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THE "CLASSICAL THEORY" OF INTERNATIONAL TRADE AND THE UNDERDEVELOPED COUNTRIES¹

THERE has recently been a considerable amount of controversy concerning the applicability of the "classical theory" of international trade to the underdeveloped countries.² The twists in this controversy may be set out as follows. The critics start with the intention of showing that the "nineteenth-century pattern" of international trade, whereby the underdeveloped countries export raw materials and import manufactured goods, has been unfavourable to the economic development of these countries. But instead of trying to show this directly, they concentrate their attacks on the "classical theory," which they believe to be responsible for the unfavourable pattern of trade. The orthodox economists then come to the defence of the classical theory by reiterating the principle of comparative costs which they claim to be applicable both to the developed and the underdeveloped countries. After this, the controversy shifts from the primary question whether or not the nineteenth-century pattern of international trade, as a historical reality, has been unfavourable to the underdeveloped countries to the different question whether or not the theoretical model assumed in the comparative-costs analysis is applicable to these countries. Both sides then tend to conduct their argument as though the two questions were the same and to identify the "classical theory" with the comparative-costs theory.

It will be argued in this paper that this has led to the neglect of those other elements in the classical theory of international trade which are much nearer to the realities and ideologies of the nineteenth-century expansion of international trade to the underdeveloped countries. In Sections I and II we shall outline these elements and show that they are traceable to Adam Smith and to some extent to J. S. Mill. In Section III we shall show how one of Adam Smith's lines of approach can be fruitfully developed to throw a more illuminating light on the past and present patterns of the international trade of the underdeveloped countries than the conventional theory. In Section IV we shall touch upon some policy implications of our analysis and show certain weaknesses in the position both of the orthodox economists and of their critics.

¹ This paper has benefited from comments by Sir Donald MacDougall, Professor H. G. Johnson, R. M. Sundrum and G. M. Meier.

² Of the very extensive literature on the subject, we may refer to two notable recent works, the first stating the orthodox position and the second the position of the critics: J. Viner, *International Trade and Economic Development*, and G. Myrdal, *An International Economy*.

I

The neglected elements in the classical theory of international trade may be traced to Adam Smith, particularly to the following key passage in the *Wealth of Nations*:

“Between whatever places foreign trade is carried on, they all of them derive two distinct benefits from it. It carries out that surplus part of the produce of their land and labour for which there is no demand among them, and brings back in return for it something else for which there is a demand. It gives a value to their superfluities, by exchanging them for something else, which may satisfy a part of their wants, and increase their enjoyments. By means of it, the narrowness of the home market does not hinder the division of labour in any particular branch of art or manufacture from being carried to the highest perfection. By opening a more extensive market for whatever part of the produce of their labour may exceed the home consumption, it encourages them to improve its productive powers, and to augment its annual produce to the utmost, and thereby to increase the real revenue and wealth of society” (Vol. I, Cannan ed., p. 413).

There are two leading ideas here. (i) International trade overcomes the narrowness of the home market and provides an outlet for the surplus product above domestic requirements. This develops into what may be called the “vent for surplus”¹ theory of international trade. Later we hope to remove some of the prejudice aroused by this “mercantilist” sounding phrase. (ii) By widening the extent of the market, international trade also improves the division of labour and raises the general level of productivity within the country. This develops into what may be called the “productivity” theory. We shall be mainly concerned with the “vent for surplus” theory and the light it throws upon the growth of international trade in the underdeveloped countries in the nineteenth century. But first it is necessary to consider the “productivity” theory briefly.

The “productivity” doctrine differs from the comparative-costs doctrine in the interpretation of “specialisation” for international trade. (a) In the comparative costs theory “specialisation” merely means a movement along a static “production possibility curve” constructed on the given resources and the *given techniques* of the trading country. In contrast, the “productivity” doctrine looks upon international trade as a dynamic force which, by widening the extent of the market and the scope of the division of labour, raises the skill and dexterity of the workmen, encourages technical innova-

¹ This term is borrowed from Professor J. H. Williams, who in turn quoted it from a passage in J. S. Mill's *Principles*, in which Mill was criticising this particular aspect of Smith's theory of international trade. Professor Williams is the only modern economist to sponsor this “crude” doctrine. While he is mainly concerned with the loss to a country on being deprived of the export market for its surplus product, we shall pay special attention to the gain to a hitherto isolated underdeveloped country on obtaining a “vent” for its surplus productive capacity. Cf. J. H. Williams, “The Theory of International Trade Reconsidered,” *ECONOMIC JOURNAL*, June 1929, pp. 195-209.

tions, overcomes technical indivisibilities and generally enables the trading country to enjoy increasing returns and economic development.¹ This distinction was clearly realised by J. S. Mill, who regarded the gains in terms of comparative-costs theory as direct gains and the gains in terms of Adam Smithian increases in productivity as "indirect effects, which must be counted as benefits of a high order." Mill even went on to extend this doctrine to countries at "an early stage of industrial advancement," where international trade by introducing new wants "sometimes works a sort of industrial revolution" (*Principles*, Ashley ed., p. 581). (b) In the comparative costs theory "specialisation," conceived as a reallocation of resources, is a completely reversible process. The Adam Smithian process of specialisation, however, involves adapting and reshaping the productive structure of a country to meet the export demand, and is therefore not easily reversible. This means that a country specialising for the export market is more vulnerable to changes in the terms of trade than is allowed for in the comparative-costs theory. We shall come back to this point later.

In the expansive mental climate of the late nineteenth century the "productivity" aspect of international specialisation completely dominated the "vulnerability" aspect. At a semi-popular level, and particularly in its application to the underdeveloped countries, Smith's "productivity" doctrine developed beyond a free-trade argument into an export-drive argument. It was contended that since international trade was so beneficial in raising productivity and stimulating economic development, the State should go beyond a neutral and negative policy of removing barriers to trade and embark on a positive policy of encouraging international trade and economic development. Under its influence, many colonial governments went far beyond the strict *laissez-faire* policy in their attempts to promote the export trade of the colonies.² Further, although these governments were frequently obliged to use "unclassical" methods, such as the granting of monopolistic privileges to the chartered companies or the taxing of the indigenous people to force them to take up wage labour or grow cash crops, they nevertheless sought to justify their policy by invoking the Adam Smithian doctrine of the benefits of international division of labour. This partly explains why some critics have associated the "classical theory" with "colonialism" and why they have frequently singled out Adam Smith for attack instead of Ricardo, the founder of the official classical free-trade theory.

