The Mercantilists of the seventeenth century held that international trade is linked with conflict. Each country has to struggle for a favourable balance of trade, since an excess of exports over imports, was considered favourable for economic activity, i.e. the level of output and employment, and vice versa. Consequently, one nation’s gains were the other nation’s loss. Thomas Mun (1571-1641) was one of the first to formulate this doctrine in his posthumously published *Discourse on England’s Treasure by Forraign Trade* (Mun, 1664). In the twentieth century, Maynard Keynes showed considerable sympathy with the mercantilist argument in his *General Theory* (Keynes, 1936, outset of chapter 23). As a consequence one might speak of a mercantilist-Keynesian theory of international trade; significantly, Joan Robinson’s Cambridge Inaugural Lecture was about *The New Mercantilism* (Joan Robinson, 1966). This theory contrasts sharply with traditional classical and modern neoclassical trade theory where
both trading partners gain, and where, as a rule, full employment prevails, and a
tendency towards harmony exists. Here, international trade is associated with
welfare gains for all trading nations on account of the principle of comparative
cost advantage. This principle was formulated for the first time in a theoretically
coherent way by David Ricardo in the seventh chapter of his *Principles of
Political Economy and Taxation* (Ricardo, 1821).

In these notes we attempt, first, to picture, very broadly, the essential features of
both approaches by going back to their origin. In a second step, we attempt to
explain, very sketchily though, why contradictions between both theories arise.
In a conciliatory and synthesising vein, it will, in the third place, be suggested that
both the mercantilist-Keynesian and the classical-neoclassical theory of
international trade embody important elements of truth and, as such, shed light
on differing aspects or, perhaps more appropriately, different dimensions, of the
complex phenomenon of international trade. The classical theory of international
trade associated with the principle of comparative cost is, in fact, valid for any
employment level. Based on this, we suggest, in the fourth place, that the trade
theory linked with classical-Keynesian political economy – an elaboration of the
mercantilist-Keynesian trade theory – may be useful to explain employment levels
in a global economy where no tendency towards a full employment equilibrium
exists.

*The Mercantilists and Trade Conflicts*

It has already been mentioned that Thomas Mun, a wealthy merchant and one of
the directors of the East India Company from 1615 until his death in 1641, was
one of the first to formulate Mercantilist trade doctrine. Because of his powers of
persuasion he was called ‘The Prince of Mercantilism’ (Overbeek, 1999, p. 4).

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1 For helpful comments I am indebted to Geoffrey Harcourt, Cambridge, and to Sergio Rossi,
Fribourg and Lugano. Of course, all responsibility remains mine.
Thomas Mun starts his *Discourse on England’s Treasure by Forraign Trade* in an almost solemn way by saying that „the Merchant is worthily called *The Steward of the Kingdoms Stock*, by way of Commerce with other Nations;“ (Mun 1664, p. 3). The core of Mun’s argument is set forth in chapters II and III (Mun 1664, pp. 11-33). Chapter II is about „The means to enrich this Kingdom, and to encrease our Treasure“ (p. 11). In modern terms the problem is about raising output and employment on the one hand, and about increasing the quantity of money – precious metals in mercantilist times – facilitating thus the building up of a state (royal) treasury. Thomas Mun, the great practical economist, starts off very firmly: „The ordinary means ... to encrease our wealth and treasure is by Forraign Trade, wherein we must ever observe this rule; to sell more to strangers yearly than we consume of their value“ (p. 11). Exports must exceed imports. In chapter III Mun considers „The particular ways and means to encrease the exportation of our commodities, and to decrease our Consumption of forraign wares“ (p. 7). We mention here some of the twelve points Mun considers.

„First, although this Realm be already exceeding rich by nature, yet might it be much encreased by laying the waste grounds (which are infinite) into such employments as should no way hinder the present revenues of other manured lands, but hereby to supply ourselves and prevent the importations of Hemp, Flax, Cordage, Tobacco, and divers other things which now we fetch from strangers to our great impoverishing“ (pp. 15-16).

„[Second, we] may likewise diminish our importations, if we would soberly refrain from excessive consumption of forraign wares in our diet and rayment, with such often change of fashions as is used, so much the more to encrease the waste and charge; which vices at this present are more notorious amongst us than in former ages. Yet might they easily be amended by enforcing the observation of such food laws as are strictly practised in other Countries against the said excesses; where likewise by commanding their own manufactures to be
used, they prevent the coming in of others, without prohibition, or offence to strangers in their mutual commerce“ (pp. 16-17).

