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Two approaches to global competition: a historical review

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Abstract
The multiple economic systems advanced since the 15th century may be aggregated into two categories: dirigiste and laissez fairist. Dirigisme takes a complex view of commodities, ranking them on a scale from low-end to high-end commodities based on their expected contributions to growth and rent. In this complex world, free global competition widens the divide between rich and poor countries. Poor countries can overcome this polarization only if they are free to employ industrial policies to promote their entry into high-end commodities. Rich countries prefer free trade and also use their power to impose free trade on the poor countries. To justify free trade, they have developed laissez fairist theories (such as neoclassical economics) that create the basis for free trade by stripping commodities (as well as markets and economic behavior) of much of their complexity.

"*Some tender monie to me… Some offer me Commodities to buy.*"
Shakespeare[1]

"*From the beginning of the reign of Elizabeth…, the English legislature has been peculiarly attentive to the interests of commerce and manufactures and in reality there is no country in Europe, Holland itself not excepted, of which the law is, upon the whole, more favorable to this sort of industry. Commerce and manufactures have accordingly been continually advancing during all this period."*
Adam Smith[2]

If you wish to make sense of the many systems of economic thought, begin by defining their relationship to industrial policies, that is, the official promotion of specific sectors, industries and firms in an economy.

On this view, nearly all the major systems of economic thought advanced since the fifteenth century align themselves into one of two broad categories: dirigiste and laissez fairist. The mercantilists, American protectionists of the nineteenth century, the German historical school, the old institutionalists, post-War development economists, and the new development economists belong in the first category; the physiocrats, classical economists, neoclassical economists, and the Austrians belong in the second category.

The laissez fairists are not opposed to growth policies per se. Eschewing industrial policies, they seek to stimulate growth through neutral policies – such as institutional reforms and education – that they claim do not affect relative prices. It is doubtful, however, if such neutrality is attainable.

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[1] *Comedy of Errors*, IV. iii. 6.
[2] Adam Smith, *Wealth of nations* (The Modern Library, 1776/1965):392.

Case for interventionism

The dirigiste schools of economics built their case for industrial policy primarily on one real-world property of commodities: their complexity.[3]

Consider the complexity of commodities.[4] In the real world, each commodity possesses multiple attributes in production, distribution and consumption. Moreover, these attributes differ greatly across different classes of commodities, such as manufactures, commerce, banking, shipping, and agriculture. At a particular stage of economic history, commodities in these classes may differ – to mention only the most important – in economies of scale, the ratios in which they combine different factors of production, the technology spillovers they create, their ability to earn rent, the rate at which they generate innovations, backward and forward linkages, the income distribution they support, their market structure, the responsiveness of demand for their products to changes in income and price, etc.[5] In addition to the variations in the attributes of commodities across these broad classes – such as agriculture, manufactures and services – it is also necessary to examine these variations at the level of individual commodities.

Variations in the attributes of commodities have important implications. It means that *some* commodities – depending on the particular stage of economic history – are likely to make greater contributions to growth and rent-generation than others. Thus, investments in commodities characterized by increasing returns to scale (IRS) are likely to generate cumulative growth. Expansion in these commodities lowers their unit cost; this spurs a second round of investment, which again lowers unit cost, leading to another round of investment; ad infinitum. The expansionary effects from investment in one set of commodities are likely to spread to other commodities that supply inputs to the former commodities or use their outputs as inputs. Commodities produced under conditions of constant or decreasing returns to scale are unlikely to generate these cumulative expansionary effects. Thus, once we recognize the complexity of commodities, it may be possible to rank classes of commodities as well as individual commodities within any class according to two criteria: the contributions they may reasonably be expected to make to economic growth, summarized in their growth-coefficients, GCs, and their ability to earn rent or their rent-coefficients, RCs.[6]

In a world of complex commodities, the invisible hand is unlikely to allocate a lagging country's resources to their best long-term uses. Once historical accidents have given some countries a competitive advantage, however small, in high-end commodities (those with high GCs and RCs), free global competition will deepen this advantage. As a result, countries that have a lock on high-end commodities will continue to get rich; and poor countries locked into the production of low-end commodities will keep falling behind the rich countries. Left alone, global competition is a disequalizing force.

