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I

From Subsistence to Exchange

When economists discuss contemporary growth in advanced Western countries, they do not think of internal trade (i.e., wholesale and retail trade) as one of the engines of growth. And they are right. It would be misplaced to associate current economic growth in the West specifically with the distributive sector. Instead, when economists discuss wholesaling and retailing in advanced Western economies, they focus on such subjects as the organization of these activities, the nature and extent of competition, concentration, economies of scale, vertical integration, and restrictive practices. The emphasis is on efficiency in the provision of distributive services: in broad terms, efficiency in the link between production and consumption.

It is unusual to examine the possibility of any relationship between the activities of traders and the growth of the economy, except to the extent that efficiency in the provision of their services releases resources for other purposes. In short, the emphasis is on the allocation of given resources. In this respect, trading activity is treated very much like any other branch of economic activity.

This orientation is justified. It focuses on the main issues of interest to both economists and policymakers. But this orientation, though appropriate now, would be misleading if it were applied to the Western economies as they were two or more centuries ago. Yet in that earlier period those economies were in many ways far more advanced than those of most less developed countries (LDCs) today. In particular, they were already very largely exchange economies in which subsistence or near-subsistence production was relatively unimportant.

INTERNAL TRADE AS AN ENGINE OF GROWTH

Historians have recognized that the economic repercussions of trading activities in, say, seventeenth- and eighteenth-century England went well beyond efficiency in the use of resources in the trading activities themselves.

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For example, in their book on shopkeeping in eighteenth-century England, Hoh-cheung Mui and Lorna Mui (1989, 291–92) conclude:

> If the major purpose of all these activities by shopkeepers was to drum up business, by so doing they eased the flow of goods and at the same time helped to stimulate as well as satisfy an increasingly widespread demand, a demand that encouraged expansion in industry and overseas trade. It was not an unimportant contributor to the overall economic development of the country—industry, overseas trading and inland distribution moved in tandem, each fructifying the other.

Jacob Price (1989, 283) has observed that in seventeenth- and eighteenth-century Britain the activities of merchants "left behind" much more than "specific markets for specific products." Their activities helped to create commercial institutions and practices and to raise the level of human capital, which proved to be "of great utility to the entire economy in the ensuing era of rapid industrialization and attendant export growth" (p. 283). Richard Grassby (1970, 106) wrote that it was "merchant capital which created markets, financed manufactures, floated the American colonial economies and launched banking and insurance."

In emerging economies the activities of traders promote not only the more efficient deployment of available resources, but also the growth of resources. Trading activities are productive in both static and dynamic senses.[1]

NEGLECT OF TRADING ACTIVITY

One would therefore expect to find that trading activities feature prominently in modern development economics. Instead, in spite of the economic history of the now-developed world, which should have been familiar to development economists, trading activities are barely mentioned in the mainstream literature. It is as if postwar development economics had to begin from scratch, its exponents faced with a tabula rasa.

A charitable interpretation is that exponents of the new development economics thought that early Western experience could not apply to the so-called Third World. This attitude would have been mistaken since it is evident that all developed countries at one time had the characteristics and levels of income and capital of the postwar Third World.

However, even if it were correct to disregard the economic history of the West, the neglect in development economics of the role of trading ac-

[1] For a further discussion of the role of traders in the development process, see Bauer (1991, chap. 1).

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tivity in the Third World is both unwarranted and surprising. First-hand observation of economic activity in many less developed regions would have shown that trading activity was ubiquitous and that large numbers of people were engaged in it on a full-time, part-time, or casual basis.[2] Moreover, even a cursory reading of the last hundred years' history of some of these regions would have drawn attention to the role of traders in helping to transform them from largely subsistence economies to largely exchange economies. For example, the historian Sir Keith Hancock (1977), after analyzing the major changes in that region, referred to West Africa as the "traders' frontier." Another historian, Allan McPhee, entitled his book, published in London in 1926, *The Economic Revolution in British West Africa*. The book makes clear both that West Africa was transformed in a period of about two generations and also that traders were major agents of that transformation.

The neglect of internal trading activity still persists in mainstream development economics. That this is so is clear from Gerald M. Meier's book *Emerging from Poverty,* published in 1984. Professor Meier is a very distinguished exponent of development economics. His book sets out the main concerns of the subject. Trading activity (as distinct from international trade) is not mentioned.

