologies originally imported from Italy (Jones, 1987).

The decline of British manufacturing prowess in relation to that of the U.S.A. and Germany has been attributed to cultural factors, to the reinforcement of gentlemanly values through public school education, and to rational adjustment of an economy whose dynamic comparative advantage lay in banking, finance and services, rather than in industry. However, the survival of Britain's dominance in some of the staples such as textiles, steel or shipbuilding has also been ascribed to the adaptation of Britain's skill endowments in a path-dependent, idiosyncratic pattern of evolution.[10]

Economists for a long time sought their analogies in classical mechanics and modelled their notions of equilibrium on those of the physicists. In this world, markets performed

perfectly, and wondrously rational individuals, who have been aptly characterized by Sen (1977) as 'rational fools'; adapted instantaneously to any change in the state of the world. The introduction of notions of 'bounded rationality' (Simon, 1982) of behaviour in the presence of risk and uncertainty (Diamond and Rothschild, 1978), or of strategic behaviour has not made a major dent in the mainstream economists' vision of an economy consisting of neurotically rational individuals operating in a social void. If we have to properly absorb the facts of human experience as captured in economic decisions and outcomes and draw lessons for behaviour aimed at creating better societies, we should perhaps turn to the philosophy of natural history rather than of classical mechanics for a guide to modes of reasoning. Students of evolution have found that nature has thrown up many different types of organisms which are wonderfully adapted to their different environments. They have also found that similar organisms starting with apparently similar environments, have ended up with very different types of adaptation; and variations in some conditions during the course of evolution have led to very different outcomes in terms of genetic organization of individuals and their behaviour in a group (for some fascinating examples, see Gould, 1977 and 1984). For example, haplodiploid organisms (those in which one of the two genders, generally the male, has an endowment of chromosomes only from one parent but the other gender has chromosomal endowments from both the parents) are much more likely to evolve tightly organized societies (such as those of bees or termites) than diploids (namely, those organisms in which members of either gender start with contributions from both the parents - as in

the case of all mammals, including human beings). But there are diploids who live in tightly-knit societies and there are haplodiploids who fail to evolve such societies. The varieties in the patterns of organization of human groups such as nations, nationalities or multinational states far more resemble the diversity found in nature than the uniformity beloved of mainstream trade theorists.

Of course, analogical reasoning is not a safe guide : we must know how to discard it and when. Organisms in nature evolved through many millenia : their adaptation, selection and survival was achieved through the blind working of myriads of natural forces. In cases of human organizations, we do have conscious agencies at work. Where our perspective differs from the conventional trade theorists' is in treating the market as just another man-made organization and the construction of the market and adaptation of human institutions as conscious acts of states, firms and particular social classes in partial or complete control of the state apparatus. The experience of the development of industrial capitalism can teach us something about how to go about designing institutions and policies.

One basic set of strategies that distinguishes industrial capitalism from situations in which commerce is conducted under the dominance of feudal or other precapitalist relations is that human beings are treated as the major source of profit and power. The first sign of a new awareness of labour as the source of riches and power was the concern displayed by many mercantilist writers for fully employing the national work force but at low wages and under the firm control of masters. It has been argued

that the doctrines propagated by mercantilist writers, stressing exports and positive balances of trade, make sense if they are interpreted as supporting a strategy for, 'using foreign trade as a device to keep the domestic economy stimulated, and for attaining full employment as the major operational end' (Allen, 1987, pp. 447-8). This interpretation harks back to Keynes' view that a favourable balance of trade, sought so eagerly by the mercantilist writers, would directly stimulate domestic demand and foreign investment, and indirectly encourage domestic investment by bringing down the rate of interest through an influx of precious metals (Keynes, 1936, pp.335-6). Keynes' view was strenuously contested by Heckscher in the second edition of his book (Heckscher, 1955, vol.2, pp.340-358). But his critique was based as much on his dislike, if not a serious misunderstanding of Keynes' own theory, as on the oversimplification practised by Keynes when he tried to distill the essence of mercantilism. For example, Heckscher (1955, vol.2, p.341) thought that the central concepts of Keynes' theory such as 'the propensity to consume, to hoard or to save', 'liquidity preference' or 'the inducement to invest' could not be verified by 'means of studies of the world about us'. Thus we have to attain a new understanding of mercantilist doctrines and policies despite the adverse judgement passed on them by the great historian of mercantilism, as we have to recover the understanding of social processes and social philosophy that underpinned Adam Smith's advocacy of free trade, despite the de-historicized and de-institutionalized political economy professed by many of his followers. By Smith's time, educating the people had come to be regarded as one of the major responsibilities of public authorities. But even

before the eighteenth century, Poor Laws had taken the place of medieval charity as the means of preventing starvation deaths of the disabled or displaced labourer or the artisan.