Could a lagging country still work its way up the commodity chain – from low- to high-end commodities – by taking advantage of its comparative advantage based on abundance of

[3] Industrial policy could be built on other independent or complementary factors: such as informational asymmetries or myopia in investment decisions.
[4] A commodity is any good or service that is produced for sale on the market.
[5] Several of these properties are linked to each other: for instance, economies of scale and innovations are likely to support monopolies or oligopolistic markets. In turn, the ability to earn rent depends on market power.
[6] If an investment of $1 in commodity X produces $5 of additional investments in X and other commodities, its GC is 5. A commodity's RC is given by the fraction of its value added that consists of rent, that is, profits above all the costs of production.

low-end skills? Conceivably, it may slowly increase its capital endowment, accumulate skills and technology, improve its governance, and build financial markets until it can lower its costs enough to enter some lines of high-end commodities. It is unlikely, however, that this slow ascent will work this way. As the ascent of the lagging country is likely to be slow, the unit costs in the targeted high-end commodities may also decline – due to expansion in its output – and the lagging country's goal of entry into this commodity will continue to recede. Over time, as their markets become saturated and their technologies become stable, some of these high-end commodities may experience a decline in their GCs and RCs. This changes the goal post for the lagging country; by the time they enter a high-end commodity it may have lost most of its advantages.[7] As a result, the only chance that lagging countries may have for moving up the commodity chain is to force the issue. They must employ a variety of industrial policies to expedite their ascent from low- to high-end commodities.

The case for *laissez faire*

If the dirigisme of the mercantilists and their successors flowed from the complexity of commodities, the laissez fairists would have to make their case by stripping commodities of their offending real-world attributes.

Adam Smith offered three arguments in favor of free trade – the gains from specialization based on absolute advantage, vent-for-surplus and the market-widening effects of trade. It was the third argument that occupied pride of place in his *Wealth of Nations*. The market-widening effects of trade depended on the complexity of the commodities traded: trade widened markets because (some of) the commodities entering trade were produced under conditions of increasing returns to scale.

Now, this argument could cut both ways. Adam Smith had used it to support free trade; it could also be used *against* free trade. If the gains from trade are cumulative in the high-end commodities, any country that loses the initiative in these commodities could forever be confined to the production of low-end commodities under conditions of free trade. Caught in this trap, industrial policy presents to the lagging country its only chance of acquiring competitiveness in one or more high-end commodities.[8]

Free trade was in trouble: it was not the best policy for lagging countries in a dynamic world of complex commodities.

David Ricardo came to the rescue in 1817 by changing the question. Adam Smith had sought to demonstrate the advantages of free trade in a dynamic context: and he fumbled. Ricardo would succeed because he chose a more modest goal: to demonstrate the superiority of free trade in a static world. He only looked at the one-time gains produced by the *opening* of trade, as each country re-allocated its labor to take advantage of its comparative advantage. To force his analysis into a static framework, Ricardo assumed that the production of wine and cloth took place under conditions of constant returns to scale (CRS), with labor as the only

[7] This discussion has made no mention of the impediments to the slow ascent that may be created by interference in the affairs of lagging countries by imperialist powers. A slow and long ascent gives the imperialist powers more time to derail a lagging country's efforts to climb up the commodity chain.
[8] There is no assurance that a lagging country, using industrial policies, would succeed in acquiring competitiveness in high-end commodities. Policy makers could pick the wrong commodities for promotion or offer support without an expiry date, and hence encourage the entry of inefficient enterprises. These risks notwithstanding, only countries that tried industrial policies have succeeded; whereas failure was uniform in the colonies that were forced into laissez faire regimes.

factor of production. This was his master stroke. With CRS in production, Ricardo stripped commodities of all differentia in production except one: cloth and wine had different (albeit fixed) labor coefficients. In this framework, a country's gains from trade did not depend on what it exported. Industrial policy was out.