Had trading activity and its effects been properly appreciated, mainstream development economics would have been radically different. For example, the influential proposition in development economics known as the international demonstration effect portrayed the availability of Western goods as encouraging consumption at the expense of saving and investment, and hence as inhibiting economic growth. However, in reality, trading activity and the availability of imported incentive goods served to initiate and sustain a process in which increases in consumption and investment (for example, in establishing and improving capacity in agriculture) were able to go hand in hand. It is no accident that throughout the Third World the most advanced regions are those with most Western commercial contacts; and, conversely, the most backward and poorest are those with few such contacts. Interestingly, Karl Marx was emphatic in the *Communist Manifesto* about the positive role of cheap consumer goods in the

[2] The large numbers involved in trading activities have usually not been reflected in official occupational statistics and official reports. This understatement, or even omission, lends plausibility to the proposition that tertiary activities (which include trading) in poor countries involved a smaller proportion of the labor force than in richer countries and that the proportion increased with economic growth. I examined this proposition, put forward in the 1930s by Colin Clark and Allan G. B. Fisher, in various publications since 1951. There it has been explained why official statistics are misleading and why the empirical and theoretical bases for the Clark-Fisher hypothesis are insubstantial. My views are summarized in my book, *The Development Frontier* (Bauer 1991).

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advance from primitive agriculture to more sophisticated and productive economic activity. The concept of incentive goods and the term itself have dropped out of the development literature.

Similarly, the central notion in this literature until quite recently has been the vicious circle of poverty. According to this proposition, poor countries cannot emerge from their poverty because incomes are too low for the saving and investment necessary to raise income. It is difficult to see how development economists could have entertained this notion if they had recognized how millions of poor producers in the Third World had in the aggregate made massive investments in agriculture. These investments were made in the context of their decisions, encouraged by the activities of traders, to replace subsistence production by production for the market. If there had been a vicious circle of poverty, these poor people had failed to notice it. Millions of acres of cultivated land under cash crops such as rubber, cocoa, and coffee, as well as foodstuffs for domestic markets, testify not only to Third World peoples' economic responsiveness and readiness to take a long view but also to the vacuousness of the idea of the vicious circle of poverty.

The notion of the vicious circle of poverty as promoted in the mainstream development literature from the 1940s to at least the 1970s is evidently insubstantial. To have money is the result of economic achievement, not its precondition. That this is so is plain from the very existence of developed countries, all of which originally must have been underdeveloped and yet progressed without external donations. The world was not created in two parts, one with ready-made infrastructure and stock of capital, and the other without such facilities. Moreover, many poor countries progressed rapidly in the hundred years or so before the emergence of modern development economics and the canvassing of the vicious circle. Indeed, if the notion of the vicious circle of poverty were valid, mankind would still be living in the Old Stone Age.

The idea of the vicious circle of poverty has been a major lapse in modern development economics. It has influenced policy considerably. It was a major element in the advocacy of massive state economic controls on the ground that only drastic policies of "resource mobilization" would enable an economy to break the vicious circle. It was also a major strand in the successful advocacy of government-to-government subsidies known as foreign aid.

Lapses in economic thinking are not, of course, confined to modern development economics. One may recall the celebrated near-consensus of economists in the 1950s that the persistent scarcity of the U.S. dollar would be a continuing problem besetting the world economy. This conclusion could be reached only by a now-inexplicable disregard of the rate of exchange (i.e., the price of the dollar). This particular lapse had a short life: the dollar shortage was, in fact, soon replaced by an international glut of

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dollars. Lapses in modern development economics have proven to be much more impervious to inconvenient evidence. Thus, the notion of the vicious circle of poverty and the disregard of price on quantities supplied and demanded (supply and demand for short), both of which engulfed much mainstream development economics from the late 1940s, persisted for more than two decades. And as I have just noted, disregard of trading has persisted much longer.

One should perhaps say that modern development economics has not neglected traders and trading activity completely. To the very limited extent that these subjects have been considered, the emphasis has been on the so-called imperfections of the market. When not ignored, trade has usually been deplored. Thus, real or alleged monopolistic elements in trade have attracted some attention. For instance, the trader who has penetrated an outlying area is apt to be scrutinized as an individual with market power because he is, after all, the only trader on the spot. The fact that his presence adds to the opportunities available to the local people tends to be ignored.

