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HOW FAR CAN INTERNATIONAL TRADE CONTRIBUTE TO GROWTH IN NON-INDUSTRIALISED COUNTRIES? RECONSIDERING THE FOUNDATIONS

Abstract

To the question: "Can non-industrialised countries find a path to growth in the opening to the world economy, through the abolition of all kind of restrictions to external economic flows?" we had to give a very qualified answer:

- *The liberalization of external relations in a world where factors of production are partly mobile and technological levels unequal induces not an optimal allocation of all resources, but a partial migration (capital, qualified, labour etc.) from the poorer countries to industrial ones and consequently the under-utilization of the other local resources.*
- *Market forces induce the use of comparative advantages in the sense of the best use of existing production structures (Ricardo) but not of the achievement of structural changes needed for the optimal uses of the factors of production (Heckscher-Ohlin), whether it be technical innovation, creation of externalities, better sectorial and regional integration. their effect is consequently limited to a better distribution of resources among sectors (Ricardo) and does not secure a growth process.*
- *Does the general equilibrium model determine proper terms of trade and can the rate of exchange be fixed accordingly? — We discovered, that on different grounds the models of both Ricardo and J.-S. Mill show, that terms of trade tend to be unfavourable to non-industrialised countries in absolute terms.*
- *According to the theory of comparative advantages (natural and acquired) a country trading with the world market tends to concentrate its exports on a limited number of products. This number may be relatively large for a complex industrial economy, which has built up all kinds of advantages, but is dangerously small in non-industrialised countries relying mainly on natural advantages. It means, that for them, market forces act against the development (by diversification) of their exports.*
- *Even after Marshall-Lerner, Ricardo's approach to the equilibrium of the balance of trade is still predominant, despite the interference of other transactions, and despite Ricardo's disregard for the loss of purchasing power of exports, when a devaluation occurs. Taking it into account results in the fact that there may be more than one, or no rate of exchange, which brings the balance of trade into equilibrium.*
- *Due to the structure of their economy and of their exports and imports, non-industrialised countries have a lesser chance than others to bring their balance of trade into equilibrium by a devaluation.*
- *Ricardo disregarded a fact, which was considered as important by his predecessors: that trade is also a sector of activity, entering in competition with the others.*

A. Smith considered, that its development could deprive others from needed capital; Fr. Quesnay denounced the enrichment of traders as a burden on the economy. Such problems are acute in lesser developed countries, but the turn taken by Ricardo excludes the issue from the theory.

— *Ricardo separated the theory of external trade from the analysis of the operation and growth of the internal economy. It was not the case with his predecessors. It has been a great theoretical loss. To it, he substituted the gain in exchange; and present theories and policies still give a priority attention to it, though it may be of secondary importance only.*

After having considered all the reasons, why external trade and a liberal external policy may not induce growth, as suggested by the models based on the classical economist, we do not consider, that external trade does not have an important role to play, but it would be more along the lines developed by 18th Century writers, whom it may be urgent to rediscover.

There is today a debate as to the contribution of international trade to the development of the countries, which have not succeeded in building up a core of industries, and which the crisis is bringing back to their role of suppliers of raw material.

There is a clear opposition between the intuition of policy makers, especially of the country itself and economists (see Raffer 1990 p. 3.). In the discussion the politicians are not able to make their case, as they are always opposed with the logical rigour of well known models.

Various ways are open for the clarification of the debate:

— to study the trade policies of countries which successfully industrialised, or are doing so, and to note the divergence between their policies and the textbooks, and the reasons for the differences. A useful light could be gained from such studies.

— to study the non-industrialised countries and the operation of their economy; then on the basis of a proper modelling of economic flows, with due regard to the country's structures and to all internal interdependencies, find out the optimal role of international trade.

Though those two approaches would be most promising, we shall not consider them now. Our only ambition is to contribute to the clarification of a prerequisite to the theoretical acceptance of such researches. Indeed their results, as meaningful as they may be, will always be refuted on the basis of the theoretical concepts drawn from the classical economists, much elaborated upon, but not changed in their substance.

We shall consequently reread David Ricardo, Augustin Cournot and John-Stuart Mill:

— David Ricardo, as the author of comparative advantages, which, combined with the distribution of capital according to its highest profitability, imply an optimal allocation of resources,

— Augustin Cournot, who in his endeavour to formulate classical economics in a mathematical form as early as 1838 introduced a new approach, which is basic in today's textbooks,

— John-Stuart Mill, who elaborated the basic principles for the conception and measurement of the gain in exchange and of its distribution.

Modern theories rest on those fundamental approaches and cannot be questioned without a careful examination of those very foundations.

Consequently, in the light of the contribution of those three authors — with minimal references to the followers, who developed it — we shall consider some fundamental issues facing non-industrialised countries:

— Does an international liberal economy offer every country a proper occasion to industrialize?

— Does it induce an optimal allocation of all resources?

— Does it secure favourable terms of trade to lesser developed countries?

— How far does it favour the expansion of exports?

— Will the balance of trade of those countries reach naturally an equilibrium, with a floating rate of exchange or alternatively with devaluations intended for the purpose?

— Will the development of external trade favour internal investment?

— What is the impact of external trade on the operation of the internal economy?

— Will it induce growth?

The answer to these questions is no problem to most of todays economists, especially in international financial circles. And any policy is challenged with the well-known straightforward answers to those questions.

How far are the classical principles applicable? — Much has been argued about special cases and situations. But the validity of such objections is only admitted as opportunistic short term solution. A real objection to the policies inspired by the straightforward application of the classical principles must rest with the questioning of the principles themselves.

1. Does an international liberal economy offer every country a proper occasion to industrialise?

Ricardo's law of comparative advantages suggests, that international trade enables every country to apply its resources to the productions, from which it gets the highest possible income. But Ricardo himself notices, that the principle applies only if there is no international mobility of the factors of production. In his well-known example of England and Portugal he writes: "It would undoubtedly be advantageous to the capitalists of England, and to the consumers in both countries, that under such circumstances, the wine and the cloth should both be made in Portugal, and therefore that the capital and labour of England employed in making cloth, should be removed to Portugal for that purpose" (Ricardo I p. 136). If the factors of production were mobile, only absolute advantages would count, and the country, which has an overall lower productivity than others, would not be able to export or even to produce anything.