Conscious investment in the upkeep of human beings in the shape, first, of Poor Laws and then of social insurance has characterized the growth of industrial capitalism in England, France and Germany, Reproducing a reserve army of labour in order to keep the latter in line has ever been part of the modus operandi of capitalism. However, that reserve army has not been treated as an unlimited reservoir to be exhausted at will : control of labour has required its delimitation. Furthermore, capitalists realized the value of a better-educated labour force. Universalizing education has again been an objective pursued by all successful capitalist states. Under conditions of imperfect information about the quality of products and services, the working of market forces tends often to throw on the market only low-quality products and services (Akerlof, 1970). Universalizing education and getting the labour market segmented along lines of education and skill are ways of checking such tendencies of the market. Such strategies are pursued not because capitalists are philanthropists but because they have to compete in markets where quality sells.

Along with such universalist strategies of successful industrial capitalism, others grow up which are more particularistic in nature. Different societies evolve different strategies for attaining the aim of perfecting the social division of labour so as to gain and retain a competitive edge.

In some cases, private enterprises and associations of private firms are the main instruments for achieving the best social division of labour. The cotton textile industry of England in the nineteenth century seems to have fitted this pattern. In other countries and other industries, such as the metallurgical and power equipment industries of Germany and the U.S.A., the growth of large-scale firms with the internationalization of most production operations seems to have provided the best scope for a profitable social division of labour. In several French industrial cities in the nineteenth century, municipal or other local public bodies provided the framework for quality control, training of labour and upgradation of technologies (Piore and Sabel, 1984; Sabel and Zeitlin, 1985). In Japan, a group of conglomerate firms using large numbers of subcontractors became the focus of social division of labour. But subcontracting is not a peculiarly Japanese phenomenon. It can grow up in other contexts, such as the Lyons conurbation in France in recent times, where firms in various branches of engineering have resorted to subcontracting on a large scale (Lorenz, 1988). The French system of municipal fostering, regional regulation, and local subcontracting networks is substained by a state apparatus which has been consciously interventionist in spite of cyclical variations from time to time : the regimes of regulation have changed in respone to international and technological challenges, but the philosophy of state intervention has not. It is not obvious that the average Frenchman has done worse than the average Englishman because of this interventionist tendency of the state.[11]

The point I would like to drive at is that in designing appropriate trade policies and strategies of international competition, governments, firms and technological research laboratories must co-operate so as to evolve operating principles suitable to each national setting. In socialist China, a publicly guided system of cooperation between local Governments, state and collective enterprises, universities or colleges and research laboratories was the chosen instrument of development, transfer, and absorption of technology. In South Korea, private firms contracting out research needs to state-controlled laboratories and collaborating with them for adapting imported technology to local needs became highly efficient instruments for upgradation and absorption of technology (Bagchi, 1987a, chapters 3 and 9; D'Costa, 1989).

India, by contrast, has failed, on a national scale, to evolve a durable system of subcontracting or technology transfer. India's international competitiveness has suffered because of inefficient absorption and diffusion of both imported and indigenous technology. In a world which is characterized by monopoly or oligopoly, surrender to international capital could be the worst way of choosing a strategy for improving the internal productivity and international competitiveness of largescale industry. As it is, it is the small and medium-scale firms which provide the major part of Indian exports. Any reorientation of economic policies and political strategies must take that fact into account, as it must take account of the employment-generating of small firms. Simple-minded cures for the sluggishness of investment in the shape of mere loosening of investment licensing regulations have not worked so

far in India, as the stagnation of rates of investment as a proportion of GNP during the last ten years or more testifies.

3. Free trade policies as strategies of dominance and the fragility of the new political economy

It was long known that in most industries and in most countries of the world, firms using best-practice techniques co-existed with firms using very different techniques, and that the diffusion of new technologies displayed the same pattern of building in of apparent inefficiencies from the very beginning (Salter, 1959; Nabseth and Ray, 1974). The massive investment of the American steel industry in open-hearth furnaces for steel-making long after the invention of the LD process is a very clear example. It was also known that transaction costs vary from economy to economy, from sector to sector, and that those costs have as much to do with the type and strength of informal networks of trade and credit as with formal laws and regulations, or with measurable differences in the advantages conferred by transport and communication systems. But trade theorists paid scant attention to these complexities. As we have noted above, the new theorists of trade and growth have taken increasing returns, learning by doing and endogenous technical progress as the basic ingrideints for their model-building. But there is a tendency on the part of some of them to project indefinitely the dominance of today's large economies on the basis of their superiority in economies of scale, and R & D set-ups; there is also an anxious insistence that results of models of strategic behaviour should not be taken too

seriously for they depend critically on the values of certain parameters. Two of the leading theorists in the new mode of reasoning have warned that a bias for free trade may still be defended because the results of the new trade models are not robust enough (Krugman 1987b; Helpman, 1989). Others have been even more peremptory in their demand that a new philosophy of state intervention should not be built on the insecure foundations of the new trade theories (Srinivasan, 1989).