Winston Churchill, who did not claim economic expertise, saw the point. Writing about East Africa, he said:

> It is the Indian trader who, penetrating and maintaining himself in all sorts of places to which no white man would go or in which no white man could earn a living, has more than anyone else developed the beginning of early trade and opened up the first slender means of communication.[3]

FROM MISFORTUNE TO DISASTER

Market-oriented economists and advocates of extensive state economic control are agreed on one matter, namely that advance from subsistence production to wider exchange is indispensable for a society's escape from extreme poverty. In the absence of opportunities for exchange, there is little scope for the division of labor and the emergence of different crafts or skills. The lack of commercial links with a wider society obstructs or precludes the inflow or emergence of new ideas, methods, crops, and wants. Indeed, unquestioning acceptance of prevailing conditions and the sway of habit and custom are familiar in such economies.

The low level of attainment is accompanied by major hazards. The absence of trading links with the outside world and lack of reserve stocks turn misfortune, such as bad weather, into disaster; belt-tightening becomes starvation. It is not accidental that large-scale famine in the less developed world occurs in subsistence and near-subsistence economies and not in

[3] Quoted in Mangat (1969, 61).

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economies already reasonably well integrated into wider regions through exchange relationships. The advance of an economy to wider exchange does not involve greater insecurity as part of the cost of material progress; in other words, there is here no conflict between progress and security.

The misery in Ethiopia, Sudan, and elsewhere in Africa is not the result simply of unfavorable weather, external causes, or population pressure. It is the result of enforced reversion to subsistence conditions under the impact of the breakdown of public security, suppression of private trade, or forced collectivization. There is a core of truth in the jibe that the weather tends to be bad in centrally controlled economies. But although the hazards of a subsistence economy are far more acute than those of an exchange economy, they tend to be politically and psychologically more acceptable as being part of the nature of things and in any case not attributable to human agency. But this greater acceptability of the hazards and hardships of a subsistence economy does not diminish their reality.

Advance from subsistence production involves trading activity. This is obvious at a simple level. There can be no production for sale without an outlet and an accessible conduit to it. Producers also need to buy inputs, such as simple tools and equipment. And they will not produce for sale unless they can use the proceeds to buy goods and services they want. The purchase of inputs and of incentive goods and production for sale are, in turn, closely linked with credit. This is required for the purchase of inputs used in the production of the crops, whether seasonal crops or slow-maturing trees, and also in many cases for sustaining producers until their crops are harvested. Traders are an effective and convenient source and channel of such finance. In these circumstances, production of cash crops, trade, and credit are intertwined.

But the significance of trade extends far beyond these pipeline services. Contacts through traders and trade are prime agents in the spread of new ideas, modes of behavior, and methods of production. External commercial contacts often first suggest the very possibility of change, including economic improvement.

SMALL-SCALE OPERATIONS

Conditions in the Third World tend to ensure the need for a substantial volume of trading and closely related activities. These activities are more labor intensive than in the West because capital is scarcer relative to labor in poor countries than in rich.

A large proportion of producers and consumers operate on a small scale and far from the major commercial centers, including the ports. Individual transactions are small. Individual farmers produce on a small scale and

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sell in even smaller quantities at frequent intervals because they lack storage facilities and substantial cash reserves. Conversely, because of their low incomes, consumers find it convenient or necessary to buy in small, often very small, amounts, again at frequent intervals. In these conditions the collection of produce and the physical distribution of consumer goods and of farm inputs are necessarily expensive in real terms. Storage, assembly, bulking, transport, breaking of bulk, and distribution absorb a significant proportion of available resources.

In Nigeria, for example, individual groundnut farmers may sell a few pounds of groundnuts at a time and operate 500 to 700 miles from the ports whence the groundnuts are shipped in consignments of thousands of tons. Imported consumer goods arrive in large consignments and are often bought in minute quantities. In Nigeria, matches arrive in consignments of several hundred cases, each case containing hundreds or thousands of boxes. The ultimate consumer may buy only part of a box. The sale of one box is at times a wholesale transaction; the buyer resells the contents in little bundles of ten matches, together with part of the striking surface of a box. Cheap imported scent arrives in large consignments: the ultimate consumer often does not buy even a small bottle but only two or three drops at a time, perhaps a dab on each shoulder of the garment. In some African countries smokers buy single cigarettes, or even a single inhaled drag of a cigarette.

To a Western audience it may seem as if sales of produce and purchases of consumer goods in such small quantities must be wasteful. This is not so. If consumers could not buy in these small quantities, they would either have to tie up their very limited capital in larger purchases or, more likely, would not be able to consume the products at all.[4] The same considerations apply to a farmer's sales of produce to an intermediary.

