Bruce Anderson: "Foreign Trade in the Light of Circulation Analysis"
Journal of Macrodynamic Analysis
1 (2001): 9-31
http://www.mun.ca/jmda/vol1/foreign.pdf

FOREIGN TRADE IN THE LIGHT OF CIRCULATION ANALYSIS

BRUCE ANDERSON

Introduction

In recent years the debate over free trade has heated up and has taken the form of violence in Seattle, Washington D.C., Quebec, and Genoa. Groups either embrace free trade or condemn it. In fact, it seems impossible to reconcile the arguments put forward by the supporters and the protestors. In this paper I want to investigate the problem by using Bernard Lonergan's work on economics. I begin by presenting the predominant view of economists, namely that trade benefits everyone. Next I turn to evidence that supports the claim that trade in the real world is not necessarily beneficial. Then I summarise Lonergan's analysis of the relation between the production of goods and services and the circulation of money in an economy in order to make the point that, if we want to make judgments about the merits or demerits of trade, we must first understand how economies actually work.

In the light of recent discussions about what counts and does not count as work pertaining to the functional speciality Dialectics, it is worth noting that my analysis does not belong to any of the functional specialities outlined by Lonergan in *Method in Theology*.[1] Even though I address opposed points of view, I am not engaged in Dialectics, and even though I present a version of Lonergan's economic analysis, I am not engaged in Interpretation. Rather, I am simply trying to communicate an aspect of economics to readers who have little

[1] (London: Darton, Longman and Todd, 1972; latest reprint, Toronto: University of Toronto Press, 1996).

knowledge of economics and who are not themselves engaged in a particular functional speciality.

1. The View of Establishment Economics

Most economists believe that "trade can make everyone better off."[2] Their view is that "trade allows all countries to achieve greater prosperity."[3] Gregory Mankiw, for example, presents the rationale for international trade in terms of opportunity cost and the principle of comparative advantage. He claims that differences in opportunity cost and comparative advantage create the gains from trade. When each person specialises in producing the good for which he or she has a comparative advantage, total production in the economy rises, and this increase in the size of the economic pie can be used to make everyone better off. In other words, as long as two people have different opportunity costs, each can benefit from trade by obtaining a good at a price lower than his or her opportunity cost of that good.[4] "These benefits arise because each person concentrates on the activity for which he or she has the lower opportunity cost."[5] "Trade can benefit everyone in society because it allows people to specialise in activities in which they have a comparative advantage."[6] According to Mankiw:

> [The] effects of free trade can be determined by comparing the domestic price without trade to the world price. A low domestic price indicates that the country has a comparative advantage in producing the good and that the country will become an exporter. A high domestic price indicates that the rest of the world has a comparative advantage in producing the good and that the country will become an importer.[7]
>
> When a country allows trade and becomes an *exporter* of a good, domestic producers of the good

---

[2] Gregory Mankiw, *Principles of Economics* (New York: Dryden Press, 1998), 359.

[3] *Ibid.*, 55.

[4] *Ibid.*, 52.

[5] *Ibid.*, 53.

[6] *Ibid.*, 53.

[7] *Ibid.*, 192.

> are better off [because domestic prices rise to equal the world price], and domestic consumers of the good are worse off [because they must pay a higher price]. Trade raises the economic well being of the nation, for the gains of the winners exceed the losses of the losers.[8] [The sum of consumer and producer surplus is greater.]
>
> When a country allows trade and becomes an *importer* of a good, domestic consumers of the good are better off [because the price is lower], and domestic producers of the good are worse off [because they sell their goods at a lower price.] Trade raises the economic well-being of a nation, for the gains of the winners exceed the losses of the losers.[9]

Trade in the Real World

After the debt crises in the 1980s orthodox views of trade such as Mankiw's were used to justify "the argument that the rapid liberalisation of trade, finance and investment would allow developing countries to overcome resource and foreign-exchange constraints on accumulation and growth."[10] The claim was that "Trade liberalization would ensure the best allocation of resources according to comparative advantage, securing the export revenues needed to import key ingredients of faster growth. Financial liberalization would attract foreign capital seeking high returns in these capital-scarce countries, allowing developing countries to invest more than they save without running into a payments constraint." Further, "a more liberal trading environment would open markets in industrial countries to exports from developing countries."[11]

However, according to the analysis of the UNCTAD Trade and Development Report 1999, "after more than a decade of liberal reforms in developing countries, their payments disorders, which had earlier ushered in a rethinking of policies,

---

[8] *Ibid.*, 178.