It is fair to say that Smith's "productivity" doctrine is instructive more

¹ Cf. *op. cit.*, Chapters II and III, Book I. This aspect of Smith's theory has been made familiar by Professor Allyn Young's article on "Increasing Returns and Economic Progress," *ECONOMIC JOURNAL*, December 1928, pp. 527-42.

² See for instance, L. C. A. Knowles, *The Economic Development of the British Overseas Empire*, Vol. I, pp. 119-20, 248-9 and 486-7. However, in Section IV below we shall argue that, in spite of the attention they have received, these export-drive policies were not successful enough to cause a significant "export-bias."

in relation to the ideological than to the actual economic forces which characterised the nineteenth-century expansion of international trade to the underdeveloped countries. It is true, as we shall see later,¹ that both the total value and the physical output of the exports of these countries expanded rapidly. In many cases the rate of increase in export production was well above any possible rate of increase in population, resulting in a considerable rise in output per head. But it is still true to say that this was achieved not quite in the way envisaged by Smith, viz., a better division of labour and specialisation leading on to innovations and cumulative improvements in skills and productivity per man-hour. Rather, the increase in output per head seems to have been due: (i) to once-for-all increases in productivity accompanying the transfer of labour from the subsistence economy to the mines and plantations, and (ii) what is more important, as we shall see later, to an increase in working hours and in the proportion of gainfully employed labour relatively to the semi-idle labour of the subsistence economy.

The transfer of labour from the subsistence economy to the mines and plantations with their much higher capital-output ratio and skilled management undoubtedly resulted in a considerable increase in productivity. But this was mostly of a once-for-all character for a number of reasons. To begin with, the indigenous labour emerging from the subsistence economy was raw and technically backward. Moreover, it was subject to high rates of turnover, and therefore not amenable to attempts to raise productivity. Unfortunately, this initial experience gave rise to or hardened the convention of "cheap labour," which regarded indigenous labour merely as an undifferentiated mass of low-grade man-power to be used with a minimum of capital outlay.² Thus when the local labour supply was exhausted the typical reaction was not to try to economise labour by installing more machinery and by reorganising methods of production but to seek farther afield for additional supplies of cheap labour. This is why the nineteenth-century process of international trade in the underdeveloped countries was characterised by large-scale movements of cheap labour from India and China.³ This tendency was reinforced by the way in which the world-market demand for raw materials expanded in a series of waves. During the booms output had to be expanded as quickly as possible along existing lines, and there was no time to introduce new techniques or reorganise production; during the slumps it was difficult to raise capital for such purposes.

¹ See footnotes on pp. 324 and 327 below. See also Sir Donald MacDougall's *The World Dollar Problem*, pp. 134-43. Sir Donald's argument that the productivity of labour in the underdeveloped countries has been rising faster than is generally assumed is mainly based on figures for productivity *per capita*. These figures are not inconsistent with our argument that on the whole the expansion of the export production has been achieved on more or less constant techniques and skills of indigenous labour, by increasing working hours and the proportion of gainfully employed labour rather than by a continuous rise in productivity per man-hour.

² Cf. S. H. Frankel, *Capital Investment in Africa*, pp. 142-6, and W. M. Macmillan, *Europe and West Africa*, pp. 48-50.

³ Cf. Knowles, *op. cit.*, pp. viii and 182-201.

This failure to achieve Adam Smith's ideal of specialisation leading on to continuous improvements in skills can also be observed in the peasant export sectors. Where the export crop happened to be a traditional crop (*e.g.*, rice in South-East Asia), the expansion in export production was achieved simply by bringing more land under cultivation with the same methods of cultivation used in the subsistence economy. Even where new export crops were introduced, the essence of their success as peasant export crops was that they could be produced by fairly simple methods involving no radical departure from the traditional techniques of production employed in subsistence agriculture.¹

Thus instead of a process of economic growth based on continuous improvements in skills, more productive recombinations of factors and increasing returns, the nineteenth-century expansion of international trade in the underdeveloped countries seems to approximate to a simpler process based on constant returns and fairly rigid combinations of factors. Such a process of expansion could continue smoothly only if it could feed on *additional* supplies of factors in the required proportions.

II

Let us now turn to Smith's "vent for surplus" theory of international trade. It may be contrasted with the comparative-costs theory in two ways.

(a) The comparative-costs theory assumes that the resources of a country are given and fully employed before it enters into international trade. The function of trade is then to reallocate its given resources more efficiently between domestic and export production in the light of the new set of relative prices now open to the country. With given techniques and full employment, export production can be increased only at the cost of reducing the domestic production. In contrast, the "vent for surplus" theory assumes that a previously isolated country about to enter into international trade possesses a surplus productive capacity² of some sort or another. The function of trade here is not so much to reallocate the given resources as to provide the new effective demand for the output of the surplus resources which would have remained unused in the absence of trade. It follows that export production can be increased without necessarily reducing domestic production.

¹ Thus A. McPhee wrote about the palm-oil and ground-nut exports of West Africa: "They made little demand on the energy and thought of the natives and they effected no revolution in the society of West Africa. That was why they were so readily grafted on the old economy and grew as they did" (*The Economic Revolution in West Africa*, pp. 39-40). Some writers argue that there was a studied neglect of technical improvements in the peasant sector to facilitate the supply of cheap labour to other sectors. Cf., for example, W. A. Lewis, "Economic Development with Unlimited Supplies of Labour," *Manchester School*, May 1954, pp. 149-50. For a description of imperfect specialisation in economic activity in West Africa see P. T. Bauer and B. S. Yamey, "Economic Progress and Occupational Distribution," *ECONOMIC JOURNAL*, December 1951, p. 743.

² A surplus over domestic requirements and *not* a surplus of exports over imports.