“[Third, in] our exportations we must not only regard our own superfluities, but also we must consider our neighbours necessities, that so upon the wares which they cannot want, nor yet be furnished thereof elsewhere, we may (besides the vent of the Materials) gain so much of the manufacture as we can and also endeavour to sell them dear, so far forth as the high price cause not a less vent in the quantity“ (p. 17).

And Mun goes on to say that England’s export goods should be transported by English ships, and that its own fishing grounds should be used better (pp. 20-22). „Our Fishing plantation likewise in New-England, Virginia, Greenland, the Summer Islands and the New-found-land, are of the like nature, affording much wealth and employment to maintain a great number of poor, and encrease our decaying trade“ (p. 23). He ends by saying that, „in all things we must endeavour to make the most we can of our own, whether it be Natural or Artificial“(p. 31), a conclusion echoed by Keynes in his National Self-Sufficiency (Keynes 1933-1982) three hundred years later.

Thomas Mun was, of course, not the only one to argue in favour of the largest possible surplus of exports over imports. Already around 1550 an English mercantilist, Clement Armstrong, worried about immense quantities of foreign products flowing into England, causing there scarcity of precious metals and destroying handicrafts, putting out of work many people, who, subsequently, have no incomes to buy food and beverages, and are forced to lie idle and who, eventually, have to beg or to steal to be able to survive (Heckscher II, 1932, pp. 109-10). William Petty went even further and claimed, around 1662, in a Keynesian vein, that it would be better to burn the produce of a thousand workers, than to let these people lose their capacity to work through unemployment. Later Friedrich List argued that the capacity to produce is more important than the increased wealth resulting from production (Heckscher II,
1932, pp. 109-10). Johann Joachim Becher said that it is always better to sell products to foreigners rather than to buy from them; selling is associated with great advantages regarding employment, buying causes unemployment; a French saying went thus: „il faut décharger le royaume de ses marchandises“ (Heckscher II, 1932, p. 102). Heckscher – a well-known neoclassical economist – concludes by saying that mercantilism was obsessed by a fear of gluts which cannot be explained (Heckscher II, 1932, p. 100). However, the mercantilist fear of gluts was evidently closely associated with a concern about unemployment and with the possibility to create workplaces through aggressive trade policy and with other measures against unemployment (Heckscher II, 1932, p. 107). This is indeed the crucial point confirmed by Keynes in his General Theory in the Notes on Mercantilism, The Usury Laws, Stamped Money and Theories of Underconsumption (Keynes, 1936/1973, ch. 23): „For some two hundred years [1550-1750 approximately] both economic theorists and practical men did not doubt that there is a peculiar advantage to a country in a favourable balance of trade and grave danger in an unfavourable balance, particularly if it results in an efflux of the precious metals“ (Keynes, 1936, p. 333). Subsequently, Keynes pictures the essential characteristics of mercantilist economic thought. First, „Mercantilists’ thought never supposed that there was a self-adjusting tendency by which the rate of interest would be established at the appropriate level. On the contrary they were emphatic that an unduly high rate of interest was the main obstacle to the growth of wealth; and they were even aware that the rate of interest depended on liquidity preference and the quantity of money [...] and several [mercantilist writers] made it clear that their preoccupation with increasing the quantity of money was due to their desire to diminish the rate of interest“ (Keynes, 1936, p. 341). And, in mercantilist times, the only possibility to increase the quantity of money was an excess of exports over imports, unless, of course, a country possessed gold or silver mines.
Second, the „mercantilists were aware of the fallacy of cheapness and the danger that excessive competition may turn the terms of trade against a country“ (Keynes, 1936, p. 345). Later, the squandering of a country’s products on foreign markets at low prices has become known as immiserising growth.