It is evident that in these conditions the task of collecting and bulking produce and of breaking bulk and physical distribution of merchandise involves much labor. What may be somewhat surprising is that a large part of this labor is self-employed. This is so because entry into small-scale trading is easy. In the absence of officially imposed obstacles such as restrictive licensing or official monopsonies, there are few if any institutional barriers, few administrative skills are needed, and little initial capital is required. The supply price of self-employed labor is low in the absence of more profitable opportunities. For these reasons small-scale operations are economic in many parts of the distribution system: large firms are at a disadvantage because their operations require more administrative and supervisory per-

[4] As Adam Smith observed, "Unless a capital was employed in breaking and dividing certain portions either of the crude or manufactured produce, into such small parcels as suit the occasional demands of those who want them, every man would be obliged to purchase a greater quantity of the goods he wanted, than his immediate occasions required." *Wealth of Nations,* Book II, chap. 5.

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sonnel, and these tend to be relatively expensive or ineffective in many poor countries. A multiplicity of small-scale traders in part represents the substitution of cheaper labor for more expensive labor.[5]

A colorful illustration of labor-intensive trade is provided by the extensive business in used containers. Petty traders purchase, collect, store, clean, repair, and resell containers such as tins, boxes, bottles, and sacks. They thereby extend the effective life and use of these products. Labor is used, and capital is conserved.

The small-scale trader often does not supply simply marketing services to his customers. In many cases he provides credit, usually in modest sums. This credit is used for such purposes as the purchase of seeds, fertilizers, pesticides, building materials, implements, and consumer goods. The advancing of this credit generally is the final stage in a flow of funds emanating from financial institutions and large trading firms that have direct access to international financial markets. These enterprises advance credit to the larger indigenous traders, the latter advance credit to smaller traders, and so on until the farmer gets his loan. There is, in short, a process of bulk-breaking in the financial market; and the farmer in the hinterland has access indirectly to the world capital market.

A Western audience may be surprised at the relatively large number of successive independent trading intermediaries who typically are involved in the movement of a farmer's output from the first collection to the final shipment from the port. Again, this succession of intermediaries may seem wasteful and suggest that it would be more economic for the flow of goods to pass through fewer successive intermediaries. But this opinion overlooks two considerations already noted: first, the supply price of the services of small traders is very low, and second, a larger vertically integrated trading firm spanning several successive stages would require relatively expensive personnel for coordination and supervision. In the circumstances, the vertical subdivision of trading activities among successive intermediaries is economic. That this is so is ensured by the option to by-pass a redundant intermediary. No producer, consumer, or intermediary is forced to use the services of any intermediary if he can perform that intermediary's services at lower cost: a redundant bulking or bulk-breaking intermediary will be sidestepped. The same is true of any other trading service such as the provision of credit.

It may be helpful if I anticipate a doubt in some readers' minds. It is often contended that farmers in poor countries are not free to choose among intermediaries in selling their produce because they are indebted to

[5] The numbers attracted to trade in LDCs may be increased as a result of rigidities in money wages for hired labor. It was Simon Rottenberg (1953) who first pointed out this necessary qualification. But even if these wages were at market-clearing levels, the numbers who would find trading attractive would still be very large as long as the underlying economic factors remain the same.

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particular traders to whom they have to sell their output at a depressed price. However, where the producer can choose among a number of would-be lenders and trader-lenders, he will choose to borrow where the terms are most advantageous to him. The terms of loans from trader-lenders are a combination of interest payments and the obligation to sell the produce to the lender; what in isolation may seem to be a forced sale at a low price may simply represent an indirect part of interest on the loan. And, of course, many producers are not in debt.

In much of the less developed world, especially in Africa, there is no clear-cut distinction between farmers and traders or moneylenders. The small trader is often the more enterprising farmer who collects produce from neighbors or relatives and takes it to the market. After a while, he may come to trade more nearly full time. And even without such progression, the trader or moneylender in rural areas in LDCs, conspicuously so in Africa, is usually very much anchored in the rural community with farming relatives.

In the same way as many Third World farmers have become part-time or full-time traders, so many traders have become manufacturers. Successful traders accumulate capital and develop business skills that are helpful for the conduct of industrial operations. In the words of Adam Smith, "The habits besides of order, economy and attention to which mercantile business naturally forms a merchant render him much fitter to execute, with profit and success any project of improvement" (*Wealth of Nations,* Book III, chap. 4). Throughout the Third World many viable industrial enterprises have been pioneered and developed by traders.