However, neither history nor theory tells us that free trade policies are more robust than policies of public regulation in the sense that they can by themselves promote growth in the long run. Both sets of policies, in order to be successful, require particular types of institutional changes, including changes in basic production relations in factories, farms, and cottage industries. Theories justifying intervention on a broad front have at least this to be said for them that they can incorporate blueprints for social change in their basic design and they do not have to appeal to ad hoc humanitarian criteria in order to justify such policies. This does not mean that all policies of protection of particular vested interests can or should be justified by appealing to some 'system', any more than particularistic policies could be justified or vilified in the Europe of the ancien regime by appealing to a posteriorly constructed mercantile model.

Successful policies for promoting economic growth in the modern world will require several major foundations, viz., widespread, and ultimately universal, literacy, abolition of

landlordism, guarantee of a minimum subsistance for every inhabitant, and a class or a government endowed with a strong propensity to invest in the home territory (for elaboration of this theme in the Indian context, see Bagchi, 1991). The second and third conditions are beeded, inter alia, for directing the incentives of the rich away from speculative activities and towards longer-term investment, for curbing the dominion of non-market power and for mobilizing potential savings for purposes of investment. Literacy is needed for facilitating the flow of information and diffusion of new, productive technologies. Finally, a high rate of investment is needed for speeding up growth with existing technologies and for promoting the spread of new technologies at the cost of old technologies and capital equipment of older vintages.

John Maynard Keynes, who regarded himself as a liberal, and can hardly be regarded as a champion of etatisme or of centrally planned economies, had found free trade doctrines wanting when it came to ensuring the satisfaction of domestic conditions or international financial conditions for guaranteeing as high a level of employment as possible. His plan for the reconstruction of the postwar economic system provided for a high degree of intervention by the major states in a coordinated manner. As is well known, only a part of his plan was embodied in the establishment of the International Monetary Fund and the International Bank for Reconstruction and Development. Whatever may have been the dynamic factors undermining the foundations of the Bretton Woods system which Keynes helped set up, while it lasted, most economies of the world enjoyed a

much higher level of employment and a higher level of growth than they had ever done in their history. Economists and other analysts differ about the underlying causes of the breakdown of that system. Hans Singer (1989) has recently argued that the main reason for the main collapse of Bretton Woods system was that it was seriously incomplete in at least two respects. The first was that the International Trade Organization which would have allowed the world to pass to a freer trade regime with internationally coordinated policies supervised by the United Nations (rather than dictated at the convenience of a few advanced market economies) was never brought into existence. The other was that the obligation on the part of the countries which routinely ran up balance of payments surpluses to adjust their own economies was never enforced, so that all the burdens of adjustment to unbalanced international payments flows were borne by the chronically deficit countries. Unfortuantely, the poorer countries were the ones which generally ran up the balance of payments deficits, partly because many of them had rulers and rich men who sought to fatten their own purses at the cost of the public treasuries (see, for an analysis, Pastor, Jr. 1990). Thus instead of providing all the players with a level playing field, an incomplete Bretton Woods system placed bigger obstacles in the path of the weaker players.

The breakdown of that system was followed by a rigorous analysis of the determinants of success or failure in international trade and domestic economic growth, and we have referred already to some of the major contributions in this area. This

analysis has added to the Keynesian armoury of policy instruments a set of technological and organizational conditions which might help a country to pursue a policy of promoting the competitiveness of its products abroad and its growth of productivity at home. As Evans (1991, p.48) has put it, the case for infant industry protection can be made on grounds of

> economies of scale such that a competitive market cannot be achieved in product markets, a lack of perfect foresight in capital markets; external economies, such as, in labour training, affecting labour markets.

Moreover,

> important producer goods such as knowledge and technology may have mixed public and private good attributes.

To these grounds can be added the advantages conferred by market lock-in, learning by doing and pre-emptive entry and entry-deterring pricing and non-price policies.