Third, the „mercantilists were the originals of „the fear of goods’ and the scarcity of money as causes of unemployment which the classicals [and the neoclassicals] were to denounce two centuries later as an absurdity“ (Keynes 1936, p. 346). They „were conscious that their policy [of aiming at a trade surplus] killed two birds with one stone. On the one hand the country was rid of an unwelcome surplus of goods, which it was believed to result in unemployment, while on the other the total stock of money in the country was increased, with the resulting advantages of a fall in the rate of interest“ (ibid., p. 347). This argument can even be carried further: The surplus of exports over imports is an autonomous or primary demand which leads to a multiple of (induced or secondary) demand for consumption goods. What mattered for the mercantilists was the primary and secondary employment thus created. Inserting beggars and people without work into the process of production was a fundamental mercantilist preoccupation associated with the „fear of goods‘ (Heckscher, 1932). This is the „real’ side of the argument associated with a direct output and employment effect of an export surplus, the monetary side being linked with the rate of interest and its influence on investment. This leads to an indirect link between export surplus and employment: The surplus of exports over imports leads to an inflow of precious metals or an increase in the quantity of money. The rate of interest declines as a consequence and, as a rule, the volume of investment increases which, again, means a rise of primary or autonomous demand inducing a secondary or indirect demand for consumption goods. On the whole, the mercantilists expected, as a rule, a cumulative process of employment creation from an export surplus, leading to a cumulative increase of national wealth in the form of a higher social product.
Forth, and finally, the "mercantilists were under no illusions as to the nationalistic character of their policies and their tendency to promote war. It was national advantage and relative strength at which they were admittedly aiming" (Keynes, 1936, p. 348). With substantial involuntary unemployment in the various trading countries and no tendency towards full employment, competition becomes a struggle for survival. This struggle was economic and political-cum-military in mercantilist times, when the European nations were basically formed. An export surplus was one important element leading to a 'strong' economy capable of yielding high tax revenues which, in turn, enabled a country to build up an efficient army or, much more important, a strong navy to protect the merchant fleet and to keep colonies or dependent regions under control. Hence a strong state (army, navy) would make the economy stronger, and vice versa. There was a cumulative interaction between the economy and the state, above all regarding its military dimension. Basically with mercantilism, sometimes combined with absolutism, with France being the leading example of this combination, the economy stood, as a rule, in the service of the state which, in turn, depended upon the economy. Agriculture and the peasants were no longer able to produce a surplus, that was sufficiently high to carry the state, which, therefore, more and more relied upon trade, local and overseas, and upon manufactures to obtain the tax revenues required, in line with the ambitions of the emerging nation states.

*The Classicals and the Neoclassicals: Welfare Gains of Trade*

The principle of comparative costs is basic to the modern theory of international trade. The theoretical framework based upon this principle is intimately related to exchange-based neoclassical theory *and* to classical models, where exchange, i.e. supply and demand, not production, governs international economic relations, i.e. the quantities that are exchanged and the prices at which exchange takes place. Internally, however, the fundamental prices are the prices of
production which are intimately associated with labour values. In the classical view, international trade sets in when goods are already produced, with ‘factors of production’ not being mobile. Hence supply and demand must govern the pattern of trade and the equilibrium prices. It is, therefore, not by chance that an eminent *classical* author, David Ricardo, is at the origin of what is presently the basic *neoclassical* model of international trade.

Ricardo says: „Under a system of perfectly free commerce, each country naturally devotes its capital and labour to such employments as are most beneficial to each. This pursuit of individual advantage is admirably connected with the universal good of the whole. By stimulating industry, by rewarding ingenuity, and by using most efficaciously the peculiar powers bestowed by nature, it distributes labour most effectively and most economically: while, by increasing the general mass of productions, it diffuses general benefit, and binds together by one common tie of interest and intercourse, the universal society of nations throughout the civilized world. It is this principle which determines that wine should be made in France and Portugal, that corn shall be grown in America and Poland, and that hardware and other goods shall be manufactured in England“ (Ricardo, 1821, pp. 133-34).

It is interesting to hear Montesquieu on the same subject: „L’effet naturel du commerce est de porter à la paix. Deux nations qui négocient ensemble se rendent réciproquement dépendantes; si l’une a intérêt d’acheter, l’autre a intérêt de vendre; et toutes les unions sont fondées sur des besoins mutuels“ (Montesquieu II, 1748/1979, p. 10).

Hence the principle of comparative cost is, intimately, associated with harmony and peace. However, the „quantity of wine which [Portugal] shall give in exchange for the cloth of England, is not determined by the respective quantities of labour devoted to the production of each, as it would be, if both commodities were manufactured in England, or both in Portugal“ (Ricardo, 1821, pp. 134-35).
“England may be so circumstanced, that to produce the cloth may require the labour of 100 men for one year; and if she attempted to make the wine, it might require the labour of 120 men for the same time. England would therefore find it her interest to import wine, and to produce it by the exportation of cloth.

To produce the wine in Portugal, might require only the labour of 80 men for one year, and to produce the cloth in the same country, might require the labour of 90 men for the same time. It would therefore be advantageous for her to export wine in exchange for cloth. *This exchange might even take place, notwithstanding that the commodity imported by Portugal could be produced there with less labour than in England.* Though she could make the cloth with the labour of 90 men, she would import it from a country where it required the labour of 100 men to produce it, because it would be advantageous to her rather to employ her capital in the production of wine, for which she would obtain more cloth from England, than she could produce by diverting a portion of her capital from the cultivation of vines to the manufacture of cloth” (Ricardo, 1821, p. 135, our emphasis). Relative prices, not absolute prices are crucial in determining the structure of international trade, as was held by Adam Smith. The theory of comparative cost advantages was born.