But Ricardo did not develop that assumption, so that it is generally forgotten. Why did he not: Because in his time, he observed, that the capital is not moving from one country to another: "In one and the same country, profits are, generally speaking, always on the same level; or differ only as the employment of capital may be more or less secure and agreeable. It is not so between different countries. If the profits of

capital employed in Yorkshire, should exceed those of capital employed in London, capital would speedily move from London to Yorkshire, and an equality of profits would be effected; but if in consequence of the diminished rate of production in the lands of England, from the increase of capital and population, wages should rise, and profits fall, it would not follow that capital and population would necessarily move from England to Holland, or Spain, or Russia, where profits might be higher." (Ricardo I p. 134). What he considered as a characteristic of the economic structures of his time is taken today no more as an observed fact, but as a necessary assumption; it is otherwise impossible to distinguish internal and external trade. Ever since the later 19th century, that assumption became less and less realistic; today it is no more realistic at all. If the assumption were valid, every country would have an opportunity to develop its production even with a productivity lower than in other countries for any product. The consequence of the fact that the assumption is not valid is rather dramatical, and Ricardo mentions it: all the capital will move from the poorer to the better developed country; and not only the capital, but also the population (Ricardo I p. 134, 136). He describes exactly the situation of the non-industrialised countries: their capital and population strive by all means to leave the country for the industrialised ones. What is called capital flight is only a rational behaviour of the owners of capital — could we expect them to be good entrepreneurs, if they were not making the best and safest use of their capital?

Could a change in the rate of exchange modify the situation: — Ricardo would not have asked the question in such terms, as he did not consider it a matter of economic policy but rather a result of economic activities. It is never-the-less possible to apply his approach to such a question. Let us imagine two countries; in one of them the labour value of all goods is higher than in the other; if there is no restriction to trade between them, the former will import from the latter without compensating exports, until their relative level of prices (or their rate of exchange) allows for an equal flow of goods in the opposite direction. At that stage, they would get the greatest benefit from their comparative advantages. The level of income in the poorer country will still be lower than in the other, but the difference, which previously reflected their relative average productivity is now nearer to their relative productivity for the products, which can just be exported. Is that difference of income borne by capital or by labour? — According to Ricardo's theory relatively to the determination of wages, it will depend on the behaviour of labour relatively to reproduction, which determines the subsistance wage and also in this case, to migration. If neither capital nor labour accepts the lower remuneration than in the other country, they will both leave their own, despite the increase in income obtained from international trade.

If we consider today's world economy, brain drain, socalled capital flight, the irrepressible migrants' pressure at the border of industrialised countries, we can but conclude, that if the use of comparative advantages brings to nonindustrialised countries some of the benefit of the high productivity of the industrialised ones, the mobility of the factors of production deprives them of the chance to industrialize. For a closer consideration of that point, see below.

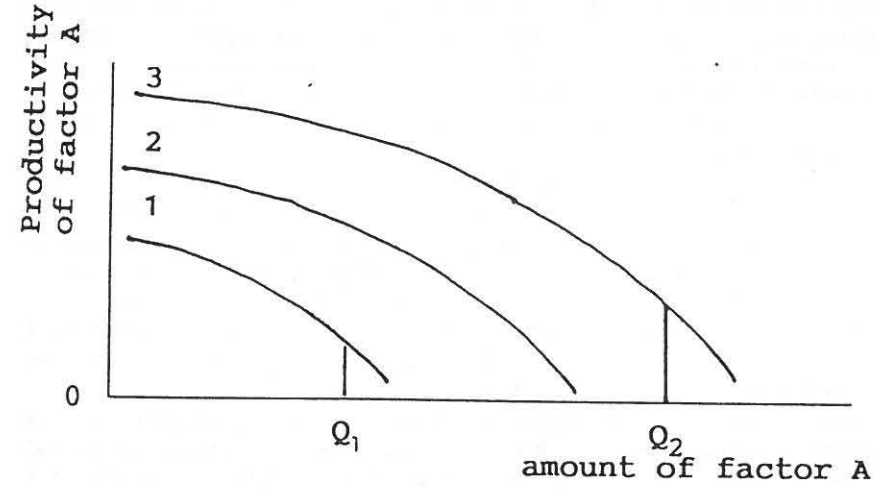
2. Does international trade induce an optimal allocation of all resources?

Today's theory founded on Ricardo's and Heckscher/Ohlin's approaches has a straightforward answer to the question. But if we take into account — as Ricardo suggested — that factors of production may be mobile, the answer is not as evident. Nor is it, if we give up ignoring the problems of structural change.

Although classical economists paid quite some attention to the optimal allocation of resources (see e.g. point 6 hereafter), they could not achieve what could only be done within a Paretian economic model. That is why we shall refer to it in the following development.

According to Ricardo, one factor of production (land) is not mobile, while capital and labour could be — which raises the issue: does the allocation of resources tend to be optimal in a world, where some of them are more mobile than others? — According to the marginal theory, mobile resources tend to migrate where their scarcity is greatest and consequently their return highest. If we remember that the scarcity of a resource is relative and is measured by the value of its marginal contribution to production, we may not be surprised, that mobile factors migrate from the countries, where they are scarcest in absolute terms to those, where they are less scarce. Indeed, the marginal theory is founded on the substituability of factors, but at the same time acknowledges their complementarity, as reminded by the following chart:

Chart 1: Relative scarcity of a factor of production



The marginal productivity of factor A depends on its amount relatively to other factors of production. If we increase the amount of those factors, then the productivity of factor A passes from curve 1 to curves 2, 3, ... It may be more abundant in one

country (Q_2) and never-the-less have a greater relative scarcity than in another one, where it is less abundant (Q_1).