[9] *Ibid.*, 180 (bracketed material added).

[10] United Nations Conference on Trade and Development (UNCTAD), *Trade and Development Report, 1999* (New York: UNCTAD, 1999), 73.

[11] *Ibid.*, v.

remain as acute as ever, and their economies depend even more on external financial resources for the achievement of growth rates sufficient to tackle the deep-rooted problems of poverty and under-development." Growth in developing countries in the 1990s has recovered from 1980s levels. But it is below the average growth rate of 5.7% in the 1970s by 2% per annum. Further, the average deficit of developing countries (excluding China) in the 1990s is higher by 3% of GDP than they were in the 1970s.[12] In other words, "In recent years, developing countries have had greater current-account deficits as a proportion of their GDP than in the past, but without achieving faster growth rates."[13]

These growing deficits have been due to the balance of trade. Export earnings have not kept pace with rapid import expansion.[14] In almost one half of the developing countries the trend is increasing trade deficits plus falling or stagnant growth rates. Where trade balances have improved, growth and imports have slowed. For most countries that achieved faster growth their trade balances deteriorated due to inflows of private capital. The problem was that these inflows couldn't always be sustained and there were currency crises, economic contractions, and massive import cuts. (China and Chile combined faster growth with improved trade performance.)[15]

Rapid trade liberalisation in developing countries has added to their trade deficits. Their imports increased sharply, but exports failed to keep pace. (The current account deficit in Latin America increased from $65 billion to $90 billion from 1997 to 1998. The trade deficit in Latin America in the 1990s averaged about 4%.[16]) In the first two years of trade liberalisation, imports grew faster than exports in all countries except Ghana, Morocco, and Tunisia where the real exchange rate depreciated. Trade liberalisation was associated with real appreciations, which added to import surges generated by tariff

[12] *Ibid.*, vi.
[13] *Ibid.*, 76.
[14] *Ibid.*, 76.
[15] *Ibid.*, vi.
[16] *Ibid.*, vii.

cuts particularly in Argentina, Kenya, Mexico, and Turkey.[17]

More statistics help round out the picture.

In the 1990s the average trade deficit of oil exporting developing countries was 3% higher than in the 1970s. The average growth rate fell by 2% per year.[18]

In the 1990s the trade deficit of non-oil producing developing countries is the same as the 1970 level. But the average growth rate is 2% lower than in the 1970s. [19]

Since the 1980s, policies and structural reforms to overcome the balance of payments constraint on growth have failed. [20]

In Latin America, the average growth rate was 3% lower in the 1990s than in the 1970s. Trade deficits remained the same.[21]

In 51 of 84 developing countries the trade balance worsened from the 1980s to the 1990s and in ½ of the countries GDP stagnated or declined.[22]

"Among the countries that have raised their growth rates in the 1990s, the majority have seen a deterioration in their trade balances, financed by large inflows of private capital; in some cases the deficits and capital inflows could not be sustained, eventually leading to payments crises, economic contraction, and sharp turnaround in trade balances." Only a few countries have combined faster growth with improved trade performance.[23]

External indebtedness of developing countries is increasing in relative and absolute terms. For example, in Latin America the ratio of debt to exports was 191% in 1997. The ratio in 1998 was 203% (and there was an increase in the ratio of interest payments to exports).

The evidence above does not support Mankiw's view that trade makes everyone better off. What, then, is the strategy for economic growth? How can people in developing countries

---

[17] *Ibid.*, 89-90.
[18] *Ibid.*, 79.
[19] *Ibid.*, 79.
[20] *Ibid.*, 79.
[21] *Ibid.*, 80.
[22] *Ibid.*, 81-84.
[23] *Ibid.*, 84-85.

improve their standard of living? The establishment view is that developing countries can export themselves out of poverty. Exports don't just earn foreign exchange for imports and investment. They also provide markets for goods that would not otherwise be produced or produced only to meet domestic consumer demand. Hence domestic savings can increase without a proportionate increase in domestic consumption.[24] However, the expansion of exports depends on foreign capital to finance it.