(b) The concept of a surplus productive capacity above the requirements of domestic consumption implies an inelastic domestic demand for the exportable commodity and/or a considerable degree of internal immobility and specificness of resources. In contrast, the comparative-costs theory assumes either a perfect or, at least, a much greater degree of internal mobility of factors and/or a greater degree of flexibility or elasticity both on the side of production and of consumption. Thus the resources not required for export production will not remain as a surplus productive capacity, but will be reabsorbed into domestic production, although this might take some time and entail a loss to the country.

These two points bring out clearly a peculiarity of the "vent-for-surplus" theory which may be used either as a free-trade argument or as an anti-trade argument, depending on the point of view adopted. (a) From the point of view of a previously isolated country, about to enter into trade, a surplus productive capacity suitable for the export market appears as a virtually "costless" means of acquiring imports and expanding domestic economic activity. This was how Adam Smith used it as a free-trade argument. (b) From the point of view of an established trading country faced with a fluctuating world market, a sizeable surplus productive capacity which cannot be easily switched from export to domestic production makes it "vulnerable" to external economic disturbances. This is in fact how the present-day writers on the underdeveloped countries use the same situation depicted by Smith's theory as a criticism of the nineteenth-century pattern of international trade. This concept of vulnerability may be distinguished from that which we have come across in discussing the "productivity" theory of trade. There, a country is considered "vulnerable" because it has adapted and reshaped its productive structure to meet the requirements of the export market through a genuine process of "specialisation." Here, the country is considered "vulnerable" simply because it happens to possess a sizeable surplus productive capacity which (even without any improvements and extensions) it cannot use for domestic production. This distinction may be blurred in border-line cases, particularly in underdeveloped countries with a large mining sector. But we hope to show that, on the whole, while the "vulnerability" of the advanced countries, such as those in Western Europe which have succeeded in building up large export trades to maintain their large populations, is of the first kind, the "vulnerability" of most of the underdeveloped countries is of the second kind.

Let us now consider the "vent-for-surplus" approach purely as a theoretical tool. There is a considerable amount of prejudice among economists against the "vent-for-surplus" theory, partly because of its technical crudeness and partly because of its mercantilist associations. This may be traced to J. S. Mill, who regarded Smith's "vent-for-surplus" doctrine as "a surviving relic of the Mercantile Theory" (*Principles*, p. 579).

The crux of the matter here is the question: why should a country isolated from international trade have a surplus productive capacity? The answer which suggests itself is that, given its random combination of natural resources, techniques of production, tastes and population, such an isolated country is bound to suffer from a certain imbalance or disproportion between its productive and consumption capacities. Thus, take the case of a country which starts with a sparse population in relation to its natural resources. This was broadly true not only of Western countries during their mercantilist period but also of the underdeveloped countries of South-East Asia, Latin America and Africa when they were opened up to international trade in the nineteenth century. Given this situation, the conventional international-trade theory (in its Ohlin version) would say that this initial disproportion between land and labour would have been equilibrated away by appropriate price adjustments: *i.e.*, rents would be low and relatively land-using commodities would have low prices, whereas wages would be high and relatively labour-using commodities would have high prices. In equilibrium there would be no surplus productive capacity (although there might be surplus land by itself) because the scarce factor, labour, would have been fully employed. Thus when this country enters into international trade it can produce the exports only by drawing labour away from domestic production. Now this result is obtained only by introducing a highly developed price mechanism and economic organisation into a country which is supposed to have had no previous economic contacts with the outside world. This procedure may be instructive while dealing with the isolated economy as a theoretical model. But it is misleading when we are dealing with genuinely isolated economies in their proper historical setting; it is misleading, in particular, when we are dealing with the underdeveloped countries, many of which were subsistence economies when they were opened to international trade. In fact, it was the growth of international trade itself which introduced or extended the money economy in these countries. Given the genuine historical setting of an isolated economy, might not its initial disproportion between its resources, techniques, tastes and population show itself in the form of surplus productive capacity?

Adam Smith himself thought that the pre-existence of a surplus productive capacity in an isolated economy was such a matter of common observation that he assumed it implicitly without elaborating upon it. But he did give some hints suggesting how the "narrowness of the home market," which causes the surplus capacity, is bound up with the underdeveloped economic organisation of an isolated country, particularly the lack of a good internal transport system and of suitable investment opportunities.¹ Further his concept of surplus productive capacity is not merely a matter of surplus land by itself but surplus land combined with surplus labour; and the

¹ *Op. cit.*, Vol. I, pp. 21 and 383. This is similar to what Mrs. J. Robinson has described as "primitive stagnation." Cf. *The Accumulation of Capital*, pp. 256-8.

surplus labour is then linked up with his concept of "unproductive" labour. To avoid confusion, this latter should not be identified with the modern concept of "disguised unemployment" caused by an acute shortage of land in overpopulated countries. Although Smith described some cases of genuine "disguised unemployment" in the modern sense, particularly with reference to China, "unproductive" labour in his sense can arise even in thinly populated countries, provided their internal economic organisation is sufficiently underdeveloped. In fact, it is especially in relation to those underdeveloped countries which started off with sparse populations in relation to their natural resources that we shall find Smith's "vent-for-surplus" approach very illuminating.

III

Let us now try to relate the "vent-for-surplus" theory to the nineteenth-century process of expansion of international trade to the underdeveloped countries. Even from the somewhat meagre historical information about these countries, two broad features stand out very clearly. First the underdeveloped countries of South-East Asia, Latin America and Africa, which were to develop into important export economies, started off with sparse populations relatively to their natural resources. If North America and Australia could then be described as "empty," these countries were at least "semi-empty." Secondly, once the opening-up process had got into its stride, the export production of these countries expanded very rapidly, along a typical growth curve,¹ rising very sharply to begin with and tapering off afterwards. By the Great Depression of the 1930s, the expansion process seems to have come to a stop in many countries; in others, which had a later start, the expansion process may still be continuing after the Second World War.

There are three reasons why the "vent-for-surplus" theory offers a more effective approach than the conventional theory to this type of expansion of international trade in the underdeveloped countries.