Of course, not each and every industry can or should be protected on such grounds. But the arguments for promotion, regulation or protection pertain not to the development of a particular industry but to the economy as a whole. Given an international economy dominated by a handful of countries, and a few hundred transnational corporations, the state may seek to create a social and economic environment which allows a less developed country to overcome the disadantages of starting with a less skilled labour force and poorer endowments of capital than others. Whether the state of a less developed economy can

sustain such an effort depends on the prevailing international payments system (e.g., of the kind that Keynes sought to create in the proposals formulated by him for Bretton Woods). If some less developed countries such as Taiwan and South Korea have been able to utilise the state apparatus to break out of a state of underdevelopment, it is at least partly because in the 1950s and 1960s they enjoyed an exceptional international payments situation through the virtual underwriting of their external deficits by the United States and institutions aligned with the Western block and because they had privileged access to the markets of the U.S.A. and Western Europe. In Taiwan and South Korea the state was willing and able to intervene effectively whereas in most less developed countries, the state was hobbled by various political and social constraints. An analysis of those constraints and attempts to break them through appropriate social policies should surely be part of an exercise in political economy. Such exercises were carried out in the seventeenth and eighteenth centuries by political philosophers seeking to strengthen and purify absolute monarchies, philosophers advocating republicanism and mercantilists and free traders seeking to liberate the economy from the trammels of corporates and feudal regulations.

Unlike Adam Smith and his immediate predecessors of the Scottish Enlightenment, his contemporaries and his immediate successors, the 'new political economy' (NPE) has virtually nothing to say about the basic institutional and political conditions for speeding up the rate of accumulation in the economy. Yet, it is obvious that the champion growers of East Asia such as Japan, South Korea, Taiwan Province of China,

Singapore, Hong Kong, the People's Republic of China, Indonesia and Thailand have also chalked up rates of investment exceeding those of most other countries : their rates of saving or investment (as percentages of GNP) exceeded 25 per cent throughout much of the 1970s and 1980s, and often exceeded 30 per cent in those years. In slow-growing countries, these rates rarely exceeded 20 per cent and often fell short of 10 per cent (the data are from ADB, 1991, Tables 2.1 - 2.23).

The adoption of different degrees of openness in external trade relations, or different measures of governmental or social regulation of different sectors of the economy and the use of different kinds of policy instruments should be all dependent on the position of the particular economy in the matrices of international trade, investment, credit and labour flows, and few a priori judgements about the exact fit of openness or stringent public regulation to the circumstances of a developing country can be advanced. It has been known at least since Austin Robinson's work on the different ways different firms resort to vertical or horizontal integration that technical economies of scale or even a larger endowment of initial financial power does not necessarily make a firm more dynamic. The takeover of Associated Electrical Industries by the General Electric Company is one of many such examples. In the Indian setting, to take an example at random, the Metalman Pipes which produces only one-third the value of output of Steel Tubes of India and has a correspondingly lower value of capital (both the firms own plants in Madhya Pradesh and produce with the help of foreign collaboration) has a much

better track record of profits. Yet Steel Tubes of India can survive and even expand (E T, 1991). If the argument of invincibility of economies of scale does not by itself ensure that only the currently advanced manufacturing countries can continue to grow, then, it is argued, the much greater capacity for R & D of the advanced economies will enforce their dominance in trade, in technology and in manufactures. The ability of East Asian economies to learn and beat the earlier masters in many fields requiring sophisticated technology can be cited as outstanding counter examples. But the R & D efforts in other developing countries than the East Asian tigers can also bear significant results. Cuba has done quite well in several fields of biotechnology. In India, the Astra Research Centre in Bangalore has been able to use recombinant DNA technologies to produce antidotes against asthma, shigella (a virulent type of diarrhoea), tuberculosis and neurocysticercosis, a neurological disease caused by tapeworms (Shetty, 1991). Such examples can be multiplied from many other poor countries.

Empirically, it can be said that all the East Asian economies which have grown fast since the 1950s or 1960s satisfied the four basic social and political conditions outlined above, viz. abolition of landlordism, spread of education to achieve universal literacy, assurance of a minimum supply of provisions for every inhabitant,[12] and government and a business class bent on raising the rate of accumulation within the country. It is also apparent that during the phase in which Japan, South Korea and Taiwan were on the trend-acceleration trajectory, none of the governments followed the laissez

faire prescriptions of the proponents of the new political economy, such as Ian Little, Jagdish Bhagwati, Anne Krueger or Bela Balassa. None of them had an open-door policy towards direct foreign investment, all of them operated various instruments for restricting imports, and most of them followed low-interest policies for fostering domestic investment; and in most of them the government played an important part in directing investment into desired channels, often by using credit instruments and controls on allocation of scarce raw materials or scarce foreign exchange.[13] It has become part of the current orthodoxy of the IMF and the World Bank, that real rates of interest must fully reflect 'market conditions', and therefore, jacked up to 20 per cent and above. Setting aside for the moment the question as to whether it is possible to define 'market conditions' in an unambiguous manner in a market in which expectations, initial asset holdings, regulatory instruments and the degree of poverty play such an important part, the orthodoxy ignores the strong evidence that real rates of interest were low and often negative in the 1970s in some of the fast-growing countries (for the Korean case, see Woo, 1991).