The consequence of this fact is very important in the international economy, where factors of production are not equally mobile. The fact that a greater amount of a factor of production increases the relative scarcity and the return of those, with which it is combined, does not matter for the owner of that factor. As a result he will probably transfer it to the area, where he gets the highest return, rather than keep it where it would most valorize other factors of production. Practically it means, that the mobile factors of the non-industrialised countries are quite rationally transferred to the developed areas, where they are more valorized, rather than stay in the countries where they would have the greatest impact on the productivity of other factors. As we can see all over the world, the mobile factors of production (trained labour, finance, ...) leave for the most developed countries, while non-mobile factors (land, ...) suffer from a very low productivity, largely as a result of the emigration of the mobile factors.

This first reason why a liberal international economy does not secure the optimal use of the factors of production is not the only one. A second should be considered.

Ricardo built his model of international trade on the labour theory of value. Heckscher and Ohlin reinterpreted it in terms of the scarcity theory of value. It involves one consequence, which should not be over-looked. In the theory of Ricardo entrepreneurs looking after their own interest will by their uncoordinated actions bring forth the optimal result described by the theory. Is it still true with the Heckscher/Ohlin model?

For Ricardo, as well as for A. Smith, (II p. 38) comparative advantages are natural or acquired (I p. 141—142); they consequently include the organization of the production sector with its many dimensions and aspects; it is a question of existing production advantages, whatever their origin is. The Heckscher/Ohlin model refers to the potential use of existing factors of production. Those factors may be natural or may be the result of human activities; but they do not include the actual organization of production. In short, Ricardo's comparative advantages are actual, Heckscher/Ohlin's are potential.

Let us assume, that the opening of trade creates new opportunities in a country; the factors of production are already engaged in existing activities, where their return is real. If the economy was only a set of enterprises independent from each other, an entrepreneur might seize the opportunity and overbid the necessary factors from other enterprises. But if the profitability of that enterprise is conditioned by the existence of others, of a network of services, ... the reallocation of the factors of production requires a decision, which cannot be taken at the level of the enterprise, but only at a higher level; it requires something like planning.

In conclusion, the operation of comparative advantages may bring the countries to obtain the best possible return from their economic structures (Ricardo's theory) but are not likely to provoke by themselves a change in those structures: the Heckscher/Ohlin model is based on a Walrasian approach, which excludes the problem of structural change. The results are quite obvious: external trade brings countries, especially the non-industrialised ones to over-expand whatever export-sectors they have (getting the most from their existing comparative advantages) but does not induce diversification even when it appears to be economically more

rational. This is scarcely a fact of experience for economists living in complex industrialised economies, but it is a basic fact in non-industrialised economies.

3. Does an international liberal economy secure favourable terms of trade to lesser developed countries?

Terms of trade of non-industrialised countries have been discussed at length. The object of the discussion is mainly their evolution: do they deteriorate? why? Their level as such is not the object of great attention (except for the research of A. Emmanuel and the controversy, it raised), as it is most difficult to appreciate their level in absolute terms.

From the theories of Ricardo and J.-S. Mill we can draw two models, which explain why the terms of trade of non-industrialised countries tend to be unfavourable in absolute terms.

The terms of trade aspect of Ricardo's theory is not given much attention, as it was rapidly over-shadowed by J.-S. Mill's theory. But it gives a very different approach to the subject than J.-S. Mill.

If two countries produce the same usual goods with the same technics, and consequently the same labour-value, external trade will make them more expensive in the country, which develops additionally some advanced industrial products. Indeed, the other one will import them, its balance of trade will become negative — which induces either an export of gold and a decrease in its level of prices or a devaluation. Consequently, it will sell to the former country the usual goods at a lower price. Such is the mechanism of the Ricardian model (I p. 141). It means that the lesser industrialised country exports to the more industrialised one goods produced with the same productivity at a price, which is lower than the cost of production of the industrialised country.

On that ground it may also be argued, that the gains of productivity of the industrialised countries are not (or only partially) benefitting the non-industrialised countries, which purchase them. How far they benefit from them depends on the structure of the balance of trade. It is not possible to determine it theoretically, but only to measure it in concrete cases — which is quite unsatisfactory to theoretical economists. Never-the-less Ricardo's answer to the question of the terms of trade is very pertinent and meaningful. Today's cheap prices for industrial goods exported by lesser industrialised countries is an expression of that phenomenon. The wider the range of industrial goods offered to lesser industrialised countries, the cheaper they are induced to sell their own products, according to Ricardo's theory.

In Cournot's model, terms of trade do not appear. J.-S. Mill builds his model on the "terms of interchange" of two goods within two countries and then generalizes to *n* goods. After having analyzed the demand side, he also considers the supply side. He expresses his conclusion in the following terms: "The only general law, then, which can be laid down, is this. The values at which a country exchanges its produce with foreign countries depend on two things: first, on the amount and extensibility of their demand for its commodities, compared with its demand for theirs; and secondly, on the capital which it has to spare, from the production of domestic commodities for its

own consumption. The more the foreign demand for its commodities, and the less capital it can spare to produce for foreign markets, compared with what foreigners spare to produce for its markets, the more favourable to it will be the terms of interchange: that is the more it will obtain of foreign commodities in return for a given quantity of its own." (Mill p. 614).

It appears, that terms of trade tend to be favourable to a country, if the external demand for its production is high, whereas its own demand for imported goods shows a great elasticity to price increases (p. 602). They tend to be favourable if its supply is inelastic in face of an increase in demand, whereas external supply is elastic in face of an increase in its demand (p. 609).

For a more rigourous and more complete application of the model, it is necessary to consider specifically all the elasticities involved. Additionally it is necessary to make the difference between upward elasticity and downward elasticity. Evidently, if supply and demand are represented by curves, it is mathematically not conceivable that elasticity might be different upward and downward. But leaving aside the mathematical expression, we consider only the economic fact that consumers and producers do not react symetrically to an increase or to a decrease in prices.

In order to have a complete picture we have to consider upward and downward elasticities of the supply of exports and of the demand for imports in both countries. The terms of trade will be most favourable with the constellation given in chart 2.

Chart 2: Elasticities favourable to the country's terms of trade

	in the country		abroad	
	to an increase	to a decrease	to an increase	to a decrease
Demand for imports	e	i	i	e
Supply of exports	i	e	e	i

e = elastic
i = inelastic

According to the economic structures of the country and of its partners abroad, according to the nature of imported and exported goods, countries will be nearer or farther to the optimal constellation.