NONMONETARY INVESTMENT

Farmers in poor countries producing for wider exchange have to make investments of various kinds. These investments include the clearing and improvement of land and the acquisition of livestock and equipment. Such investments constitute capital formation. A part of this capital formation is financed from personal savings and borrowing from traders and others. But much of it is nonmonetized. For example, the clearing or improvement of land is the result of additional effort on the part of the farmer and his family. Very little monetary expenditure is involved.

These forms of investment, when made by small farmers, are generally omitted from official statistics and are still largely ignored in both the academic and the official development literature.

In many poor countries these overlooked categories of investment are in the aggregate highly important both quantitatively and qualitatively. They are quantitatively significant because agriculture and the activities closely related to it account for much of economic activity. They are qualitatively significant because these categories of investment are critical in the advance

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from subsistence to exchange. Moreover, such investments are especially likely to be productive because they are made by people who have a direct interest in the returns.

Besides presenting a misleading picture of economic activity in the Third World, the neglect of this capital formation has had adverse practical consequences. Taxation and other policies have often retarded the expansion of the exchange sector by reducing the farmer's proceeds or by increasing his costs. I believe that these policies would not have been pursued so extensively and intensively if the scale and significance of capital formation on small farms had been recognized.

The reasons for this neglect are necessarily conjectural. But their consequences are clear. This neglect issues in a highly misleading picture of economic activity and of the attitudes of peoples over a large part of the Third World. For instance, in discussions of the plantation rubber industry attention had focused almost entirely on the estate side of the industry to the neglect of the small holdings. Yet in the aggregate this latter category in area and output was at least equal to that of the estates. Cultivated agricultural properties are income-yielding assets, the productivity of which exceeds that of unimproved land as a result of effort and activity. The process of establishing, extending, and improving the land is investment. To disregard it neglects all direct agricultural investment in the nonmonetary sector of the economy and also much of it in the monetary sector when the land is used for the production of cash crops. The disregard of these categories of investment has encouraged the notion that the peoples of the Third World suffer from economic myopia and give no thought for the morrow. It has also lent superficial plausibility to doomsday prophesies of population growth. The neglect of direct agricultural investment also precludes the framing of policy designed to maximize productive saving and investment.

Disregard of this capital formation resembles neglect of the extent and role of trading activity. In both cases the extent and importance of the neglected activity should have been evident from direct observation of economic activity in poor countries. Indeed, reflection on readily available statistics alone would have indicated the importance both of capital formation in agriculture and also of trading activity: statistics such as those regarding exports and imports and the volume of freight handled on the railways, and also changes in those statistics over time, all of which are relevant and informative in this context.

THE SCOPE AND EFFECTIVENESS OF ECONOMICS

I have here been criticizing features of mainstream development economics. Let me recapitulate briefly. In recent decades, major shortcomings dis-

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figured this branch or subdiscipline of economics. These have included the disregard of trading activity; the neglect of major determinants of economic performance such as cultural and political factors; the notion of the vicious circle of poverty; and the practice of price-less economics, that is, the disregard of the relationship between price and quantities supplied and demanded.

These are failures of observation or failures to apply basic economic reasoning. These defects have had serious practical consequences, some of which I have alluded to earlier in this lecture. The neglect of cultural and political factors necessarily involves disregard of the reciprocal interaction between the familiar variables of economic analysis and these determinants of economic performance and progress.

You will appreciate that I am not saying here that economists have little or nothing to contribute by way of explaining economic phenomena and processes in the Third World and thereby assisting in the framing of economic policies. On the contrary, they have much to offer. Economic analysis is generally applicable as a major step in understanding the likely effects of a change in any of the familiar economic variables. Economists working in unfamiliar settings will, however, be more effective if, in addition, they recognize that cultural and political factors, usually taken as given, may be influenced by changes in one or another of these variables. For example, a change in the foreign trade regime, and hence in the availability of imported goods, is likely to affect the spread of new ideas and information and thereby people's attitudes and modes of behavior.

The potentialities of economics both for explanation and policy in poor countries have been enriched by recent advances in other fields of economic enquiry, such as the economic theory of politics and bureaucracies, the economics of property rights, the analysis of the dichotomy between insiders and outsiders in the labor market, the economics of transaction costs, and the theory of effective protection.

Critical assessment of contemporary development economics, therefore, must not serve to obscure the relevance of economics for the understanding of economic activities and sequences in the less developed world. Many years of work in this field have reinforced my confidence in the scope and effectiveness of economics in the most diverse institutional settings.

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