Free trade policies have been generally pursued by an economy which enjoys comparative advantage in most of the advancing sectors of manufacturing or services or which has established a financial hegemony in international capital markets, or both. Smaller economies which are in an essentially common market relationship with the dominant country and enjoy the benefit of influx of capital from the latter can also then practise a degree of openness in their external trade policies.

But a free trade policy does not necessarily follow, as the relationship of Britain to her whitesettled overseas colonies before the First World War demonstrates. Britain enjoyed dynamic comparative advantage in most branches of manufacturing up to the 1860s, and dominated the international capital market throughout the long nineteenth century. The U.S.A. enjoyed both types of dominance from the 1940s up to the 1970s, and her financial and economic dominance was completed by military dominance. In the 1980s while she lost her dominant position in many branches of manufacturing, her dominance in services, banking and military preparedness were not yet seriously challenged. The U.S.A. also enjoys a special position as the ultimate haven of the rich everywhere. The latter characteristic is unlikely to be duplicated except in an European community which can give up the attitude of 'fortress Europe' and shed some of the most serious pieces of protectionism.

Most poor countries have not adopted 'external liberalization' voluntarily. It has been forced on them because of their entrapment in a network of foreign aid and loans, an entrapment in which some sections of their ruling class have deliberately colluded. Liberalization has often been adopted as a substitute for basic institutional changes that could promote growth and development and naturally has led to impoverishment and stagnation in most cases.[14] External liberalization is accompanied by all the wrong signals for accelerating investment and growth : devaluation is generally accompanied by an immediate acceleration in the rate of inflation and the pressure to cut down domestic absorption leads to domestic recession; a rise in rates of interest and a state of

credit stringency adds to recessionary tendencies, and anticipation of devaluation leads to further capital flight. Capital flight has been one important reason for the enmeshing of many Latin American countries in the debt trap. Despite claims to the contrary, little evidence has been found that capital flight is greatly sensitive to changes in rates of interest as such. Moreover, it also turns out that the removal of controls over capital movements mandated by IMF programmes of adjustment tends to accelerate rather than arrest capital flight (Pastor, Jr., 1990). Many studies also show that so long as the massive debt overhang persists there is little prospect of private investment responding positively to various liberalization and stabilization measures. A recent paper published by two IMF staff members, concludes that 'developing countries with high growth rates, and income levels, low inflation and debt, and substantial public investment have higher levels of private investment relative to GDP' (Greene and Villanueva, 1991). So some of the key results or recommendations of IMF-style liberalization such as increasing the rate of inflation as a natural consequence of higher interest rates, drastic devaluation and removal of subsidies and de-scaling of public investment (and public expenditure in general) are precisely likely to dampen the prospects of prosperity of the countries that the IMF and new political economy doctors want to treat with their medicine.

Looking at the historical record of today's developed or industrialized countries, a broad generalization can be hazarded : all of them had restricted trade regimes in place during the period when they were experiencing trend acceleration

in economic growth and when their occupational and earnings structure were changing to increase the importance of the secondary and tertiary sectors, and marginalize the primary sector. Even while they were practising such restricted trade regimes, they were advocating free trade policies for others, and on occasion were able to cajole and force other countries to adopt free trade policies. Even while British publicists and policy-makers were persuading the newly liberated Latin American countries to do away with all trade restrictions, Britain herself was still practising a wide array of trade restrictions not only against other European countries but also against her direct colonies such as India. Similarly, even while the U.S. and European policy-makers were more or less forcing the less developed countries to introduce external trade liberalization, the protectionist barriers were going up in the shape of multifibre agreements, voluntary export restraint agreements, and straight subsidies to agriculture, steel and many other industries under threat from foreign competition.

The new political economy (NPE) not only ignores this dominance-subordination relationship in contemporary developments. It has also either ignored history or misread it in order to suit its purposes. The revolutionary restructuring of European policies and societies before the onset of industrialization is simply taken for granted by them and they seem to regard institutional and social changes to be a passive consequence of commercialization rather than as a necessary precondition for the building of a society ruled by free contracts and free choice. There is no reference in their writings to the kind

of debates in social philosophy that led to the emergence of political economy as a separate discipline. Where there is an attempt to invoke history, it often consists of arbitrary juxtaposition of some evidence of malfunctioning of markets in less developed countries with evidence of better functioning markets in advanced industrialized societies. The malfunctioning of markets is generally attributed, by using the logic of post hoc ergo proper hoc, to government intervention, ignoring most other sources of malfunctioning such as the prevalence of non-market power, private monopoly or acute insecurity on the part of people continually on the verge of starvation. Moreover, the extensive evidence of malfunctioning of markets in early phase of industrialization in many of today's industrialized societies is also ignored by the proponents of the 'new political economy.[15]