If we consider the case of non-industrialised countries, we discover, that their situation is generally unfavourable. Indeed:

— their demand for imports is inelastic to higher prices, as imports are largely indispensable to the operation of the economy or to the survival of the population,
— if import prices decrease (which scarcely happens), as imports are mainly limited by foreign exchange, they will be maintained in value rather than in volume; i.e. elasticity=I.
— their supply of export products is dramatically inelastic to a decrease in prices, partly because they consist of natural products, the output of which cannot be modified in the short term, partly because they fight to maintain their earnings of foreign exchange. To an increase in prices, their production is for the same reasons relatively inelastic in the short term, but too elastic in the long run.
— The external demand for their products is generally inelastic in the short term for raw materials, though stockpiling in consumer countries may make it very elastic to an increase in price and push prices down. In the longer term it is generally elastic to an increase in prices (See K. Raffer 1987 & 1990 p. 8).
— Finally, the supply of imported goods is generally elastic to a decrease in prices, esp. for industrial products (producers decrease their production rather than their prices), but it is also elastic to an increase in prices.

From these general characteristics of non-industrialised countries, even without a detailed examination, it appears, that according to this approach as well, their terms of trade tend to be unfavourable. We surely did develop the model of J.-S. Mill beyond what he had himself proposed, but did we betray his line of thought, while giving it a more rigourous shape: — In any case his approach enables us today to analyze in a meaningful light the situation of non-industrialised countries.

4. How far does a liberal international economy favour the expansion of exports?

According to Ricardo, the opening of borders will induce the country to develop the products for which it is most competitive and to abandon those for which it is least competitive relatively to others. In a two country model, the range of goods exported is large, as the external demand is limited by the market of the other country. If we consider an country model, economic rationality induces the country to concentrate on the product(s) showing the greatest comparative advantage, and to drop all others. This is the logical consequence of Ricado's theory. Empirically, industrialised countries do not show a clear tendency to such a concentration, as they have built up "acquired" advantages in a number of fields. If such a tendency is not very evident (though present) in industrialised countries, it is on the contrary very meaningful in non-industrialised ones. As we have seen earlier, acquiring a comparative advantage is not just a question of factors endowment, but of production structures. Consequently in countries, which depend mainly on natural advantages, market forces induce a great concentration on a very limited number of products, all the more so that infrastructures and complementary services are set up for those products. Many governments made great endeavours to diversify their exports ... but without success. Their unsuccess has not to be explained by the weakness of their policy, or by the ill-will of economic actors. It is the sheer consequence of Ricardo's principle. Enlarging the range of exports goes against the immediate economic rationality of producers and exporters. It requires a political intervention, which history has shown to be requiring more, than could be assumed by governments in the recent decades.

If the greatest comparative advantage is to be drawn from a limited — very limited — range of products, considering that the market will open the way to other products, when saturation point is reached for the first ones, should it be a problem?

In a purely theoretical approach including no other parameters, we may say no. But we cannot ignore the consequences of the concentration of exports resulting from comparative advantages:

— first the dependency of the national economy on receipts of foreign exchange, which prove to be highly insecure, with fluctuations and crises; and sooner or later a saturation point, which will compromise the growth of the national economy,

— secondly, the fact that the national economy builds itself around these export products — which creates a structural setting in which the constitution of comparative advantages for other products is made more difficult. The polarization by the export products makes it difficult to develop alternatives or even substitutes, when they reach their ceiling or fall.

Besides those internal factors, we should also consider the limits imposed from outside to the expansion of exports by a liberal international economy. But we limit ourselves to the contribution of the authors chosen; the impact of comparative advantages on the concentration of exports as shown by Ricardo requires in itself quite some rethinking.

5. Will the balance of trade of non-industrialised countries reach an equilibrium? Can a devaluation help?

Ricardo proposes a way by which equilibrium of the balance of trade is secured or restored (I p. 139—140). Cournot is not preoccupied by the balance of trade (1877 p. 207—209). J.-S. Mill and A. Marshall work on the assumption, that it is in equilibrium. Present policies for balancing imports and exports are in fact based on Ricardo's theory: a devaluation makes exports more competitive abroad and imports less so on the local market.

Is it enough to bring the balance of trade to equilibrium? — The demonstration of Ricardo has been followed ever since. But it requires some more examination.

Let us first follow Ricardo's assumptions:

— supply is perfectly elastic,

— demand perfectly inelastic,

— transaction prices are the internal prices of the exporting country.

In a two country, two product model, there is no permanent equilibrium. An equilibrium can only be reached in an product model. Ricardo did not elaborate much on an product model — which may explain that he did not pay more attention to a crucial fact.

According to his theory, equilibrium is restored through a modification in relative levels of prices (which is equivalent to a devaluation). Such a modification has two effects:

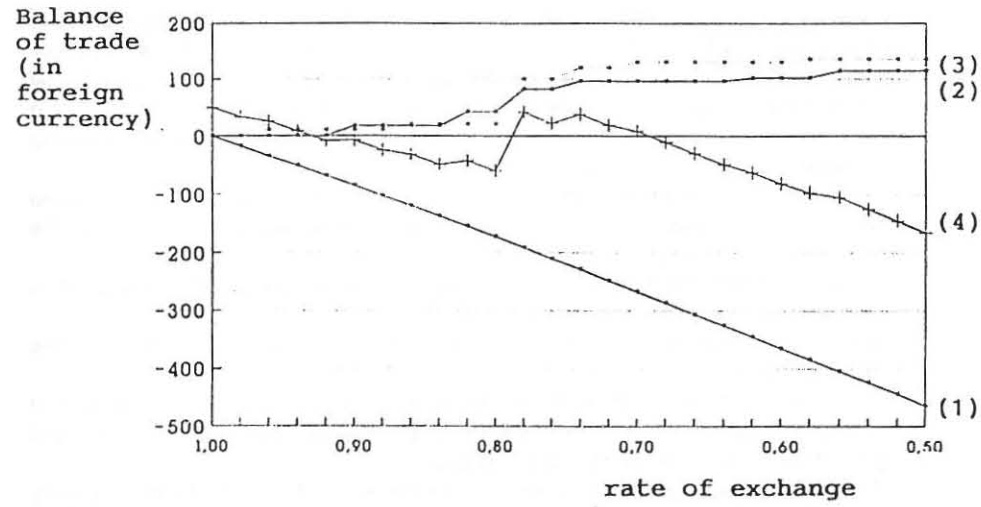
— The one — which Ricardo considered — is the fact that products which in terms of labour value, or at the former level of prices, could not be exported become competitive, while some imported products are no more competitive on the national market (I p. 140). This effect improves the balance of trade.