„Thus England would give the produce of the labour of 100 men, for the produce of the labour of 80. Such an exchange could not take place between the individuals of the same country. The labour of 100 Englishmen cannot be given for that of 80 Englishmen, but the produce of the labour of 100 Englishmen may be given for the produce of the labour of 80 Portuguese, 60 Russians, or 120 East Indians. The difference in this respect, between a single country and many, is easily accounted for, by considering the difficulty with which capital moves from one country to another, to seek a more profitable employment, and the activity with which it invariably passes from one country to another in the same country“ (Ricardo, 1821, p. 136).
To this passage Ricardo adds an illuminating footnote: „It will appear then, that a country possessing very considerable advantages in machinery and skill, and which may therefore be enabled to manufacture commodities with much less labour than her neighbours, may, in return for such commodities, import a portion of the corn required for its consumption, even if its land were more fertile, and corn could be grown with less labour than in the country from which it was imported“ (Ricardo, 1821, p. 136, note*). On Ricardo’s full employment assumption this kind of trade makes sense for both trading partners. However, as Nicholas Kaldor has extensively argued, with no tendency towards full employment an exchange of primary products (agricultural products, raw materials) with industrial goods may have important employment effects, the reason being that, as a rule, industrial products are more labour-intensive than agricultural products, if direct and indirect labour is taken account of. Cumulative processes aggravating already existing disequilibria may set in (Kaldor, 1985). Hence, to come back to the above example, Portugal is in a position to produce both goods more cheaply: less labour is required to produce a given quantity of wine and of cloth in Portugal. As a consequence, „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, 1821, p. 136). This would undoubtedly have disastrous employment effects in England.

„Experience, however, shows, that the fancied or real insecurity of capital, when not under immediate control of the owner, together with the natural disinclination which every man has to quit the country of his birth and connexions, and intrust himself with all his habits fixed, to a strange government and new laws, check the emigration of capital. These feelings, which I should be sorry to be weakened, induce most men of property to be satisfied with a low rate of profits in their
own country, rather than seek a more advantageous employment for their wealth in foreign nations“ (Ricardo, 1821, pp. 136-37). The dominating position of the owner entrepreneur in the early nineteenth century makes this a very convincing argument. However, in our age of globalisation, dominated by the multinational and the transnational joint stock company, capital-mobility goes without saying. This is bound to have employment effects which shall be sketched in the next section. But before doing so we have a glance at the neoclassical developments of Ricardo’s classical theory of international trade. As a rule, the neoclassical theory of international trade is divided in positive theory and in normative (welfare) theory.

„[In positive theory] the traditional preoccupation of international economics with the explanation of the pattern of trade among nations has continued to present date to be a major area of theoretical speculation, and currently empirical research. Indeed, the serious study of international economics might be considered to have emerged contemporaneously with Ricardo’s celebrated theory of comparative advantage [...]“ (Bhagwati, 1969, pp. 8-9). Building on Ricardo, „the Heckscher-Ohlin theory of comparative advantage ... builds the explanation of the pattern of trade around differences in factor endowments between countries. While assuming that production functions are the same everywhere ... the Heckscher-Ohlin theory deduces that each country will export that commodity which is intensive in the use of a countries abundant factor“ (Bhagwati, 1969, p. 9).

„The welfare theory of trade has traditionally been concerned with determining the optimal nature of policy intervention for open economies. International trade economists further have pioneered second-best analysis, which relates to constrained maximization when, for institutional reasons, the first-best optimum is not feasible. Moreover, they have been almost unique in dealing with second-best problems which arise from constraints imposed by 'non-economic’ objectives“ (Bhagwati, 1969, p. 13).
On this conceptual basis the classical and neoclassical economists have built a rich theoretical and empirical analysis. The primary preoccupation of the liberal economists has been, what could be called, the ‘structure aspect’ of trade. International and interregional trade is brought about by differing natural endowments but also by man-made differences within regions and countries having resulted, for example, in a specific specialisation within the social process of production which leads to particular trade pattern.