Little, Scitovsky and Scott (1970) for example, asserted that the gap between urban and rural wages was high in developing countries. Then they explained the puzzle by attributing the 'high and increasing wages' of urban labour to the strength of trade unions and to protectionist policies which boosted profits and hence increased the pressure for increasing wages. They did not pause to enquire as to whether average urban wages had increased, say, in India faster than the cost of living. In fact, between 1939 and 1970, with some cyclical fluctuations, real wages of factory workers remained virtually stagnant in India, and trade unions were just about able to secure restoration of the very low prewar standards of real wages after their disastrous fall during the second World

War, Little, Scitovsky and Scott attributed the urban-rural wage gap to protectionism. Again, if they had enquired into the phenomenon seriously, they would have found that the wage gap long preceded the restricted trade regime in India and it pertained only to the wages of the socalled organized sector as against those of the socalled unorganized or informal sector.

There was also an implicit assumption in Little, Scitovsky and Scott (1970) that rural-urban wage gaps were a peculiarity of underdeveloped countries. When they appear in an extreme form, they are the direct or indirect reflection of racial discrimination, discrimination along lines of communities and castes, or other status groups, sluggish economic growth and obstacles against mobility of labour. But they are not the direct result of a restricted trade regime, nor are rural-urban wage gaps or regional wage gaps the peculiarity of underdeveloped countries, as the case of Britain in the century from 1760 to 1860 would amply illustrate.

In individual instances practitioners of NPE displayed some awareness of the historical dimensions of the problem of malfunctioning markets and slow growth in the less developed countries. Thus, for example, Bhagwati Desai (1970, chapters 2 and 3) were aware both of the constraints that British rule imposed on the development of indigenous entrepreneurship in India and of the limitations of the indigenous mercantile class inherited by independent India. But when it come to analysing the roots of monopolistic and 'rent-seeking' behaviour, they

sought them almost entirely in the package of government policies inherited or instituted by government of post-independence India to the exclusion of the survival of landlordism over most parts of rural India, the deeply rooted tendency of merchants to rig prices or corner stocks and the infraction of normal free market behaviour because of the existence of a vast mass of people continually on the verge of unemployment and starvation.

Some other students of NPE have gone further and denied any untoward effects on prospects of industrialization caused by the spread and persistence of formal and informal colonialism over most parts of the globe, beginning from the sixteenth century and lasting well beyond the middle of the twentieth century. The abundant evidence of the relative and even absolute retrogression of most parts of the world outside the North Atlantic and East Asian economies (Bairoch, 1982) has been entirely ignored by them. Some of the practitioners of NPE, such as IMD Little (1982) have argued that India, the most populous country ever to have been a formal colony of a European power, lost nothing in terms of industrialization by the commercial dominance of Britain or by British rule and in fact gained substantially through the growth of modern industry. Little's evidence is entirely culled from secondary sources. His story starts in the beginning of the nineteenth century, and ignores near prohibition of most varieties of Indian cotton textiles in Britain during the whole of the eighteenth century (Thomas, 1926). For the nineteenth century he makes very selective use of his evidence, pointedly ignoring

the evidence of discrimination against domestically produced Indian textiles in favour of British textiles.[16]

As in colonial India, so in other parts of the world, 'free trade' has been a policy often practised under external constraints of formal and informal domination by another country or another group of countries, and within an institutional setting that impeded the mobility of factors of production and the working of freely competitive markets. There is evidence, for example, that India paid higher prices for many commodities that were produced by British firms but were available from other sources, and received lower prices for some of her most important exports when the destination was the U.K. rather than countries outside the British Empire (Banerjee, 1990; Bagchi, 1972, chapters 6 and 8). Evidence has also accumulated that the Indian cotton textile industry became less competitive compared with that of Japan by the beginning of the twentieth century, mainly because of the blinkered faith of Indian industrialists and their British advisers in the superiority of Lancashire technology and mill management (Bagchi, 1988).