In the 1950s, Paul Samuelson (or his formalization of the theories of Eli Heckscher and Bertil Ohlin) recast this stripping of commodities in a neoclassical framework. In this model too, goods differ from each other only in their capital intensities, thus eliminating any basis for industrial policy. In addition, the competitive paradigm of neoclassical economics strips markets and individuals of any properties that may cause market failures. Markets always produce efficient outcomes: no trades exist that could make any one person better off without making someone else worse off.

Politics of the two approaches

The asymmetric dynamics of free global competition produces its own peculiar politics and economics in advanced and lagging countries.

This dynamics places the advanced and lagging countries in opposite camps: the former favor free markets, the latter favor industrial policies. More often than not, the advanced countries – collectively and, in several cases, individually – also possess the power to keep the world open. Imperialism, therefore, is the inevitable corollary of the asymmetric dynamics of global competition. History bears this out abundantly; the advanced countries have used their power to keep as much of the world as possible open to their own capital. Imperialism has its pitfalls though: the advanced countries will compete over global markets and if necessary wage wars over them. Financial crises in the advanced countries may also push them into depressions. Wars and depressions offer lucky breaks to lagging countries: some of them take advantage of their ensuing independence to try to catch up with the advanced countries. Their game-changing weapons are industrial policies.

The advanced countries' support for free global competition, together with their imperialist interests, create two ideological demands in the advanced countries. First, they must debunk the interventionist economics that made them rich and replace it with a laissez faire economics that camouflages the asymmetries of free markets. Can they find thinkers in advanced countries willing to deliver this lie? Don't the best thinkers strive to serve truth? For the most part, the leading Western thinkers have been quite happy to accommodate their country's political demands. Not surprisingly, British economists took the lead in developing the laissez faire doctrines of classical economics; since the late eighteenth century Britain had been Europe's leading economy. All the new variants of laissez faire economics – the marginalists, neoclassical economics, the old and new Austrians – were developed in advanced countries: Britain, Austria, Sweden, the United States, etc.

The advanced countries also needed a narrative to justify the violence they employed to open the lagging countries to their manufactures and capital. Again, several Western thinkers rose to the occasion: they produced a variety of racist discourses that posited a hierarchy of races and cultures. Once established, Western nations used these discourses to justify their depredations against the population of lagging countries. Violence against 'inferior' races was necessary; their 'civilizing mission' demanded that they be improved against their will. They could also be sacrificed if they stood in the path of progress.

The lagging countries had an opposite interest in promoting the entry of their own capital into high-end commodities. However, they could pursue this goal only infrequently for two reasons. In a few cases – such as the Ottoman empire before the nineteenth century – the interests of their ruling classes were best served by free trade. More frequently, the economic ambitions of the lagging countries were thwarted by the imperialism of one or more advanced countries.

In the colonial era, nearly all the countries in Africa, Asia and the Caribbean were thrown open to colonial capital. Together with discriminatory colonial policies, this drove indigenous capital and skills out of manufactures, international trade, large-scale domestic trade, finance, shipping and various branches of government. When the colonial empires were dismantled during the first two decades after WWII, several decolonized countries enjoyed a period of real independence. But this did not last long. By the late 1980s, most of them had lost control over their policies to various multilateral agencies dominated by the advanced countries. In Latin America, these losses have been reversed over the past decade. Over the same period, growing Chinese interest in their resources has given several African countries somewhat greater autonomy in the conduct of their economic policies.