A hallmark of the liberal, classical and neoclassical, theory of international trade is that the level of employment is taken as given. As a rule, full employment is postulated. Say’s Law holds: there may be too much production of some goods, overproduction of all goods, e.g. general overproduction, is impossible, however. J.B. Say argues as follows: „Les entrepreneurs des diverses branches d’industrie ont coutume de dire que la difficulté n’est pas de produire, mais de vendre; qu’on produirait toujours assez de marchandises, si l’on pouvait facilement en trouver le débit. Lorsque le placement de leur produits est lent, pénible, peu avantageux, ils disent que l’argent est rare; l’objet de leurs désirs est une consommation active qui multiplie les ventes et soutienne les prix“ (Say, 1841, p. 138). Given this, Say continues: „L’homme dont l’industrie s’applique à donner de la valeur aux choses en leur créant un usage quelconque, ne peut espérer que cette valeur sera appréciée et payée, que là ou d’autres hommes auront les moyens d’en faire l’acquisition. Ces moyens, en quoi consistent-ils? En d’autres valeurs, d’autres produits, fruits de leur industrie, de leurs capitaux, de leurs terres: d’où résulte, quoiqu’au premier aperçu cela semble un paradoxe, que c’est la production qui ouvre les débouchés aux produits. Que si un marchand d’étoffes s’avisa de dire: Ce ne sont pas d’autres produits que je demande en échange des miens, c’est de l’argent, on lui prouverait aisément que son acheteur n’est mis en état de payer en argent que par les marchandises qu’il vend de son coté. “Tel fermier peut-on lui réproudre, achètera vos étoffes si ses récoltes sont bonnes; il achètera d’autant plus qu’il
aura produit davantage. Il ne pourra rien acheter, s’il ne produit rien. Vous-mêmes, vous n’êtes mis à même de lui acheter son froment et ses laines, qu’autant que vous produisez des étoffes“ (Say, 1841, pp. 138-39).

„C’est donc avec la valeur de vos produits, transformée momentanément en une somme d’argent, que vous achetez, que tout le monde achète les choses dont chacun a besoin“ (Say, 1841, p. 139).

„Lors donc qu’on dit: *La vente ne va pas, parce que l’argent est rare*, on prend le moyen pour la cause; on commet une erreur qui provient de ce que presque tous les produits se résolvent en argent avant de s’échanger contre d’autres marchandises, et de ce qu’une marchandise qui se montre si souvent, paraît au vulgaire être la marchandise par excellence, le terme de toutes les transactions dont elle n’est qu’intermédiaire. On ne devra pas dire: *La vente ne va pas, parce l’argent est rare*, mais parce que les autres produits le sont“ (Say, 1841, pp. 139-40).

Needless to say that these remarks of Say’s have become of the highest importance for classical and neoclassical economic theory in general, and, for the theory of employment in particular. Two points are crucially important for the theory of international trade which we are considering here.

First, there can be no general overproduction and hence no involuntary unemployment in the exchange economy depicted by J.B. Say. Hence the crucial assumption in the classical and in the neoclassical theory of international trade: *employment is given and is at the full employment level.*

Second, at the international level there may be overproduction of some commodity in one country because other goods are not produced in sufficiently large quantities in another country. In his first letter to Malthus – *Que les produits ne s’achètent que par le moyen d’autre produits* – J.B. Say explicitly mentions that there is overproduction in England because Brazil is not capable of developing its production (Say, 1820, pp. 17-18). „*[Ou encore] il y a trop de
marchandises offertes en Italie et ailleurs, parce qu’il n’y a pas assez de marchandises italiennes qui puissent convenir à l’Angleterre. Un pays n’achète que ce qu’il peut payer; car, s’il ne payait pas, on se lasserait bien vite de lui vendre“ (Say, 1820, pp. 15-16). In this letter he also condemns tariffs which lead to a mutual impoverishment of the trading countries. In this context, a very important argument arises: Countries which refuse to trade, like China and Japan, in the 19th century, are acting immorally because they thereby impoverish other countries. Hence overproduction may occur in England and in the United States because China and Japan are unwilling to step up production and exchange the additional production against English and American goods. As a consequence, both China and Japan have been forced to engage in trade relations with the West.

Hence, an exchange economy characterised by the sequence ‘commodity-money-commodity’

\[
C - M - C' 
\]

underlies most of the classical and neoclassical theory of international trade. In this view of the economy, money is simply a veil covering the real transactions. It has also been widely argued that money is simply the most easily exchangeable commodity. As such, money greatly facilitates exchange in that it serves as an intermediary to avoid the problem of ‘double coincidence’ of wants. The exchange economy considered is also an economy of independent producers (individuals and firms inside a country; countries in international trade) which engage in exchange. Indeed, exchange occupies a dominating position in the neoclassical model, so dominating that even production is relegated to the sphere of exchange. This emerges from the concept of factor markets where distribution and employment are governed. In this context, it has already been pointed out that the basic principle of the classical and neoclassical theory of international trade – the principle of comparative cost advantages – is almost exclusively
applied to a given employment level. As a rule, full employment is assumed to be established by the smooth functioning of the market mechanism.