It is widely accepted that capital accumulation and economic growth in developing countries depend on foreign capital because:

1. If a developing country does not have enough savings, "external capital flows allow developing countries to invest more than they can save, thereby closing their savings gap."[25]
2. If a developing country does not have enough foreign exchange to import intermediate and capital goods, capital inflows provide foreign exchange so that investment is not constrained, thereby closing the foreign exchange gap. Even if domestic savings are sufficient to finance all investment needs, imported intermediate and capital goods have to be imported and paid for.[26]

The UNCTAD *Report on Trade and Development 1999* describes the link between exports and investment in the following way. "Since export expansion depends on investment, a sustainable growth process requires mutually reinforcing dynamic interactions between capital accumulation and exports, or an 'export-investment nexus.'"[27] The nexus is that, initially, the savings and foreign exchange gaps are large, but over time they narrow as exports and domestic savings grow faster than imports and investment. In this way, an economy can continue to grow rapidly despite a relative decline in real resource transfers from abroad. But if this nexus between exports and investment cannot be established, growth

[24] *Ibid.*, 75.
[25] *Ibid.*, 75.
[26] *Ibid.*, 75.
[27] *Ibid.*, 75.

will depend on external resources and will be restrained when such resources are in short supply.[28]

As I see it, the writing about the investment-export nexus is vague. The nature of this link is not explained with any degree of precision. Why it is that increasing imports and decreasing exports will help developing countries grow is not explained. I want to use Bernard Lonergan's writings on economics to introduce an explanatory context in which to analyse economic problems that is more adequate than the current vague views informed by superficial economic models and analyses. In particular, my aim is to provide a fuller context in which to help you appreciate the links between trade and monetary circulations in an economy in order to help understand the nature of the links between trade and investment.

2. Lonergan's Circulation Analysis

Bernard Lonergan's explanation of how an economy works is quite different from the views of establishment economists. Philip McShane has referred to it *not* as a paradigm shift, but as the invention of economic science. In order to have any appreciation of how international trade affects an economy you first have to understand Lonergan's explanation of how an economy with no foreign trade and no government sector works. The problem is that an effort to communicate that perspective would comprise many pages. Hence all I can do in this paper is simply to state the key elements in his perspective and hope that you take the additional time necessary to understand his ideas.[29]

What are the basic elements of an economy?

Establishment economists distinguish between capital goods and consumer goods. A capital good is a commodity that is used in the production of other goods and services. For example, a pencil bought for use in a drawing-office is a

[28] *Ibid.*, 76.

[29] I recommend Philip McShane's *Economics for Everyone* (Halifax: Axial Press, 1998). Of course, there are Lonergan's writings on the topic, Collected Works of Bernard Lonergan vols. 15 and 21.

capital good, but a pencil bought for a child is a consumer good. A consumer good is any good purchased by households for final consumption.

By contrast, Lonergan pushes this distinction. *He sharply distinguishes between surplus goods and services and basic goods and services*. For Lonergan, goods produced in order to produce other goods are surplus goods. Machine tools, transport trucks, cargo ships, tractors would be surplus goods. Goods that are not made in order to produce other goods to be sold are basic goods. For example, groceries, movie tickets, spy novels, clothes would be basic goods.

In fact, for Lonergan, the production and sale of surplus goods and services and the money that is used to make and buy them amounts to a distinct productive process with its own corresponding monetary circulation. Moreover, the production and sale of basic goods and services and the money that is used to make and buy them amounts to a distinct productive process with its own corresponding monetary circulation. In other words, there are two distinct types of exchanges: 1) surplus exchanges and 2) basic exchanges. Establishment economists do not make this sharp distinction.

The complicating aspect of the distinction is that the same goods and services can be classified as either surplus or basic. Their classification depends on how they are used. The purchase of a car solely for the work of a travelling salesperson would be a surplus expenditure, but the purchase of a car solely for going on picnics would be a basic expenditure. The purchase of a table saw by a carpenter would be a surplus expenditure, but if a do-it-yourselfer bought a table saw it would be a basic expenditure.

