CHAPTER 16

THE DISCONTINUOUS WORLD ECONOMY

"They're sending Armies to my side—
The Americans & Russians are sending bombing planes tanks
Chinese Egyptians Syrians help me battle for my righteous
house my Soul's dirt Spirit's Nation body's
boundaries & Self's territory my
Zionist homeland my Palestine inheritance
The Capitalist Communist & Third World Peoples'
Repubhcs Dictatorships Police States Socialisms
& Democracies
are all sending Deadly Weapons to our aid!
We shall triumph over the Enemy!"
Allen Ginsberg, 1974
"Jahweh and Allah Battle"

16.1. Global Dualism and International Immiserization

16.1.1. Neoclassical Approaches

Broadly two views of the impact of international trade on economic relations between nations have competed for acceptance. The standard Heckscher-Ohlin-Samuelson model, building on the comparative advantage foundation of Ricardo, suggests that freer trade will lead to gains for all countries involved and a tendency to convergence in income and living standards. This last result is asserted in its strongest form in Samuelson's (1948, 1949) factor-price equalization theorem. For two countries, two homogeneous factors, and two commodities, producible by linearly homogeneous production functions exhibiting diminishing marginal productivity, and with both countries producing some of both goods competitively without transport costs or trade restrictions, then factor prices will be equalized across both countries.

In contrast to this sunnily optimistic view has been the argument that over time trade and growth will lead to a dualistic divergence with the rich getting richer and the poor getting poorer. This "immiserization thesis" was developed by Friedrich List (1841) and has been promulgated in various forms by numerous authors since. Whatever the cause, it happens to be the case in the current
world economy that the gap between the richest and poorest nations is widening, with the disturbing addendum that many of the poorest nations have actually been experiencing negative real per capita growth, a downward vicious spiral. This increasing dualism portends a profound global instability.

A neoclassical explanation of this tendency as arising from the dynamics of growth and trade has been developed by Bhagwati (1958). He finds that a country can be made worse off from growing in a free trade situation if the ratio of domestic production to imports of importables is small, the constant-utility demand-elasticity for importables is small, the elasticity of supply of importables is small, and either the foreign offer curve is inelastic or growth actually reduces domestic production of importables at constant relative commodity prices. More precisely:

$$ (C/M) \cdot \epsilon + (Y/M) + y < -r_m, $$

where $C$ is total demand for importables, $M$ is actual imports, $Y$ is domestic production of importables, $\epsilon = -p \frac{aC}{aP}$, $p$ is price of importables, $\sigma = P \frac{aY}{aP}$, $y = p(\sigma Y/\sigma K)$, $K$ is domestic productive capacity, and $r_m = p \frac{aS_m}{aP}$, with $S_m$ the supply of imports. In short the terms of trade turn against the immiserizing country and it ends up with fewer importables after it grows. It has been argued that such conditions apply to LDC's exporting basic agricultural commodities. This observation and argument forms the basis of the Prebisch-Singer thesis (Prebisch, 1963; Singer, 1975) that the terms of trade will turn inevitably against primary goods exporters.¹

This model has been extended into other frameworks. Thus Bhagwati (1968) shows that wage or other distortions can bring it about. Hatta (1984) shows in a multi-commodity world that the immiserization result can arise from complementarities between goods, inferiority in either production or consumption of goods, or Walrasian instability of the equilibrium (assuming one exists). Following an argument by Kemp (1962), Young and Miyagawa (1986) show that a country receiving capital investment may be worse off under certain production conditions with low elasticities and if foreigners own a large share of capital in a sector with large capital rentals payments. Choi and Yu (1987) show the possibility with variable returns to scale if in a transfer the terms of trade shift to favor the higher-returns-to-scale industry in the paying country and the lower-returns-to-scale industry in the receiving country. Other efforts tying accumulation patterns to specialization and terms of trade effects have been made by Findlay (1980), Taylor (1981), and Dutt (1989).

Another mechanism that implies a tendency to increased inequality, if not necessarily outright immiserization, is learning-by-doing. Such models are due to Krugman (1985), Lucas (1988), Arthur (1990), and Boldrin and Scheinkman (1988). The latter consider two countries starting out almost identical with two industries, one high technology and responsive to learning-by-doing, the other low technology and less responsive. With a simple Ricardian model, differential learning-by-doing generates a saddle point surrounded by two stable equilibria