*Developments of the mercantilist-Keynesian aspect of international trade: the external and the internal employment mechanism of Classical-Keynesian Political Economy*

While the classical-neoclassical theory of international trade is about structures of trade, *given* the level of employment, the mercantilist-Keynesian theory of international trade deals with the scale or employment effect of international trade, with structures already determined. The basic contention is that the given employment level of classical trade theory need not correspond to full employment. In this sense, both theories are complementary, dealing with two different aspects of international trade. In this section we present, very sketchily though, some implications for international trade of the Classical-Keynesian branch of development of Keynes’s *General Theory* as is broadly and tentatively sketched in (Bortis, 1997).

The starting point is Keynes’s contribution to the *Festschrift* for Arthur Spiethoff (Keynes, 1933) where he distinguishes between the ‚real exchange economy‘ and the ‚monetary production economy‘. The notion of the ‚real exchange economy‘, symbolically represented by scheme (1) above, underlies the body of classical and neoclassical theory, including the theory of international trade based upon the principle of comparative cost advantages. However, the concept of the *monetary production economy* is basic for the mercantilist-Keynesian theory and its developments, for example, post Keynesian and classical-Keynesian political economy. As a consequence, all these theoretical strands are, explicitly or implicitly, based upon a more or less complete *monetary theory of production*:

\[ M - C \ldots P \ldots C' - M' \]
Money and finance $M$ is used to buy means of production $C$ (labour, machines, raw materials) which, within the social process of production, $P$, are transformed into final goods $C’$ that are exchanged against money $M’$.

While in a real exchange economy, the level of output and employment, is supply determined, economic activity is demand determined in a monetary production economy. *Goods are always exchanged against money, not against other goods.* This is evident from comparing schemes (1) and (2), but the issue comes to the open more clearly by considering the theory of the *big push* set forth by Rosenstein-Rodan (1943-58). The starting point is an underemployment equilibrium where aggregate demand and supply in money terms are balanced.

"Let us now assume that 20'000 unemployed workers [...] are taken from the land and put in to a large shoe factory. [...] If these workers spent all their wages on shoes, a market for the products of their enterprise would arise representing an expansion which does not disturb the pre-existing market [...]. The trouble is that the workers will not spend all their wages on shoes [; as a consequence, the shoe factory will go bankrupt because only a fraction of the production can be sold].“ (Rosenstein-Rodan, p. 249). It is of the utmost importance to note that there would be no major problem in a real-exchange economy where, ultimately, goods are exchanged against goods and money is only a veil. The shoe production would be exchanged against products, eventually at a lower price for shoes, since the quantity of shoes produced has increased. Rosenstein-Rodan goes on to say: "If, instead, one million unemployed workers were taken from the land and put, not into one industry, but into a whole series of industries which produce the bulk of the goods on which workers would spend their wages, what was not true in the case of one shoe factory would become true in the case of a whole system of industries: it would create its own additional market, thus realizing an expansion of world output with the minimum disturbance of the world markets. The industries producing the bulk of the wage goods can therefore be said to be complementary“ (Rosenstein-Rodan, p. 249).
In fact, „complementarity of different industries provides the most important set of arguments in favour of a large-scale planned industrialization [i.e. a big push]“ (p. 49).

However, there is no need to plan economic development if economic activity is set into motion by autonomous expenditures, government expenditures G and exports X, as is exhibited in the supermultiplier relation (3) below (Bortis 1997, specifically, pp. 143-46; generally, ch. 4).

\[
Q = \frac{G + X}{z[1 - \frac{1}{k}]} + t(b_1 + b_2) - (g + d)v
\]  

(3)

The supermultiplier links the autonomous variables with output Q (and, hence to ‘profit sector’ employment N, because of \(Q = AN\), where A is labour productivity). The supermultiplier relation is of a long-period nature. All the prices and quantities involved represent a system equilibrium and are, as such, governed by technology and institutions which are constant or slowly evolving. The long-period trend output Q may be at any level below full employment output \(Q_f\).