Political economy and its antecedent discoursess from the sixteenth to the early nineteenth century were discourses of power and plenty : they were discourses of power of the state over the activities of the citizens, of capital over labour, of domestic manufacturing and trade over foreign manufacturers and traders. But they also produced analyses of whole societies and states, and were not abstractions delinked from the situations of particular states and societies. After

Ricardo and the vulgar Ricardians such as J.R. McCulloch and Harriet Martineau, laissez faire became entirely a discourse of dominance of the rich countries over the poor : the new 'nationalist' or historicist schools based in the U.S.A. and Germany produced defensive discourses but aimed at eventual dominance. The neoclassical political economy is also basically a discourse of dominance of rich over poor nations, of financial over manufacturing capital, of internationalized domestic capital over more narrowly domestically based capital and of course, of aggressive capital over weak or non-existent trade unions. It is not the logical profundity or the empirical soundness that gives NPE its cutting edge. It is its alliance with the power of the dominant nations, with internationalized domestic capital and with transnational capital that makes it powerful. The new theories of international trade, and technical progress through localized learning, adaptive learning and idiosyncratic evolution can produce a discourse that can show up the hollowness of the universalism claimed by the proponents of the new political economy. But the production of such a discourse has to battle with the detritus and debris, the casual empiricism and the shoddy history churned out by the knights of free trade and liberalization.

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FOOTNOTES

1. Adam Smith was much more aware of the importance of considerations of justice, prevailing public opinion, and designing of appropriate institutions in making political economy serve as the 'science of the legislator' than most historians of economic thought have credited him with. His Theory of Moral Sentiments was published originally in 1759, reprinted several times in his lifetime and extensively revised by him in 1790 (Smith, 1759) long after the publication of the first edition of his Wealth of Nations. Hence we can assume that he took the principles of morality and justice adumbrated there to underlie the practical policy proposals made in the Wealth of Nations. The theoretical disembedding of the principles of free trade, in other words, assumed the functioning of a definite institutional framework. For an elaboration of Smith's position in this respect see Winch, 1983; for a brief account of the philosophical underspinnings and background of the Wealth of Nations, see Taylor, (1960), chapters 2-4.

2. On the experience of Sir James Steuart as a Scotsman with predominantly continental European connections and its influence on his work, see the editor's introduction to Steuart, 1966, vol.1.

3. For a masterly resume of the theoretical developments until the 1930s, see Viner (1937), chapters VI and VII.

4. My analysis in this paragraph and the next is entirely based on Semmel,(1970), chapter 2.

5. The view implicitly advanced here, viz., that after Adam Smith, political economy was set adrift from its moorings in a general theory of society and institutional change and made into a system which was peculiarly suited to the needs of advanced capitalist economies, has been challenged. But this view has been defended again by Winch, (1983), See also in this connection, Evans, (1988), chapter 3.

6. The literature on Japan, South Korea and the Taiwan Province of China is vast and growing as fast as their economies. Some major references are given in Bagchi (1987a and 1987b), Amsden, (1989) and Woo (1991).

7. For summary and a critique of the 'new political economy' as applied to problems of development, see Toye (1987). I had critically reviewed Bhagwati and Desai (1970), and Little, Scitovsky and Scott (1970), in Bagchi (1971).

8. For surveys of the new theory of international trade, upto about 1984, see Jones and Kenen (1984, 1985); see also Helpman and Krugman (1985, 1989); Krugman (1987a), Dixit (1987), and Krugman (1989). For a survey of the literature on product differentiation and its relationship to Kaldor's pioneering work on the relationship between firms with similar but differentiated products and locations, see Eaton and Lipsey (1978, 1979 and 1989). For other approaches to strategic trade policy, see Brander and Spencer (1981, 1983 and 1985). The relation of increasing returns and technical progress to the rate and pattern of economic growth is treated by Romer (1986), Lucas (1988), Murphy, Shleifer and Vishny (1989) and Krugman (1991).

9. For references to the work of Gunnar Myrdal, Paul Baran, Andre Gunder Frank and Samir Amin, and the dependency and schools, see Bernstein (1973), Brewer (1980), Bagchi (1982), Patnaik (1986), Palma (1987) and Evans (1988).

10. See Elbaum (1990). Elbaum's argument can be nested in the theoretical propositions advanced by Atkinson and Stiglitz (1969) and Arthur (1989). While Elbaum is sensitive to the social and political setting of British industry in the nineteenth century, he still tends to underestimate the significance of the markets provided by Britain's dependent, non-white colonies, and the massive migration of capital and labour from Britain to the New World. Britain could continue to sell the products of its cotton mills abroad because her biggest customer by then was India, a dependent colony in which the financial and marketing networks were dominated by British businessmen. There is also some evidence that Britain bought its cotton at a lower price from India than its major non-Indian competitor, viz., Japan did. The monopoly of cotton textile machinery sales to India enjoyed by the British manufacturers was another knot tying the Indian market to British mill interests. Elbaum has noted that Lancashire mills enjoyed an elastic supply of skilled labourers even though the wages of the latter were not rising fast. This was connected with the fact that greater numbers of unskilled labourers and agricultural labourers migrated from the United Kingdom than other sections of the population, at least during the peak migration decades of 1876-1901. Out of a total number of 2,032,450 migrants with stated occupations, 1,044,225, or more than 50 per cent were domestic servants, (general) labourers and agricultural labourers (Thomas, 1973, Table 11). Thus Britain was left with a larger endowment of workers with traditional industrial skills in 1900, than she had, proportionately speaking, in 1876, and this provided an added impulse to her path-dependent trajectory.