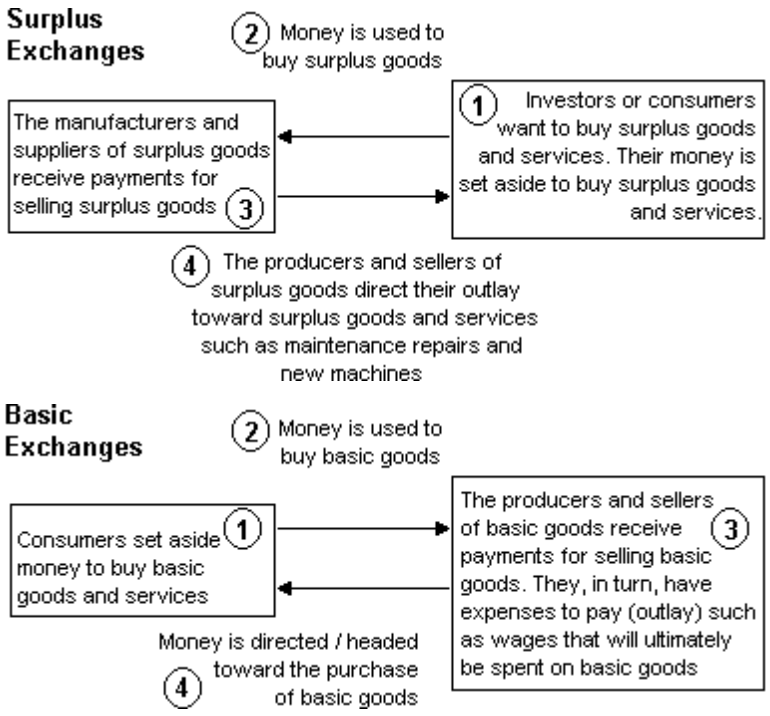
The third distinct type of exchange Lonergan identifies are redistributive exchanges. These exchanges, strictly speaking, do not involve the production and sale of goods and services. The exchange is merely a change, or transfer of, property rights in items such as shares, debt, buildings, second-hand goods, insurance pay-outs, government transfer payments. The point is that exchanges of this type are not part of the productive process per se.

When someone buys shares the ownership is transferred

from the seller to the buyer. This is simply a redistributive exchange because nothing new has been produced. A broker's fee for handling the transaction is, however, another story. The fee the broker collects for his work may be used to buy basic goods or it may be saved and later directed to, and spent as, an investment in surplus goods or services.

Let's recap. The basic elements of an economy are: 1) a surplus exchange comprising the production and sale of surplus goods and services and the corresponding monetary flow that makes this possible, 2) a basic exchange comprising the production and sale of basic goods and services and the corresponding monetary circulation that makes this possible, and 3) a redistributive exchange comprising changes solely in property rights and the corresponding monetary circulation that makes this possible.

These exchanges can be captured by diagrams. It is worthwhile studying these diagrams as they express the essence of Lonergan's view.

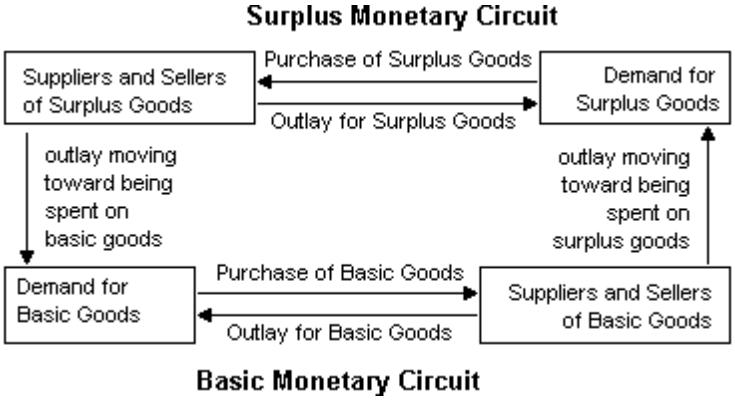


The Links Between the Surplus and Basic Monetary Circuits

I presented the surplus and basic exchanges *as if* they were independent of each other. But they are actually connected to each other. The suppliers and producers of basic goods may need to buy surplus goods such as new tools or machines for their businesses. A florist may need to buy a new truck – a surplus good – to deliver flowers. A grocer may need to buy a new fridge – a surplus good – to store ice cream. Hence some of their outlay will be directed to the surplus exchange to buy surplus goods and services. In this way, money leaves the basic monetary circuit and enters the surplus monetary circuit.