To bring to the open the essential features of this relation we postulate that ordinary or normal wages – governed by collective or individual bargaining - are entirely consumed. The leakage as a fraction of property income – the economic surplus - is \(z_s = 1 - c_s = s_s + t_s\) (\(c_s, s_s, t_s\) = fractions of property income consumed, saved and paid for taxes, respectively). Property income (profits, land and labour rents, the latter arising on account of special abilities or of privileges) is \(1 - (1/k)\), where k is the mark-up on ordinary wages (the ‘variable costs’ in a vertically integrated economy); \(b_1\) is the propensity to import of necessary goods, required in the process of production, \(b_2\) stands for the import propensity of non-necessary goods which are related to consumption and
t equals the terms of trade; \((g + d) v\) is the gross investment-income ratio: \(g\) is the – trend – growth rate of the autonomous variables \((G+X)\), \(d\) is the drop-out ratio of fixed capital – depending on physical and technical obsolescence and hence upon the innovative dynamism of the entrepreneurs - and \(v\) represents the capital coefficient.

Given the autonomous variables, output \(Q\) is, in principle, positively linked with a large investment-output ratio \((g+d)v\), negatively with a strong import dependence, as is reflected in large import coefficients, and in unfavourable terms of trade \((t\) is high\). Most importantly, an unequal income distribution, reflected in a relatively large value of the property share \([1-(1/k)]\) is, in principle, associated with a lower level of output and employment; if property income is itself unequally distributed, the leakage coefficient \(z_s\) will be large – because of a high saving coefficient \(s_s\) - which further depresses output \(Q\), and employment \(N\). The negative link between unequal distribution, and output and employment is the crucial feature of the supermultiplier relation.

The supermultiplier governs the long-period output and employment trend and, as a consequence, persistent, long-period unemployment; all the prices and quantities are, in a classical vein, governed by persistent and slowly evolving factors which are technology and institutions (Bortis, 1997, ch. 3 and 4).

The relevant point now is that the supermultiplier embodies two employment mechanisms, the internal and the external employment mechanism (Bortis, 1997, pp. 190-98). The internal employment mechanism is based upon the macroeconomic equilibrium condition \(S = I\) (relation 4 below), the external employment mechanism on the balance on current account, \(X = tM = t (b_1 + b_2) Q\) (relation 5 below); see Bortis (1997, pp. 190 ff.).

As a rule, output determined by the internal mechanism \((Q_I)\) and by the external mechanism \((Q_E)\) diverge. This will be reflected in a current account surplus or deficit appearing in the numerator of relation (4). Various possibilities exist to
adjust both employment levels to each other. For example, $Q_I$ and $Q_E$ may adjust mutually to each other through variations in government expenditures $G$ or through variations in the propensity to import non-necessary goods related to consumption ($b_2$). As a rule, however, the external mechanism will govern economic activity in the long run, implying that $Q_I$ will have to adjust to $Q_E$ (Bortis, 1997, p. 169 and pp. 190-99; Kaldor, 1989).

$$Q_I = \frac{G + (X - tM)}{z\left[1 - \frac{1}{k}\right] - (g + d)v}$$

(4)

The internal mechanism (4) will, as a rule, determine economic activity in large countries like the United States, Russia, China, France. Hence, government expenditures, income distribution and gross investment will be crucial in governing economic activity. The foreign balance will, in normal circumstances, play a secondary role – in contrast to the mercantilist doctrine sketched above.

$$Q_E = \frac{X}{t(b_1 + b_2)}$$

(5)

Densely populated countries lacking primary resources (agricultural products, raw materials and energy resources) are, as a rule, outward oriented with the external mechanism (5) governing economic activity. Obvious examples are Germany, Japan, Singapore, Switzerland, Taiwan.

The internal employment mechanism (relation 4) is politically exceedingly difficult to manage in an open economy. There is, first, an inherent difficulty. The internal employment mechanism in fact requires establishing socially sound proportions between state and the private sector, reflected by the ratio $G/Q$, and a socially acceptable distribution of incomes, such that economic activity is near to, or,
ideally at, the full employment level. And, second, internal policies must be such that the external balance \((X = tM)\) is broadly preserved. Given the immense difficulties associated with the internal employment mechanism it is natural that, with the creation of large free-trade areas and with globalisation, more and more countries will rely upon the external employment mechanism to secure levels of employment as high as possible. The employment effect of foreign trade will be particularly strong if the bulk of exports consists of high-quality industrial products and services and if imports are, in the main, made up of primary goods as is necessarily the case with the successful exporters just mentioned, and with the terms of trade being favourable. High-quality industrial goods and services are, as Nicholas Kaldor has emphasised time and again, labour-intensive - if account is taken of direct and indirect labour – while primaries are land-intensive. Now, there is, in our view, a contradiction between the external and the internal employment mechanism at the world level. In fact, world economic activity \((Q_W)\) must be governed by the internal employment mechanism (relation 6 below) since the world as a whole is a closed system. The share of world economic activity attributed to each country is, however, governed by the external employment mechanism (relation 5 above). Hereby, the shares in world industrial production and services activities are, of course, of particular importance.