(i) The characteristically high rates of expansion which can be observed in the export production of many underdeveloped countries cannot really be explained in terms of the comparative-costs theory based on the assumption of given resources and given techniques. Nor can we attribute any significant part of the expansion to revolutionary changes in techniques and increases in productivity. As we have seen in Section I, peasant export

¹ For instance, the annual value of Burma's exports, taking years of high and low prices, increased at a constant proportional rate of 5% per annum on the average between 1870 and 1900. Similar rates of expansion can be observed for Siam and Indonesia (Cf. J. S. Furnivall, *Colonial Policy and Practice*, Appendix I; J. H. Boeke, *The Structure of Netherlands Indian Economy*, p. 184; and J. C. Ingram, *Economic Change in Thailand since 1850*, Appendix C). African export economies started their expansion phase after 1900, and the official trade returns for the Gold Coast, Nigeria and Uganda show similar rates of increase after that date, although the expansion process was arrested by the depression of the 1930s.

production expanded by extension of cultivation using traditional methods of production, while mining and plantation sectors expanded on the basis of increasing supplies of cheap labour with a minimum of capital outlay. Thus the contributions of Western enterprise to the expansion process are mainly to be found in two spheres: the improvements of transport and communications ¹ and the discoveries of new mineral resources. Both are methods of increasing the total volume of resources rather than methods of making the given volume of resources more productive. All these factors suggest an expansion process which kept itself going by drawing an increasing volume of hitherto unused or surplus resources into export production.

(ii) International trade between the tropical underdeveloped countries and the advanced countries of the temperate zone has grown out of sharp differences in geography and climate resulting in absolute differences of costs. In this context, the older comparative-costs theory, which is usually formulated in terms of qualitative differences ² in the resources of the trading countries, tends to stress the obvious geographical differences to the neglect of the more interesting quantitative differences in the factor endowments of countries possessing approximately the same type of climate and geography. Thus while it is true enough to say that Burma is an exporter of rice because of her climate and geography, the more interesting question is why Burma should develop into a major rice exporter while the neighbouring South India, with approximately the same type of climate and geography, should develop into a net importer of rice. Here the "vent-for-surplus" approach which directs our attention to population density as a major determinant of export capacity has an advantage over the conventional theory.³

(iii) Granted the importance of quantitative differences in factor endowments, there still remains the question why Smith's cruder "vent-for-surplus" approach should be preferable to the modern Ohlin variant of the comparative-costs theory. The main reason is that, according to the Ohlin theory, a country about to enter into international trade is supposed already to possess a highly developed and flexible economic system which can adjust its methods of production and factor combinations to cope with a wide range of possible variations in relative factor supplies (see Section II above). But in fact the economic framework of the underdeveloped countries is a

¹ This is what Professor L. C. A. Knowles described as the "Unlocking of the Tropics" (*op. cit.*, pp. 138-52).

² Cf. J. Viner, *International Trade and Economic Development*, pp. 14-16.

³ Those who are used to handling the problem in terms of qualitative differences in factors and differential rent may ask: why not treat the surplus productive capacity as an extreme instance of "differential rent" where the transfer cost of the factors from the domestic to export production is zero? But this does not accurately portray the situation here. The transfer cost of the factors is zero, not because land which is used for the export crop is not at all usable for domestic subsistence production but because with the sparse population in the early phase there is no demand for the surplus food which could have been produced on the land used for the export crop. As we shall see, at a later stage when population pressure begins to grow, as in Java, land which has been used for export is encroached upon by subsistence production.

much cruder apparatus which can make only rough-and-ready adjustments. In particular, with their meagre technical and capital resources, the underdeveloped countries operate under conditions nearer to those of fixed technical coefficients than of variable technical coefficients. Nor can they make important adjustments through changes in the outputs of different commodities requiring different proportions of factors because of the inelastic demand both for their domestic production, mainly consisting of basic foodstuff, and for their exportable commodities, mainly consisting of industrial raw materials. Here again the cruder "vent-for-surplus" approach turns out to be more suitable.

Our argument that, in general, the "vent-for-surplus" theory provides a more effective approach than the comparative-costs theory to the international trade of the underdeveloped countries does not mean that the "vent-for-surplus" theory will provide an exact fit to all the particular patterns of development in different types of export economies. No simple theoretical approach can be expected to do this. Thus if we interpret the concept of the surplus productive capacity strictly as pre-existing surplus productive capacity arising out of the original endowments of the factors, it needs to be qualified, especially in relation to the mining and plantation sectors of the underdeveloped countries. Here the surplus productive capacity which may have existed to some extent before the country was opened to international trade is usually greatly increased by the discovery of new mineral resources and by a considerable inflow of foreign capital and immigrant labour. While immigrant labour is the surplus population of other underdeveloped countries, notably India and China, the term "surplus" in the strict sense cannot be applied to foreign capital. But, of course, the existence of suitable surplus natural resources in an underdeveloped country is a pre-condition of attracting foreign investment into it. Two points may be noted here. First, the complication of foreign investment is not as damaging to the surplus-productive-capacity approach as it appears at first sight, because the inflow of foreign investment into the tropical and semi-tropical underdeveloped countries has been relatively small both in the nineteenth century and the inter-war period.¹ Second, the nineteenth-century phenomenon of international mobility of capital and labour has been largely neglected by the comparative-costs theory, which is based on the assumption of perfect mobility of factors within a country and their imperfect mobility between different countries. The surplus-productive-capacity approach at least serves to remind us that the output of mining and plantation sectors can expand without necessarily contracting domestic subsistence output.