On the other hand, the producers and suppliers of surplus goods and services use part of their outlay to pay the wages of their employees. Because people must eat, pay mortgages or rent, buy clothes, buy movie tickets, and buy spy novels, a portion of the outlay by the suppliers of surplus goods and services will be directed to the basic monetary circuit to be used to purchase basic goods and services. In this fashion, money flows from the surplus monetary circuit to the basic monetary circuit.

Lonergan calls these two connections or links between the surplus and basic exchanges *cross-overs*. They are captured by the vertical lines in the diagram.



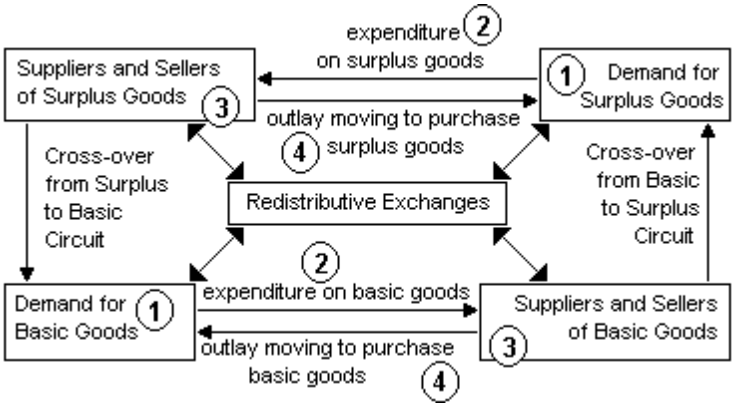
The Redistributive Exchange is Linked to the Surplus and Basic Circuits

I stated above that, strictly speaking, redistributive

exchanges were involved in transferring property rights (ownership, possession, etc.) concerning items like shares, debt, insurance pay-outs, loans, second-hand goods, and I stressed that this monetary circuit did *not* correspond to the production and sale of goods and services, either surplus or basic. Nonetheless, the redistributive exchange is connected to the surplus monetary circuit. Money from the redistributive exchange flows to the surplus circuit when the producers and suppliers of surplus goods borrow money from a bank to expand their business. Money flows in the opposite direction when they make a bank deposit.

The redistributive exchange and the basic circuit are also linked. Money flows from the redistributive exchange and joins the basic circuit when people use their credit cards to buy groceries, obtain a bank loan to buy a new car, and when producers and sellers of basic goods borrow money to finance a new delivery truck.[30] When consumers and sellers of basic goods and services make bank deposits, money flows from the basic circuit to the redistributive exchange.

This diagram captures the additional connections, expressing the basic elements of an economy.



[30] In this third instance, the money for the new truck subsequently flows to the capital circuit.

The Rules of Thumb, Norms, or Policies for Running a Closed Economy Properly

1 (a) The surplus circuit cannot be allowed to expand by draining money from the basic circuit. We do not want the production and sale of basic goods and services to collapse.

(b) The basic circuit cannot be allowed to expand by draining money from the surplus circuit. We do not want the production and sale of surplus goods to collapse.

(c) Hence the cross-overs must be balanced. The amount of money flowing from the basic circuit to the surplus circuit per interval must equal the amount of money flowing from the surplus circuit into the basic circuit.

(d) The cross-overs can be balanced by directing a portion of surplus or basic monetary flows to and from the redistributive exchange as required.

2 (a) The production and sale of surplus goods and services and the surplus monetary circuit must be kept in step with each other. If you increase the production and sale of surplus goods you must increase, interval by interval, the amount of money in the surplus monetary circuit. If you decrease the production and sale of surplus goods you must decrease proportionately the amount of money in the surplus circuit to keep step with production and sale.

(b) The same rule applies to the production and sale of basic goods and services and its corresponding monetary circulation.

(c) The consequence of not matching the money in the circuits to the needs of the productive process is price spirals – up or down.

(d) The job of redistributive exchanges is to supply, or remove, money from the two circuits.