\[
Q_W = \frac{G}{z[1 - \frac{1}{k}] - (g + d)v}
\]  

(6)

In order to successfully set to work the external employment mechanism, countries and regions have to offer favourable conditions in order to attract firms, which create additional work places and, subsequently, export the bulk of their production. The work force has to be of good quality, but wages not too high, the infrastructure should be in a good state and should be available at low
costs to the users, public services, education in the main, should be of high quality, but taxes not too high. Taxes may, in turn, be lowered if state activities are privatised. Given the endeavour to create, in each country, a favourable environment for exporting firms, it is likely that government expenditures stagnate or even decline at the world level. Even more importantly, income distribution has become markedly more unequal in the last twenty years or so (Galbraith and Berner, 2001). According to relation (6) a more unequal income distribution and stagnating or eventually declining government expenditures both imply that, in principle, long-period world economic activity – output and employment - remains more or less constant or even declines. As a consequence, the struggle for world market shares, mainly of industrial goods and services, will intensify. Through the external employment mechanism the successful exports of high-quality industrial goods and services may nevertheless enjoy a satisfactory, even a booming economic situation. The losers, however, will be precipitated into the abyss of mass unemployment and of social and political instability. Owing to the law of increasing returns and to the principle of effective demand, Kaldorian cumulative processes may be set into motion resulting in larger inequalities of income, wealth and employment opportunities worldwide.

Given these negative aspects of globalisation, Professor Gaston Gaudard rightly advocates regulating the process of globalisation. Here it is crucial what is meant by regulation, and which form or shape regulation should take on. We strongly feel that regulation of behaviour may be necessary, but is probably not sufficient. Instead we advocate that the system must be regulated. Most importantly, a high employment level associated with a socially acceptable distribution must be brought about within each country; this means putting to work the internal employment mechanism. This, in turn, requires a supranational money (Keynes’s Bancor) to effect international transactions, with each country or even region having a money of its own, precisely to be able to carry out employment and distribution policies. Hence globalisation must take place upon a solid socio-
economic basis comprising, most importantly, high employment levels and fair 
distributional arrangements. The point is that with massive unemployment, life 
becomes a struggle for survival, implying social conflicts, e.g. conflicts between 
ethnic and religious groups. However, when the employment level is high, and 
distribution socially acceptable, people can live together while preserving their 
cultural identity. Cultural diversity, in our view, is crucial since an exchange of 
ideas may take place, with individuals, regions and countries mutually enriching 
each other.

Conclusions

In the mercantilist-cum-classical-Keynesian view of international trade, the state 
must deal, in cooperation with the ‘social partners’, with the scale of economic 
activity and with the problem of distribution, the great distributional shares and 
the distributional structures, mainly the wages structure. If states are broadly 
successful in solving these two problems, a worldwide socio-economic and 
political basis would be created upon which individuals and collectives could act 
within a maximum degree of liberty. At the international level, liberty mainly 
implies free trade, within the constraint of the foreign balance, to bring about 
optimum welfare effects of international trade, with structures of trade in 
accordance with the principle of comparative cost advantage. Moreover, a high 
level of employment and a socially acceptable distribution of incomes would 
enable free mobility of individuals between countries. With a high employment 
level everywhere the immigrant would, from an economic point of view, no 
longer be an enemy who will eventually occupy a scarce work place, but an ally 
and a partner within the social process of production. 
Given this, we do not see the future world a kind of ‘oligarchic’ capitalism where 
huge multinational and transnational enterprises engaged in the production of 
goods and services are struggling in a semi-feudal way for market shares and for
power. This world view would be defendable if the world market system were self-regulating. But, a large number of great authors, strongly – and, in our view, rightly - feel that there is no self-regulation of the market system. In a monetary production economy, effective demand ultimately governs economic activity, and the broad management of demand requires state intervention. Hence, we conceive of the coming world as a family of strong and sovereign states, where each state creates internal stability in terms of a high employment level and of fair distribution. On this solid social basis a very large degree of liberty of movement would be open for individuals and goods as is in the spirit of economic and political liberalism. Hence the point is to leave presently ascending hardline liberalism, to go quite far beyond the Soziale Marktwirtschaft where the state is, fundamentally, the repair shop of the market, and to create the social basis for a truly liberal world.

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