— The other one — which Ricardo omitted to consider — is that the purchasing power of exports decreases. It may of course be compensated for by the increase

in their volume, but not necessarily so. In national currency, a 1 % devaluation would increase the value of exports by the value of their possible increase in volume, and increase by 1 % the value of imports, minus the effect of their possible decrease in volume. In foreign currency, the value of exports would be decreased by 1 % minus the effect of their possible increase in volume, and that of imports decreased by their possible decrease in volume.

If we combine the two effects, the link between rate of exchange and balance of trade appears as in chart 3.

Chart 3: The effect of a change in the rate of exchange in a ricardian model



(1) Effect of the decrease in the unit value of exports
(2) Effect of the increase in the volume of exports
(3) Effect of the decrease in the volume of imports
(4) Balance of trade

According to the structure of exports and imports and to the increase or decrease in volume, which can be expected at every change in the rate of exchange, there will be one, more than one or no rate of exchange, for which the balance of trade will be in equilibrium. An expression of this phenomenon is to be found in A. Marshall (1879).

We so far have worked with Ricardo's assumptions. It is worth while checking if with the assumptions of Cournot (1838) relatively to demand and supply elasticities and to prices, we can expect the same result. His assumptions have been taken over by the modern theory.

With Cournot's assumptions, prices correspond to the international equilibrium of supply and demand, quantities imported to national demand at that price and quantities exported to national supply at that price. Relatively to Ricardo's model, it modifies the effect of a devaluation in four ways:

— not only are new goods exported, but also greater quantities of previous exports,
— in national currency the price of exports increases, to reach a new equilibrium along the supply curve,
— the volume of each import decreases,
— the prices for imports in foreign currency should decrease.

Those four elements tend to damp down the perverse effect of a devaluation, but do not eradicate it (see Marschall/Lerner theorem), especially not in non-industrialised countries, where it is stronger.

But the conclusions, which we draw from Cournot's assumptions, are only valid in a two country model, or at least a model with a limited number of countries. When a smaller country is facing the world market, it cannot influence it. It brings us nearer to Ricardo's assumptions, with that difference that export prices are not the internal ones, but the foreign ones. If the country is able to increase its share of foreign markets by under-bidding its competitors, we are nearly back to the problems arising from Ricardo's model.

The equilibrium of the balance of trade is a very different issue in industrialised and in non-industrialised countries. From chart 3, it appears, that reaching the equilibrium means simultaneously:

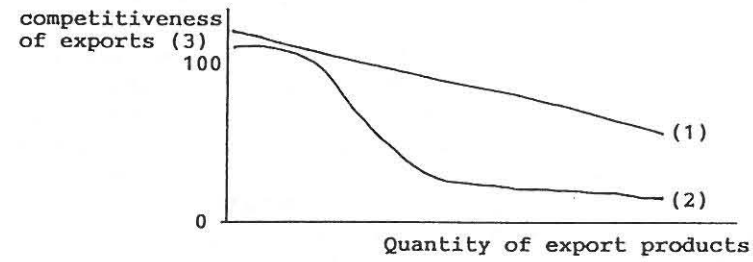
— in foreign exchange: a competition between the decreasing unit prices of exports and the increase in their volume,
— and in national prices, between the increased prices of imports and the decrease of their volume.

The conditions of the competition are quite different in industrialised and in non-industrialised countries. Besides the difference in the effect on prices, there is a great difference in the reaction of the economy:

— for exports, industrialised countries have a wide range of products to offer, at every rate of exchange their supply of exports is quite elastic; whereas non-industrialised countries live from a very limited number of export products, the supply of those products cannot be increased in the short period; if it could, the fight for a larger share of a raw material market, where competitors also consider their share as a survival affair ... may be detrimental to all producers. See chart 4.

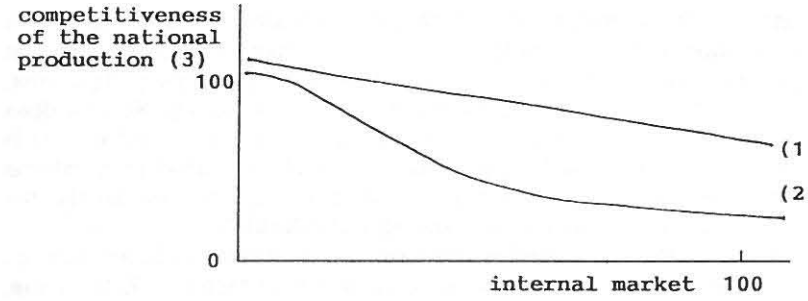
A similar phenomenon affects imports: industrialised countries can substitute national production to imports for a non-negligeable share of their imports, and market forces will bring it forth if import prices increase. On the contrary, in non-industrialised countries imports have no local substitutes in the short term, and their decrease instead of favouring local production makes it more difficult by lack of inputs. Chart 5 illustrates the situation.

Chart 4: Goods available for export



(1) industrialised countries
(2) non-industrialised countries
(3) world prices as a percentage of internal cost

Chart 5: National production available for the internal market



(1) industrialised countries
(2) non-industrialised countries
(3) world prices as a percentage of internal cost

While developing the Ricardian approach, we come to the conclusion, that balancing trade in non-industrialised countries is not very evident. Their situation has been made ambiguous by the fact that they are partners to industrial countries: it gives them great opportunities to export some natural products, for which they have a relative avantage. But those markets are unstable, and they have practically no means of facing efficiently a deficit. A manipulation of the rate of exchange does not bring them what Ricardo expected; nothing less of a restructuring of the economy can solve the problem. Hence the puzzle of IMF policies in Africa.