3 Money (in the form of short-term capital flows, government transfer payments, ODA, donations) indiscriminately added to, or removed from, either the surplus or basic monetary circulations has the potential to adversely affect an economy.

Phases in the Economic Cycle

Establishment economists are concerned with keeping an economy in equilibrium, balancing the supply and demand of goods, services, money, etc. In an effort to combat inflation they advocate manipulating the money supply. Their aim is to keep the economy on an even keel. So, when the production and sale of goods and services grows rapidly, central bank economists increase the interest rate in order to combat inflation. This follows the standard paradigm, since establishment economists don't distinguish between the effects of interest rate changes on producers and on consumers. Moreover, the production and sale of goods and services is forced to adjust to the money supply. In other words, production is at the beck and call of the needs of money.

By contrast, in Lonergan's opinion, an economy is cyclical, not static. To be more specific, the relation between the turnover size and frequency of the production of surplus goods (and its monetary circuit) and the turnover size and frequency of the production of basic goods (and its monetary circuit) can vary. Further, the monetary circulation of an economy should be allowed to vary as production increases and decreases. To put it another way, the presumed needs of money should not be allowed to dictate levels of production. Rather, money should keep step with the needs of the productive process. The point is that variations in the production of surplus and basic goods must be recognised and dealt with intelligently. Variations should *not* be smoothed out.

What types of variations in production and sale are there in an economy? I'm sure you can imagine various combinations: a steady production of surplus and basic goods, an increasing production of surplus goods and a steady production of basic goods, a steady production of surplus goods and an increasing production of basic goods, an increasing production of surplus goods and a falling production of basic goods, a falling production of surplus goods and increasing production of basic goods, an increasing production of both surplus and basic goods, a falling production of both surplus and basic goods.

Lonergan argues that if an economy is to function properly

the varying relations between the production of surplus goods and the production of basic goods should take particular forms and occur in a particular order. By *phases* Lonergan means the particular relations between the surplus and basic circuits. The occurrence of these phases in their proper order comprise a *cycle*. The names of the phases are steady-state, surplus expansion, and basic expansion.

The Steady-State Phase

Imagine an economy in which the production and sale of surplus goods is constant. Surplus goods are repaired as needed and replaced when they wear out, but the production of surplus goods is not growing and it is not falling. Also, the production and sale of basic goods is constant. There is a steady sale of basic goods. In this state of affairs the cross-over flows from the basic circuit to the surplus circuit and from the surplus circuit to the basic would be balanced. The amount of money leaving the basic circuit for the surplus circuit each interval would be equal to the amount of money entering the basic monetary circulation from the surplus monetary circulation. Nothing dramatic is happening in this economy.

The Surplus Expansion Phase

Imagine that someone had a brilliant idea and invented computers. Of course, they want to go into the business of making and selling them to everyone. They would need to borrow money in order to start up the business – to buy land, build a factory, design an assembly line, purchase machines, pay workers, and so on. When their computers are sell rapidly they may want to expand their business. They would likely need to borrow money to expand. They might come up with further brilliant ideas. Even more money is required. Other people may want to get in on the act. They may start their own competing companies. Others may start a new business to supply the computer company with parts. Existing businesses may expand their factories to meet the new level of demand. An expansion in the production of surplus goods is underway.

Interval by interval, more and more money is needed to keep the expanding production of surplus goods going as more and more companies want to get in on the act. This money is

supplied to the surplus circuit through various financial instruments – loans, bonds, new share issues, etc.

The production and sale of surplus goods is booming. Lonergan stresses that this cannot happen at the expense of the proper functioning of the basic circuit. Money in the basic circuit should not be diverted to be used for the surplus expansion. The production and sale of basic goods should be maintained at a steady-state. (Money required for the surplus expansion should come from the redistributive exchange.)

Lonergan recognises that during a surplus expansion more money will be available for spending on basic goods and services as the production of surplus goods takes off. But he argues that when the surplus expansion is underway purchasing increasing amounts of basic goods would prematurely curtail the surplus expansion. There would be less money available to finance the surplus expansion because money would be spent on basic goods. If people used their wages to buy basic goods during a surplus expansion the prices of basic goods would rise, and more and more money would be diverted from the surplus expansion to the basic circuit. The consequences would be inflation and the surplus expansion coming to a premature end, i.e., ending before it reached its peak of production.