Since industrial policies served the interests of lagging countries, the leading proponents of dirigiste economics were based in the lagging countries or – more recently, if they were based in the advanced countries – they brought a moral commitment to the economic development of the lagging countries. Between the fifteenth and eighteenth centuries, most of Europe's mercantilist literature came out of Britain, Spain, France, and Southern Italy, lagging countries that were trying to catch up with Holland and the city states of northern Italy. During the nineteenth century, the leading protectionist writers were to be found in Germany and United States, two countries that lagged behind Britain but had ambitions of catching up to Britain. In the twentieth century, protectionist thought shifted first to countries in eastern Europe and, starting in the 1940s, to Latin America, India, and centers in Britain that hosted several economists from eastern Europe.

As lagging economies gain competitiveness in an increasing array of high-end commodities, their leading economists begin to embrace laissez fairist positions in international trade. British economists began making this switch in the late eighteenth century; most West European economists began advocating free trade at various points in the mid- to late nineteenth century; and American economists displaced their British counterparts as the leading advocates of free trade only in the post-War era when the United States replaced Britain as the global hegemon. Over the last two decades, as India and China have been gaining competitive advantage in several high-end commodities, many of their leading economists too have been converted to the doctrine of free markets. Other factors too operate to convert economists from the lagging countries to free markets and free trade. It is the ambition of many of the brightest young men and women studying economics in lagging countries to become professors at the top universities in the USA. Success in this ambition demands that they internalize the hegemonic discourse in economics about free markets.

While laissez faire economists are emphatic in proclaiming that governments cannot pick winners, the historical evidence demonstrates the opposite. No lagging country (barring Hong Kong, the commercial hub of the British empire in East and Southeast Asia) has succeeded in indigenizing the production of high-end commodities – or moving in that direction – without the help of dirigiste policies.[9] Britain's economic leadership came after nearly four centuries of adherence to mercantilist policies. Adam Smith acknowledges this but this inconvenient fact did not diminish his enthusiasm for free markets.

Concluding remarks

From the standpoint of their policy implications, all the schools of economics collapse into two categories: dirigiste and laissez fairist.

The first views commodities as complex objects that can be ranked in terms of their contribution to growth and rents; accordingly, dirigistes seeks to promote high-end commodities characterized by high GCs and RCs. In order to deny that commodities can be ranked in this manner, the laissez fairists strip commodities of their complexity until one commodity differs from another only in its capital intensity. In this simplistic world, the commodity composition of a country's economy under free trade is fully determined by its endowments of capital and labor; nothing else matters. Laissez faire economics – built on heroic assumptions – primarily serves an ideological function. It camouflages the unequal distribution of gains from free global competition; it also frees corporations from interference by government except when this happens at their behest.

Since dirigiste economics is founded on real-world properties of commodities and markets, its arguments are generally transparent and it finds support for its theses in historical evidence. On the other hand, neoclassical economics – the dominant branch of laissez faire economics since the late nineteenth century – has employed mathematics to hide its unreal assumptions and its disconnect from the real world. In the nineteenth century, a growing band of physicians and psychologists tried obsessively to establish correlations between quantitative measures of several human traits, on the one hand, and measures of brain size, shape of the skull and different aspects of facial physiognomy; they hoped that this quantification would give scientific legitimacy to their racist theories. In a similar endeavor, since the late nineteenth century, neoclassical economists began to mathematize their discipline in order to gain the prestige of physics. This goal continues to elude neoclassical economics despite its complete mathematization since the 1950s.

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[9] For evidence on this connection, see M. Shahid Alam, *Poverty from the wealth of nations: Integration and polarization in the global economy since 1760* (St. Martin's Press, 2000); M. Shahid Alam, "Colonialism and Industrialization: A Critique of Lewis," *Review of Radical Political Economics*, Spring 2004, pp. 217-40; Erik Reinert, *How rich countries got rich: Why poor countries stay poor* (Constable and Robinson, 2007); Ha-Joon Chang, *Kicking away the ladder: Development strategy in historical perspective* (Anthem Press, 2003); Ha-Joon Chang, "The double life of Daniel Defoe," in: *Bad Samaritans* (Bloomsbury Press, 2008).