6. Will the development of trade favour internal investment?

For the classical economists, investment depends mainly from available capital. When it is not the case, the models of 18th century writers are more appropriate (we shall not consider them here). The contribution of the classical writers, which we shall consider is consequently meaningful for countries with a dominant capital constraint.

On the relation between external trade and internal investment, Ricardo opposes violently A. Smith. For the latter, external trade is a sector of activity like the others, which mobilizes resources, and especially capital. Consequently if a part of capital is withdrawn from other sectors to be invested in external trade:

— there will be less capital available for the other sectors (e.g. agriculture)

— the rate of profit expected from any investment will be higher, to the detriment of the least productive sectors (II p. 23).

Ricardo, with due respect to his master (I p. 128—129) opposes strongly that view. Why? — It appears as a strange case of misunderstanding, as Ricardo does not really answer to the argument of A. Smith. He does not enter into his views at all, as for him, trade is not a sector of activity. When he comes to investment in trade, it is investment in the export sector. Consequently he occults completely the problem raised by A. Smith. This fact has had heavy consequences, as the theory of international trade lost at that time and until now an important issue and set aside important phenomena:

— competition between investment in trade and in industry. It was strong in 18th century Europe and raised many controversies. It has devastating effects in today's non-industrialised countries. Indeed, trade and especially imports is safer, brings higher dividends, more rapidly than any production activity. Not only does it hijack national capital from production, but it also raises the expected profit in other activities — which withdraws parts of the national market from national production. Besides, as traders are a politically strong group, they can bias the institutionnal system in their favour ... and against industrial development

— the burden of trade on productive activities. Modern theory excludes such an eventuality, as it is founded on the assumption that in all sectors including trade, remunerations are equal to marginal productivity; skimming the economic surplus of other sectors is consequently excluded. In the 18th Century, Fr. Quesnay had brought this phenomenon to light and had protested against the idea that the enrichment of traders is a source of economic growth. This problematic has been excluded by Ricardo, but it is very actual in non-industrialised countries. To develop, productive activities must benefit from favourable terms of exchange (in internal as well as in international trade). IMF is stressing it for agricultural output, but does not seem to consider the second element of the question: the faculty for rural producers to purchase useful products at favorable prices. Unhappily on the countryside in those countries, traders enjoy more or less a monopoly in selling and purchasing, and consequently risk to block rural development by the deterioration of the terms of exchange of producers due to their excessive margins and profits. Market economy may prove inefficient in that context. The same phenomenon occurs in the external relations: the accumulation of wealth by export-import traders compromises the chances of internal growth.

7. What is the impact of external trade on the operation of the internal economy?

The influence of external trade on the internal economy had been the object of much thinking and research in the 18th century. A. Smith still gives it quite some importance. On the other side, he states, that it increases utilities, but not values (II p. 25). Their is no gain from exchange. Ricardo first follows this statement (I p. 128), though his own theory proves the contrary. (I p. 140). A. Cournot and J.-S. Mill were more sensitive to the gain in exchange and to its distribution.

Gain in exchange is presently the main argument to advocate the integration of non-industrialised countries in the world economy: "If every country produced that for what it has the greatest conparative advantages ..." ... but who gets the benefits of the gain in exchange: J.-S. Mill has studied the reasons why one of the partners may not get anything: "It is even possible to conceive an extreme case, in which the whole of the advantage resulting from the interchange would be reaped by one party, the other country gaining nothing at all. There is no absurdity in the hypothesis that, of some given commodity, a certain quantity is all that is wanted at any price; and that, when that quantity is obtained, no fall in the exchange value would induce other consumers to come forward." (p. 599). To his reasons, Arthur Lewis later added the conditions of the labour market in a very meaningful way: "La principale raison pour laquelle les produits commerciaux d'origine tropicale sont si bon marché, en termes du niveau de vie qu'ils peuvent assurer, est l'inefficacité de la production de produits alimentaires d'origine tropicale par habitant. La quasi totalité des avantages résultant d'un accroissement de l'efficacité dans les industries exportatrices va aux consommateurs étrangers; alors qu'un accroissement de l'efficacité dans le secteur de la production alimentaire de subsistance entraînerait automatiquement une augmentation des prix des produits commerciaux." (p. 90)

18th century economists were not so sensitive to the gain in exchange, as to the effect of external trade on internal flows, to such point that Hume considers, that trade may be dispensed with after a time, after it has had a sufficient chance to change internal economic structures (p. 18) and Fr. Quesnay that the possibility of external trade may in some cases have the desired effect even if it does not occur (p. 536).

Those very meaningful developments on the effect of external trade on internal flows and structures were completely left aside by Ricardo, and consequently by economic theory after him. It is indeed a great loss and it is worth while wondering why Ricardo disregarded such a rich inheritance.

He surely did not disconsider it, and he surely knew it. If he left it aside, it is to our understanding because it did not enter into his model. His whole economic model is built with a dominant capital constraint. Nothing can increase production short of an increase in capital. Development of new flows, effect on prices,...left him indifferent, except when it came to flows and prices of subsistence, which in his system affect the rate of profit. When Malthus in his "Principles" tried to convince him that outlay may be a problem, he trusted his belief in Say's loi des débouchés.

The opening of new markets had more meaning for A. Smith, who paid great attention to the effects of trade with America. He even considered, that countries which did not participate in it might get benefits from it (II p. 211—213). Of course,

for him, the rate of profit tends to decrease when capital accumulates, the market getting narrower. Therefore new markets meant new potential developments. But for the 18th century economists, it was not only a question of market, but of stimulation between external and internal flows (See J.- P. Gern: "L'industrialisation en Afrique: sortir des modèles de pensée mercantilistes" in: Etudes Internationales, juin 1990).

If we summarize the influence of Ricardo and of his followers on this point, we have to acknowledge a great impoverishment of the theory. And we can actually regret, that today's policies are still bearing the burden of that impoverishment: very little attention is given to the link between exports (or imports) flows and the dynamic of internal flows. Using for instance a model of export led growth means not so much sponsering exports, as working on the internal effects of the flows of export. If the rest of the economy is impoverished to favour exports (as is sometimes the case in IMF recomendations) how far can the impact of the flows of export be positive. Fr. Quesnay would raise many questions!