11. For a concise account of the post-Second World War record of the State intervention in critical areas of the French economy, see Hayward (1986) and Mytelka (1982).

12. For assessments of the relative roles of public action and economic growth in different countries in sustaining a basic minimum acceptable standard of living, see Dreze and Sen (1989).

13. For a summary of various regulatory policies followed in the Republic of Korea up to about 1985, see Bagchi (1987a) chapter 3; see also IBRD (1987). For a recent account which assigns a preeminent role to government policies of allocation of domestic credit and foreign loans in South Korea's emergence as an industrialized economy, see Woo (1991).

14. For evidence that 'liberalization' and 'stabilization' have not promoted growth in most of the poor countries, see Dornbusch (1990).

15. In one of the earliest salvoes of the new political economy, viz., Little, Scitovsky and Scott (1970, chapter 3), it is asserted, for example, that urban population were increasing much too fast in the seven developing countries picked by the authors for special analysis. However, in India, the most populous of the countries chosen by them, rates of growth of urban population (3.5 per cent per annum) and the degree of urbanization (around 20 per cent in 1970), were low by the standards of, say, western Europe in the nineteenth century. Moreover, China, a developing country and the most populous country in the world the speed of urbanization was low by international standards. In fact, barring the cases of a few Latin American countries, urbanization rates in today's less developed countries are probably no higher than in the advanced market economies at a comparative stage of development (Preston, 1968). This does not mean that rates of urbanization are not too high in relation to the resource of these countries. But that has to be established with a close analysis of the social structures, including, for example, agrarian relations. That task is not on the agenda of NPE.

16. Little (1982) claims that India's 'export trade in handicrafts was killed by the Industrial Revolution, not by the British Raj' (p.357). He then admits that colonialism had something to do with the constriction of the domestic market for Indian cottons, and attributes it to the very low level of tariff on imports into India. He quotes Dutt (1906) but not the evidence cited there from various Parliamentary enquiries and enquiries by British officials in India about the prohibitive nature of duties imposed on Indian cotton and silk and the 'reverse protection' suffered by Indian handloom products within India herself (Dutt, 1906, pp. 179-182). Dealing with the differential treatment of Indian and imported British cotton manufactures in India, Lord Ellenborough pointed out in 1835 that while the British goods imported into India paid a duty of 2.5 per cent, the cotton manufactures of India in their home country paid a duty of 17.5 per cent (Dutt, 1906, p.212). Little misses out all this, and citing the authority of Harnetty (1972) states that 'during 1814-49 the Indian tariff on cotton piece goods was 5 per cent and 3.5 per cent on yarns (Little, 1982, p.357).

Little goes on to assert : 'The hardest time for the handloom weavers was probably the 1820s, the scanty evidence suggesting that there was no decline in output in any other period and that the weavers' relative position 'seems not to have changed in 100 years' before the first World War' (Little, 1982, pp. 357-8). I had used the evidence of Francis Buchanan Hamilton to show that the view shared by British officials such as Charles Trevelyan, H.H. Wilson and nationalists such as Dadabhai Naoroji, R.C. Dutt and M.G. Ranade that British policies led to a massive decline of Indian handicrafts and the casting of vast members of people on to a relatively stagnant agricultural sector had a solid foundation. More recent work, by J. Krishnamurty (1985), S. Krishnamurty (1987) and R. Chatterjee (1987) for Bengal and western India has strengthened that conclusion by tracing the relative decline of handicrafts (in terms of the proportion of population supported by them) and the sagging of real wages of agricultural labourers down to the end of the nineteenth century. Some recent work of Amalendu Guha (1989) shows that for India as a whole handloom output fell in several decades in the nineteenth century.

Official evidence of immiserization of weavers, small peasants and agricultural labourers piled up also in the

various Indian Famine Commission Reports and their minutes of evidence, the Gazetteers of the Bombay Presidency, and in the reports prepared by many other British administrators and scientists. But Little, of course, would not 'believe' that these were credible results of the era of free trade beloved of him ('I believe' and 'I do not believe' seem to be a recurrent refrain in his style of argument).

The experience of India in suffering absolute or relative de-industrialization was not unique. Many parts of the Ottoman empire in Africa and Asia, and indeed many regions of central and southern Europe went through a similar experience in the nineteenth century, but public action often cushioned the impact of such developments in Europe (Sabel and Zeitlin, 1985).

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