The use of the surplus-productive-capacity approach may prove in particular to be extremely treacherous in relation to certain parts of Africa,

¹ Cf. R. Nurkse, "International Investment To-day in the Light of Nineteenth Century Experience," *ECONOMIC JOURNAL*, December 1954, pp. 744-58, and the United Nations Report on *International Capital Movements during the Inter-war Period*.

where mines, plantations and other European enterprises have taken away from the tribal economies the so-called "surplus" land and labour, which, on a closer analysis, prove to be no surplus at all. Here the extraction of these so-called "surplus" resources, by various forcible methods in which normal economic incentives play only a part, entails not merely a reduction in the subsistence output but also much heavier social costs in the form of the disruption of the tribal societies.¹

When we turn to the peasant export sectors, however, the application of the "vent-for-surplus" theory is fairly straightforward. Here, unlike the mining and plantation sectors, there has not been a significant inflow of foreign investment and immigrant labour. The main function of the foreign export-import firms has been to act as middlemen between the world market and the peasants, and perhaps also to stimulate the peasants' wants for the new imported consumers' goods. As we have seen, peasant export production expanded by using methods of production more or less on the same technical level as those employed in the traditional subsistence culture. Thus the main effect of the innovations, such as improvements in transport and communications² and the introduction of the new crops, was to bring a greater area of surplus land under cultivation rather than to raise the physical productivity per unit of land and labour. Yet peasant export production usually managed to expand as rapidly as that of the other sectors while remaining self-sufficient with respect to basic food crops. Here, then, we have a fairly close approximation to the concept of a pre-existing surplus productive capacity which can be tapped by the world-market demand with a minimum addition of external resources.

Even here, of course, there is room for differences in interpretation. For instance, there is evidence to suggest that, in the early decades of expansion, the rates of increase in peasant export production in South-East Asian and West African countries were well above the possible rates of growth in their working population.³ Given the conditions of constant techniques, no significant inflow of immigrant foreign labour and continuing self-sufficiency with respect to the basic food crops, we are left with the question how these peasant economies managed to obtain the extra labour required to

¹ Cf. The United Nations Report on the *Enlargement of the Exchange Economy in Tropical Africa*, pp. 37 and 49-51.

² It may be noted that the expansion of some peasant export crops, notably rice in South-East Asia, depended to a much greater extent on pre-existing indigenous transport facilities, such as river boats and bullock carts, than is generally realised.

³ For instance, cocoa output of the Gold Coast expanded over forty times during the twenty-five year period 1905-30. Even higher rates of expansion in cocoa production can be observed in Nigeria combined with a considerable expansion in the output of other export crops. Both have managed to remain self-sufficient with regard to basic food crops (cf. West African Institute of Economic Research, *Annual Conference*, Economic Section, Achimota, 1953, especially the chart between pp. 96 and 98; *The Native Economies of Nigeria*, ed. M. Perham, Vol. I, Part II). In Lower Burma, for the thirty-year period 1870-1900, the area under rice cultivation increased by more than three times, while the population, including immigrants from Upper Burma, doubled. (Cf. also, Furnivall, *op. cit.*, pp. 84-5.)

expand their export production so rapidly. A part of this labour may have been released by the decline in cottage industries and by the introduction of modern labour-saving forms of transport in place of portage, but the gap in the explanation cannot be satisfactorily filled until we postulate that even those peasant economies which started off with abundant land relatively to their population must have had initially a considerable amount of under-employed or surplus labour. This surplus labour existed, not because of a shortage of co-operating factors, but because in the subsistence economies, with poor transport and little specialisation in production, each self-sufficient economic unit could not find any market outlet to dispose of its potential surplus output, and had therefore no incentive to produce more than its own requirements. Here, then, we have the archetypal form of Smith's "unproductive" labour locked up in a semi-idle state in the underdeveloped economy of a country isolated from outside economic contacts. In most peasant economies this surplus labour was mobilised, however, not by the spread of the money-wage system of employment, but by peasant economic units with their complement of "family" labour moving *en bloc* into the money economy and export production.

The need to postulate a surplus productive capacity to explain the rapid expansion in peasant export production is further strengthened when we reflect on the implications of the fact that this expansion process is inextricably bound up with the introduction of the money economy into the subsistence sectors. To the peasant on the threshold of international trade, the question whether or not to take up export production was not merely a question of growing a different type of crop but a far-reaching decision to step into the new and unfamiliar ways of the money economy.

Thus let us consider a community of self-sufficient peasants who, with their existing techniques, have just sufficient land and labour to produce their minimum subsistence requirements, so that any export production can be achieved only by reducing the subsistence output below the minimum level. Now, according to the conventional economic theory, there is no reason why these peasants should not turn to export production if they have a differential advantage there, so that they could more than make up for their food deficit by purchases out of their cash income from the export crop. But, in practice, the peasants in this situation are unlikely to turn to export production so readily. Nor is this "conservatism" entirely irrational, for by taking up export production on such a slender margin of reserves, the peasants would be facing the risk of a possible food shortage for the sake of some gain in the form of imported consumers' goods which are "luxuries" to them. Moreover, this gain might be wiped off by unfavourable changes in the prices of both the export crop they would sell and the food-stuffs they would have to buy and by the market imperfections, which would be considerable at this early stage. Thus, where the margin of resources is very small above that required for the minimum subsistence output, we

should expect the spread of export production to be inhibited or very slow, even if there were some genuine possibilities of gains on the comparative costs principle.¹

In contrast, the transition from subsistence agriculture to export production is made much easier when we assume that our peasants start with some surplus resources which enable them to produce the export crop *in addition* to their subsistence production. Here the surplus resources perform two functions: first they enable the peasants to hedge their position completely and secure their subsistence minimum before entering into the risks of trading; and secondly, they enable them to look upon the imported goods they obtain from trade in the nature of a clear net gain obtainable merely for the effort of the extra labour in growing the export crop. Both of these considerations are important in giving the peasants just that extra push to facilitate their first plunge into the money economy.

Starting from this first group of peasants, we may picture the growth of export production and the money economy taking place in two ways. Firstly, the money economy may grow extensively, with improvements in transport and communications and law and order, bringing in more and more groups of peasants with their complements of family labour into export production on the same "part-time" basis as the first group of peasants. Secondly, the money economy may grow intensively by turning the first group of peasants from "part-time" into "whole-time" producers of the export crop.² In the first case, surplus resources are necessary as a lubricant to push more peasants into export production at each round of the widening circle of the money economy. Even in the second case, surplus resources are necessary if the whole-time export producers buy their food requirements locally from other peasants, who must then have surplus resources to produce the food crops above their own requirements. Logically, there is no reason why the first group of peasants who are now whole-time producers of the

¹ Of course, this argument can be countered by assuming the differences in comparative costs to be very wide. But, so long as export production requires withdrawing some resources from subsistence production, some risks are unavoidable. Further, remembering that the middlemen also require high profit margins at this stage, the gains large enough to overcome the obstacles are likely to arise out of surplus resources rather than from the differential advantages of the given fully employed resources. The risk of crop-failure is, of course, present both in subsistence and export production.