8. Will external trade induce growth?

External trade as the best way to induce growth is central in today's approach. Which is the theoretical background for that belief? Interestingly enough, 18th century economists, who had developed quite adequate models to that end are presently ignored; the background is the use of comparative advantages. But Ricardo did not expect growth from external trade.

Ricardo considers each country with its advantages, natural or acquired, that is with its existing structures: social, economic, ... What he expects from trade is to get the best from the operation of the existing structures. He does not expect that trade might modify them in the sense of growth; giving up less productive activities and using the resources made available for more productive ones, that is what he expected. It improves the situation, increases the income, but to a limited extent, and nothing beyond. His theory is now used with a very different meaning, even without noting the difference, as if getting the best from comparative advantages was a way of transforming economic structures. It is surely the influence of the marginal theory, which did not investigate growth, and could not really do it as long as it ignored structures and structural changes. It could only work on the best allocation of resources, which imply structural changes, but without giving in any way account for the operation of such changes.

There is consequently a great ambiguity in using models based on comparative advantages as a basis for growth policies. If comparative advantages are understood in the sense of Ricardo, they cannot be the basis of a growth process; if they are understood in the sense of Heckscher/Ohlin, the process of structural change is occulted and market forces cannot be expected to produce it.

It is the dominant capital constraint which brought Ricardo not to expect anything from trade to foster growth, except in one case: trade can counteract the effect of diminishing returns in food production and consequently maintain low wages, the rate of profit high and consequently the investment (I p. 133). This specific impact of trade on growth is still meaningful, and could even be enlarged to a wider range of issues:

the productivity of a sector may depend in many ways from that of others; if it is unefficient, imports may bring a solution. In the case where most of the economy is rather inefficient, there may be a critical choice as to which sectors to maintain, while improving their external economies through imports and which ones to give up, and this in a dynamic time perspective. Ricardo is opening here an interesting path to reflexion. But for the rest, his theory does not show that trade can be the basis for growth.

Other effects of external trade on growth were brought to light by A. Cournot. He made long calculations to measure the effects of trade on national income; they are not very convincing, less than Fr. Quesnay's approach. But he rose meaningful questions for non-industrialised countries:

— As a result of his calculations (1838 p. 180/181) he fears a loss of income for the importing country. Of course exports will be needed to pay for that additional import; but is a decrease in internal demand coupled with difficulties in the balance of payments a neutral phenomenon: At which cost will the equilibrium of the balance of payments be re-established?

— For A. Smith it is an economic stimulation...for leading economies, of course, but for low productivity ones:

— He brings to light the fact that the export of a given good makes it more expensive on the national market (unless marginal cost decreases with quantity) (1838 p. 102). The result is a loss of purchasing power for the consumers of that good, but a gain for its producers. According to their income level, consumers may have to give up purchasing it. For instance the opening of a market for cassava in Europe as food for chicken may have disastrous effects in Africa. With a higher level of income, Europe may exclude African consumers from the market. Will receipts in foreign exchange allow them to buy an equivalent quantity of food: Will the beneficiaries be the consumers: What will be the impact on consumption in Africa: — The answer is not straightforward.

9. Conclusions

Every economist bears in his mind the wonderful construction of the marginalist school. Confronted with the problems of trade cycle in industrial countries, he may oppose to it a keynesian approach. But did the Keynesian revolution reach international trade? Development economics were built on the basis of a Smithian and post-Keynesian approach (the Harold-Domar model is the key stone of most of it). Consequently, the problem of international trade and development is today treated in the light of a Ricardian approach (for development) enriched with the neoclassical contribution of Heckscher and Ohlin (for trade).

We therefore reconsidered the problematic as it was brought forth by the classics -often problems raised by the founders of a paradigm are ignored by the followers, or faults in the construction appear better in the early stages of a theory. We should have considered as well the contribution of earlier and later authors, which we left aside for the time being.

The theory of general equilibrium and international trade built in the context of the marginal school of thought give to our mind such a coherent, rational and convincing

model, that it is but too understandable that most of today's policies for poorer countries are elaborated on that ground.

But the ground is not safe, our short analysis of Ricardo, J.-S. Mill and A. Cournot has brought to light a few traps. More could have been found out, and even more could have been said on the applicability of the approach to present problems in a world, which is structurally so different from the one, in which the basis of the theories were laid: for instance to interference between balance of payment and balance of trade — which surely would have suggested to Ricardo a quite different approach, if it had been so in his time.

Besides the comfortable, rational background just mentioned, today's economists have another reason to hold their views: the success of a number of countries, which opened their economy to the world market and industrialised in a remarkable way. It is just a question of horse and cart: did the opening to the world market open the way to industrialisation: or did a strongly built industrialisation process require a rapid development of external relations: — Except for enclave economies like Singapore, the latter may well be true.

To the question: "Can non-industrialised countries find a path to growth in the opening to the world economy, through the abolition of all kind of restrictions to external economic flows" we had to give a very, very qualified answer. The opposite to bad policies is not the exclusion of policies, but the good management of proper ones. The free operation of the market does not fulfill the expectations of the text-books. For the main points:

1. The liberalization of external relations in a world where factors of production are partly mobile induces not an optimal allocation of all resources, but a partial migration (capital, qualified labour, ...) from the poorer countries to industrial ones and consequently the under-utilization of the other local resources.
2. Market forces induce the use of comparative advantages in the sense of the best use of existing production structures (Ricardo) but not of the achievement of structural changes needed for the optimal use of the factors of production (Heckscher/Ohlin), whether it be technical innovation, creation of externalities, better sectorial and regional integration. Their effect is consequently limited to a better distribution of resources among sectors (Ricardo) and does not secure a growth process.
3. Does the general equilibrium model determine proper terms of trade and can the rate of exchange be fixed accordingly: — We discovered, that on different grounds the models of both Ricardo and J.-S. Mill show, that terms of trade tend to be unfavourable to non-industrialised countries in absolute terms.
4. According to the theory of comparative advantages (natural and acquired) a country trading with the world market tends to concentrate its exports on a limited number of products. This number may be relatively large for a complex industrial economy, which has built up all kinds of advantages, but is dangerously small in non-industrialised countries relying mainly on natural advantages (besides, acquired advantages tend to narrow their range of exports). It means, that for them, market forces act against the development (by diversification) of their exports.
5. Ricardo's approach to the equilibrium of the balance of trade is still predominant in todays theories, despite the interference of other transactions, and despite what we would call an error in Ricardo's approach: his disregard for the loss of purchasing power of exports, when a lower price level (or a devaluation) occurs (or despite Marshall/Lerner). Taking it into account results in the fact that there may be more than one, or no rate of exchange, which brings the balance of trade into equilibrium.
6. Due to the structure of their economy and of their exports and imports, non-industrialised countries have a lesser chance than others to bring their balance of trade into equilibrium by a devaluation.
7. Ricardo disregarded a fact, which was considered as important by his predecessors: that trade is also a sector of activity, entering in competition with the others. A. Smith considered, that its development could deprive others from needed capital; Fr. Quesnay denounced the enrichment of traders as a burden on the economy. Such problems are acute in lesser developed countries, but the turn taken by Ricardo excludes the issue from the theory.
8. Ricardo separated the theory of external trade from the analysis of the operation and growth of the internal economy. It was not the case with his predecessors. It was a great theoretical loss. To it, he substituted the gain in exchange; and present theories and policies still give a priority attention to it, though it may be of secondary importance only.
9. After having considered all the reasons, why external trade and a liberal external policy may not induce growth, as suggested by the models based on the classical economists, we do not consider, that external trade does not have an important role to play, but it would be more along the lines developed by 18th Century writers, whom it may be urgent to rediscover.

Today's policies, in their endeavour to develop exports as a basis for growth come badly near to the approach of the mercantilists. That approach was duly challenged in the 18th Century as it fosters specific sectors or enterprises to the detriment of others without taking into account the fact that the economy is an integrated system of flows — which makes such policies self-defeating.

Reading the founders of the present approach to development and international trade reminds of the choices made at the time:

— not all aspects of the problem were taken into account,
— some assumptions were made, which have become questionable largely as a result of changes in economic structures,
— those theories opened the way to lines of thought, unhappily left aside,
— those theories are not exclusive of other approaches, which may prove more powerful as a foundation to the solution of today's problems.

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Figures for Chart X

Rate of exchange	Exports nat. c.	Exports for. c.	Imports for. c.	CHART (1)	CHART (2)	PARAMETERS (3)	(4)
1	850	850	800	0	0	0	50
.98	850	833	800	-17	0	0	33
.96	850	816	790	-34	0	10	26
.94	850	799	790	-51	0	10	9
.92	850	782	790	-68	0	10	-8
.90	870	783	790	-85	18	10	-7
.88	870	765.60	790	-102.40	18	10	-24.40
.86	870	748.20	780	-119.80	18	20	-31.80
.84	870	730.80	780	-137.20	18	20	-49.20
.82	900	738	780	-154.60	42.60	20	-42
.80	900	720	780	-172.60	42.60	20	-60
.78	950	741	780	-190.60	81.60	100	41
.76	950	722	700	-209.60	81.60	100	22
.74	970	717.80	680	-228.60	96.40	120	37.80
.72	970	698.40	680	-248	96.40	120	18.40
.70	970	679	670	-267.40	96.40	130	9
.68	970	659.60	670	-286.80	96.40	130	-10.40
.66	970	640.20	670	-306.20	96.40	130	-29.80
.64	970	620.80	670	-325.60	96.40	130	-49.20
.62	980	607.60	670	-345.10	102.70	130	-62.40
.60	980	588	670	-364.70	102.70	130	-82
.58	980	568.40	665	-384.30	102.70	135	-96.60
.56	1000	560	665	-403.90	113.90	135	-105
.54	1000	540	665	-423.90	113.90	135	-125
.52	1000	520	665	-443.90	113.90	135	-145
.50	1000	500	665	-463.90	113.90	135	-165

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PLANUNGSPROBLEME IN ENTWICKLUNGSAGENTUREN
Entscheidungsorientiertes Management als Vorbedingung für ein kritisches Planen

Abstract

The classification of donor countries into the two opposed communities of 'hard-liner' and 'like-minded' countries with regard to the contents of their development cooperation policy is still customary. Germany is clearly seen as part of the former and Sweden as part of the latter. However, recent comparative studies have indicated an approximation of development policy approaches of donor countries regardless whether they belong to the one or other community. In this article the point of attachment to analyse the processes of approximation are the planning and control systems within the respective development administrations of Germany and Sweden. The planning and control systems are seen as filter and key elements between the input (political decisions) and the output (factual impact) of development cooperation policy.

In a first step the most important planning approaches are described. They are based on the categories of abstract theoretical planning paradigms, but enlarged with aspects of practical development cooperation. Subsequently, single strategies of the different approaches are worked out since processes of approximation are not revealed through the change of the entire planning approach, rather through the change of particular strategies within the given approach. Therefore, the identified strategies can serve as indicators of approximation. All planning approaches and pertinent strategies are grouped around the distinction between 'decision-oriented' and 'critical' planning type.

In a second step the study focuses on an important German and Swedish development agency which are in charge of the implementation of development programmes respectively. The 'Deutsche Gesellschaft für Technische Zusammenarbeit' (GTZ) and the 'Swedish International Development Authority' (SIDA) stand out in their national development policy systems. An important factor for the determination of a particular planning approach had been in both cases the position of the agencies in the national development policy network at the initial stage of the establishment of the agencies. SIDA received far more autonomy against the responsible ministry than the GTZ which had been to a certain extend outside the German policy network and received, unlike SIDA, directions from the superior ministry. With the lapse of time, however, there had been contrary political processes in Germany and Sweden through which the GTZ could increasingly make itself independent and pursue more development-related goals. SIDA on the other hand forfeited its quasi monopoly and was urged to consider more economic goals. At both agencies the processes lead to a modification of the initial planning approaches. The