² In either case the expansion process may be looked upon as proceeding under conditions approximating to constant techniques and fixed combinations between land and labour once equilibrium is reached. The distinctive feature of peasant export economies is their failure to develop new and larger-scale or extensive methods of farming. It is true that in subsistence agriculture "fixed factors," such as a plough and a pair of bullocks, were frequently used below capacity, and one important effect of cash production was to increase the size of the holding to the full capacity of these "fixed factors." But this may be properly looked upon as equilibrium adjustments to make full use of surplus capacity rather than as the adoption of new and more land-using methods of production. Increasing the size of holding to make a more effective use of a pair of bullocks is different from the introduction of a tractor! Our assumption of constant techniques does not preclude the development of large-scale ownership of land as distinct from large-scale farming.

export crop should buy their food requirements locally instead of importing them. But, as it happens, few peasant export economies have specialised in export production to such an extent as to import their basic food requirements.

The average economist's reaction to our picture of discrete blocks of surplus productive capacity being drawn into a widening circle of money economy and international trade is to say that while this "crude" analysis may be good enough for the transition phase, the conventional analysis in terms of differential advantages and continuous marginal productivity curves must come into its own once the transition phase is over. Here it is necessary to distinguish between the expansion phase and the transition phase. It is true that in most peasant export economies the expansion process is tapering off or has come to a stop, as most of the surplus land suitable for the export crop has been brought under cultivation. This, of course, brings back the problem of allocating a fixed amount of resources, as we shall see in the next section when we consider issues of economic policy. But even so, the surplus-productive-capacity approach is not entirely superseded so long as the transition from a subsistence to a fully developed money economy remains incomplete. In most underdeveloped countries of Asia and Africa¹ this transition seems not likely to be over until they cease to be underdeveloped.

The continuing relevance of the surplus-productive-capacity approach may be most clearly seen in the typical case of a peasant export economy which with its natural resources and methods of production has reached the limit of expansion in production while its population continues to grow rapidly. According to the surplus-productive-capacity approach, we should expect the export capacity of such a country to fall roughly in proportion as the domestic requirement of resources to feed a larger population increases. This common-sense result may, however, be contrasted with that obtainable from the conventional theory as formulated by Ohlin. First, it appears that the Ohlin theory puts to the forefront of the picture the *type* of export, *i.e.*, whether it is more labour-using or land-using as distinct from the total export capacity measured by the ratio of total exports to the total national output of the trading country. Secondly, in the Ohlin theory there is no reason why a thickly populated country should not also possess a high ratio of (labour-intensive) exports to its total output.

The ideal pattern of trade suggested by the Ohlin theory has a real counterpart in the thickly populated advanced countries of Europe, which for that very reason are obliged to build up a large export trade in manufactures or even in agriculture as in the case of Holland. But when we turn to the thickly populated underdeveloped countries, however, the ideal

¹ Cf. the United Nations Report cited above on the *Enlargement of the Exchange Economy*. Even in the most developed peasant export economies the money economy has not spread to the same extent in the market for factors of production as in the market for products.

and the actual patterns of international trade diverge widely from each other. Indeed, we may say that these countries remain underdeveloped precisely because they have not succeeded in building up a labour-intensive export trade to cope with their growing population. The ratio of their export to total production could, of course, be maintained at the same level and the pressure of population met in some other way. But given the existing conditions, even this neutral pattern may not be possible in many underdeveloped countries. Thus, in Indonesia there is some evidence to suggest that the volume of agricultural exports from the thickly populated Java and Madura is declining absolutely and also relatively to those of the Outer Islands, which are still sparsely populated.¹ Of course, there are other causes of this decline, but population pressure reducing the surplus productive capacity of Java seems to be a fundamental economic factor; and the decline spreads from peasant to plantation exports as more of the plantation lands, which were under sugar and rubber, are encroached upon by the peasants for subsistence production.² In general, given the social and economic conditions prevailing in many underdeveloped countries, it seems fair to conclude that the trend in their export trade is likely to be nearer to that suggested by the surplus-productive-capacity approach than to that suggested by the theory of comparative costs.³

IV

This paper is mainly concerned with interpretation and analysis, but we may round off our argument by touching briefly upon some of its policy implications.

(i) We have seen that the effect of population pressure on many underdeveloped countries, given their existing social and economic organisation, is likely to reduce their export capacity by diverting natural resources from export to subsistence production. If we assume that these natural resources have a genuine differential advantage in export production, then population pressure inflicts a double loss: first, through simple diminishing returns, and secondly, by diverting resources from more to less productive use.

¹ Cf. J. H. Boeke, *Ontwikkelingsgang en toekomst van bevolkings-en ondernemingslandbouw in Nederlandsch-Indië* (Leiden, 1948), p. 91. I owe this reference to an unpublished thesis by Mr. M. Kidron.

² The same tendency to transfer land from plantation to subsistence agriculture may be observed in Fiji with the growing population pressure created by the Indian immigrant labour originally introduced to work in the sugar plantations. The outline is blurred here by the decline in the sugar industry. The reason why this tendency does not seem to operate in the West Indies is complex. But it may be partly attributable to the tourist industry, which helps to pay for the food imports of some of the islands.

³ The surplus-productive-capacity approach also partly helps to explain why underdeveloped countries, such as India, which started off with a thick population tend to retain large and persistent pockets of subsistence sectors in spite of their longer contacts with the world economy, while the subsistence sectors in thinly populated countries, such as those in West Africa, tend to disappear at a faster rate in spite of their much later start in international trade.

Thus, if Java has a genuine differential advantage in growing rubber and sugar, she would obtain a greater amount of rice by maintaining her plantation estates instead of allowing them to be encroached upon by peasants for subsistence rice cultivation. The orthodox liberal economists, confronted with this situation, would, of course, strongly urge the removal of artificial obstacles to a more systematic development of the money economy and the price system. Now there are still many underdeveloped countries which are suffering acutely from the economic rigidities arising out of their traditional social structure and/or from discriminatory policies based on differences in race, religion and class. Here the removal of barriers, for instance, to the horizontal and vertical mobility of labour, freedom to own land and to enter any occupation, etc., may well prove to be a great liberating force.¹ But our analysis has suggested that it is much easier to promote the growth of the money economy in the early stage when a country is newly opened up to international trade and still has plenty of surplus land and labour rather than at a later stage, when there are no more surplus resources, particularly land, to feed the growth of the money economy. Thus in a country like Java there is a considerable amount of artificial restriction, customary or newly introduced, which the liberal economists can criticise, *e.g.*, restriction on land ownership. But given the combination of population pressure, large pockets of subsistence economy and traditional methods of production which can no longer be made more labour-intensive, it seems very doubtful whether the mere removal of artificial restrictions can do much by itself without a more vigorous policy of state interference. The truth of the matter is that in the underdeveloped countries where, for various reasons described above, the exchange economy is still an extremely crude and imperfect apparatus which can make only rough-and-ready responses to economic differentials, it may require a considerable amount of state interference to move toward the comparative-costs equilibrium. Thus given that Java has genuine differential advantages in the production of rubber and sugar, a more optimal reallocation of her resources may require, for instance, the removal of her surplus population either to the thinly populated Outer Islands or to industries within Java and a vigorous export-drive policy supplemented by bulk purchase and subsidies on the imported rice. Here we come to a fundamental dilemma which is particularly acute for the orthodox liberal economists. On a closer examination it turns out that their free-trade argument, although ostensibly based on the comparative-costs principle, is buttressed by certain broad classical presumptions against protection and state interference:² *e.g.*, the difficulty of selecting the right

¹ This is why the case for the "liberal" solution is strong in places such as East and Central Africa, where due both to the general backwardness of the indigenous population and the presence of a white settler population, both types of rigidity prevail (cf. *The Royal Commission Report on East Africa*).

² Cf. J. Viner, *International Trade and Economic Development*, pp. 41-2. See also Sidgwick, *Principles of Political Economy*, Book III, Chapter V.

industry to protect, the virtual impossibility of withdrawing protection once given, the tendency of controls to spread promiscuously throughout the economic system strangling growth, and so on. These presumptions gain an added strength from the well-known administrative inefficiency and sometimes corruption of the governments of some underdeveloped countries. Thus even if we believe in the "nineteenth-century pattern" of international trade based on natural advantages, how can we be sure that the state is competent enough to select the right commodities for its export-drive policy when it is considered incompetent to select the right industry for protection?

(ii) We have seen that the rapid expansion in the export production of the underdeveloped countries in the nineteenth century cannot be satisfactorily explained without postulating that these countries started off with a considerable amount of surplus productive capacity consisting both of unused natural resources and under-employed labour. This gives us a common-sense argument for free trade which is especially relevant for the underdeveloped countries in the nineteenth century: the surplus productive capacity provided these countries with a virtually "costless" means of acquiring imports which did not require a withdrawal of resources from domestic production but merely a fuller employment for their semi-idle labour. Of course, one may point to the real cost incurred by the indigenous peoples in the form of extra effort and sacrifice of the traditional leisurely life¹ and also to the various social costs not normally considered in the comparative-costs theory, such as being sometimes subject to the pressure of taxation and even compulsory labour and frequently of having to accommodate a considerable inflow of immigrant labour creating difficult social and political problems later on. One may also point to a different type of cost which arises with the wasteful exploitation of natural resources.² But for the most part it is still true to say that the indigenous peoples of the underdeveloped countries took to export production on a voluntary basis and enjoyed a clear gain by being able to satisfy their developing wants for the new imported commodities. Thus our special argument for free trade in this particular context still remains largely intact. The orthodox economists, by rigidly insisting on applying the comparative-costs theory to the underdeveloped countries in the nineteenth century, have therefore missed this simpler and more powerful argument.

¹ It may be formally possible to subsume the surplus-productive-capacity approach under the opportunity-cost theory, by treating leisure instead of foregone output as the main element of cost. But this would obscure the important fact that the underdeveloped countries have been able to expand their production very rapidly, not merely because the indigenous peoples were willing to sacrifice leisure but also because there were also surplus natural resources to work upon.

² The social cost of soil erosion can be very great, but this may be caused not merely by an expansion of export production but also by bad methods of cultivation and population pressure. The problem of adequately compensating the underdeveloped countries for the exploitation of their non-replaceable mineral resources belongs to the problem of the distribution of gains from trade. Here we are merely concerned with establishing that the indigenous peoples do obtain some gains from trade.

(iii) We have seen in Section I that the deep-rooted hostility of the critics towards the "classical theory" and the nineteenth-century pattern of international trade may be partly traced back to the time when Western colonial powers attempted to introduce export-drive policies in the tropical underdeveloped countries; and tried to justify these policies by invoking the "classical theory" of free trade and the Adam Smithian doctrine of international trade as a dynamic force generating a great upward surge in the general level of productivity of the trading countries. To the critics, this appears as a thinly disguised rationalisation of the advanced countries' desire for the markets for their manufactured products and for raw materials. Thus it has become a standard argument with the critics to say that the nineteenth-century process of international trade has introduced a large "export bias" into the economic structure of the underdeveloped countries which has increased their "vulnerability" to international economic fluctuations.

In Section II we have seen that once we leave the ideal world of the comparative costs theory in which the resources not required for the export market can be re-absorbed into domestic production, every country with a substantial export trade may be considered "vulnerable." Thus a country may be said to be vulnerable because it has built up a large ratio of export to its total production simply by making use of its pre-existing surplus productive capacity. *A fortiori*, it is vulnerable when it has genuinely improved upon its original surplus productive capacity. How does the idea of "export bias" fit into our picture?

The term "export bias" presumably means that the resources of the underdeveloped countries which could have been used for domestic production have been effectively diverted into export production by deliberate policy. The implication of our surplus-productive-capacity approach is to discount this notion of "export bias." In the peasant export sectors, at the early stage with sparse populations and plenty of surplus land, the real choice was not so much between using the resources for export production or for domestic production as between giving employment to the surplus resources in export production or leaving them idle. In the later stage, when the population pressure begins to increase as in the case of Java, we have seen that the bias is likely to develop against, rather than in favour of, the export sector. Even when we turn to the mining and plantation sectors, it is difficult to establish a significant "export bias" in the strict sense. Here the crucial question is: how far would it have been possible to divert the foreign capital and technical resources which have gone into these sectors into the domestic sector? The answer is clear. For a variety of reasons, notably the smallness of domestic markets, few governments of the underdeveloped countries, whether colonial or independent, have so far succeeded in attracting a significant amount of foreign investment away from the extractive export industries to the domestic industries. In criticising the

colonial governments it should be remembered that the only choice open to them was whether to attract a greater or a smaller amount of foreign investment within the export sector and not whether to attract investment for the domestic or the export sector.

This is not to deny that the colonial governments had a strong motive for promoting export production. Apart from the interests of the mother country, the individual colonial governments themselves had a vested interest in the expansion of foreign trade because they derived the bulk of their revenues from it.¹ In their search for revenue they have pursued various policies designed to attract foreign investment to the mining and plantation sectors, such as granting favourable concessions and leases, favourable tariff rates for rail transport, taxation policy designed to facilitate the supply of labour, provision of various technical services, etc.² But on the whole it is still true to say that the most important contribution of the colonial governments towards the expansion of the colonial exports is to be found, not in these export-drive policies, but in their basic services, such as the establishment of law and order and the introduction of modern transport, which enabled the pre-existing surplus productive capacity of the colonies to be tapped by the world market demand. If we wish to criticise the export-drive policies of the colonial governments it would be more appropriate to do so, not on the ground of "export bias" but on the ground that they may have diverted too great a share of the gains from international trade and of the public services of the colonies to the foreign-owned mines and plantations at the expense of indigenous labour and peasant export producers.

It may be argued that we have given too strict an interpretation of the "export-bias" doctrine which is merely meant to convey the general proposition that, whatever the exact cause, the nineteenth-century process of international trade has landed many underdeveloped countries with a large ratio of raw materials exports to their total national products, making it desirable to reduce their "vulnerability" to international economic fluctuations. But the trouble is that the "export bias" doctrine tends to suggest that the raw-materials export production of the underdeveloped countries has been artificially over-expanded, not merely in relation to their domestic sector, but absolutely. Given the strong feelings of economic nationalism and anti-colonialism in the underdeveloped countries, this can be a very mischievous doctrine strengthening the widespread belief that to go on producing raw materials for the export market is tantamount to preserving the "colonial" pattern of trade. Thus already many underdeveloped countries are giving too little encouragement to their peasant

¹ This is true for the governments of most underdeveloped countries, whether colonial or independent, past or present.

² For a discussion of the question of the possible export bias through the operation of the 100% sterling exchange system of the colonies, see A. D. Hazlewood, "Economics of Colonial Monetary Arrangements," *Social and Economic Studies*, Jamaica, December 1954.

export sectors by diverting too much of their capital and technical resources to industrial-development projects, and are also crippling their mining and plantation export sectors by actual or threatened nationalisation and various restrictions and regulations. The effect is to reduce their foreign-exchange earnings so urgently needed for their economic development. Of course, no competent critic of the nineteenth-century pattern of international trade would ever suggest the drastic step of reducing exports absolutely; some would even concede the need for vigorous export drive policies.¹ But having built up a pervasive feeling of hostility and suspicion against the "nineteenth-century" or the "colonial" pattern of international trade, they are not in a position to ram home the obvious truths: (a) that, even on an optimistic estimate of the possibilities of international aid, the underdeveloped countries will have to pay for the larger part of the cost of their economic plans aiming either at a greater national self-sufficiency or at the export of manufactured goods; (b) that the necessary foreign exchange for these development plans can be earned by the underdeveloped countries at the present moment only by the export of raw materials (though not necessarily the same commodities for which they were supposed to have a differential advantage in the nineteenth century); and (c) that therefore to pursue their development plans successfully it is vitally important for them to carry out the "export-drive" policies, which in their technical properties may not be very different from those of the colonial governments in the past.² In trying to carry out their development plans on the foreign-exchange earnings from raw-materials export they would, of course, still be "vulnerable"; but this should be considered separately as a problem in short-term economic stability³ and not as a criticism of the nineteenth-century pattern of international trade in relation to the long-term development of the underdeveloped countries. From a long-term point of view, even countries which have successfully industrialised themselves and are therefore able to maintain their population at a higher standard of living by building up a large export trade in manufactures, such as Japan or the

¹ Cf., for example, Gunnar Myrdal, *An International Economy*, p. 274.

² Colonial governments have frequently defended their export-drive policies as the means of taxing foreign trade to finance services needed for internal development. But because they were colonial governments, their motives were suspect. At first sight we might imagine that the new independent governments of the underdeveloped countries would be free from this disability. But unfortunately, given the atmosphere of intense nationalism and anti-colonialism, this is not true. In some cases the hands of the newly independent governments seem to be tied even more tightly, and economic policies admitted to be desirable are turned down as "politically impossible." Here those economists who regard themselves as the critics of the classical theory and the nineteenth-century pattern of international trade have a special responsibility. Instead of dealing tenderly with the "understandable" emotional reactions which they have partly helped to create, they ought to be emphatic in pointing out the conflicts between rational considerations and "understandable" mental attitudes. The underdeveloped countries are too poor to enjoy the luxury of harbouring their emotional resentments.

³ Cf. the United Nations Report on *Measures for International Economic Stability* and Myrdal's comments on it, *op. cit.*, pp. 238-53.

thickly populated countries of Western Europe, will continue to be "vulnerable."¹

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¹ It is particularly in relation to the thickly populated advanced countries of Western Europe which have specialised and adapted their economic structure to the requirements of the export market that Professor J. H. Williams found Adam Smith's "vent-for-surplus" approach illuminating. We have, in this paper, interpreted the "surplus" more strictly in its pre-existing form without the improvements and augmentation in productive capacity due to genuine "specialisation." (Cf. J. H. Williams, "International Trade Theory and Policy—Some Current Issues," *American Economic Review, Papers and Proceedings*, 1951, pp. 426-7.)