To re-cap, in the surplus expansion phase the production and sale of surplus goods increases dramatically (and the circulation of money in the surplus circuit keeps pace with the production of surplus goods). The production and sale of basic goods remains steady. The cross-overs are kept in balance by workers saving their money; they do not increase their spending on basic goods. They direct their savings to the redistributive exchange and ultimately to the surplus circuit.

The Basic Expansion Phase

After a time sufficient factories have been built to meet the market projections of surplus goods and of future sales of basic goods. The production of surplus goods has slowed down from a frantic pace to a new higher rate sufficient to cover repairs and replacements. For the moment basic production is still at a constant rate. The economy is now poised to shift from a surplus expansion to a basic expansion.

Lonergan refers to this as a shift from an anti-egalitarian phase to an egalitarian phase, from a phase in which the income of high income earners grows (and they invest their increased incomes in the surplus expansion) to a phase in which the incomes of lower income groups grows so that they can purchase the new basic products being produced as a result of the production and sale of more surplus goods and services. One might think of the production of surplus goods such as tractors leading to an increase in basic goods such as the production of more potatoes.[31]

The basic expansion proceeds until it reaches its maxima and levels out to a new higher steady production of basic goods and services. Then, perhaps, someone with another good idea comes along and a surplus expansion begins.

Lonergan emphasises that the transitions from one phase should be done intelligently. Even though an expansion may at some time proceed at a frantic pace, it must be intelligently managed so that it slows and reaches a steady-state before the next phase gets underway. Otherwise, a cycle of boom and bust will result.

3. Foreign Trade

Establishment economists distinguish between a favourable balance of trade and an unfavourable balance of trade in goods and services. When a country has a favourable balance of trade the value of its exports is greater than the value of its imports. If a country has an unfavourable balance of trade its imports are greater than its exports. They fail to separate surplus and basic goods and services in their analyses.

Because there are two distinct productive processes each with its own corresponding monetary circulation, Lonergan distinguishes between:

1. a favourable balance of trade in surplus goods,
2. a favourable balance of trade in basic goods,
3. an unfavourable balance of trade in surplus goods, and
4. an unfavourable balance of trade in basic goods.

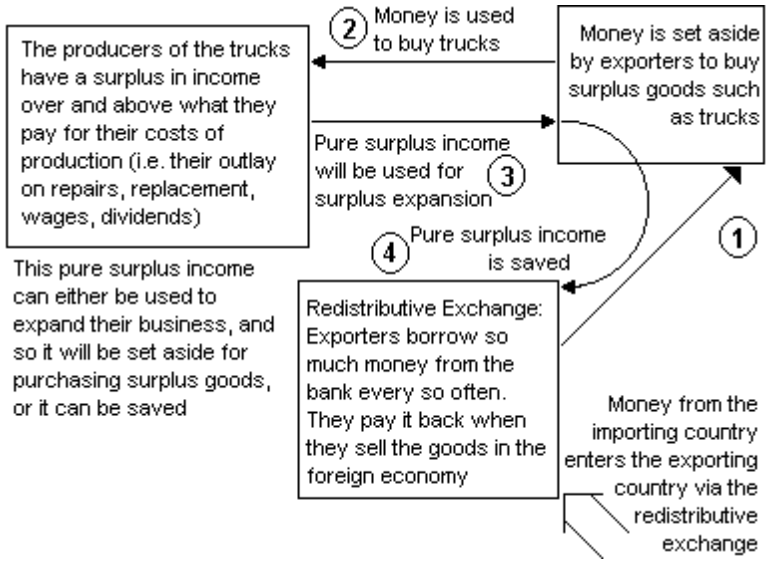
---

[31] See Philip McShane, *Economics for Everyone*, for an excellent discussion of the surplus and basic phases.

In discussing trade, one must bear in mind that goods or services *leaving* one economy for another have passed beyond the productive process of the exporting country. For Lonergan, they have become redistributive goods and services sold on the redistributive markets of the importing country. Goods or services *entering* an economy enter as redistributive goods or services, even if they enter the productive process for further fashioning or for sale in a regular commercial channel.[32]

A Favourable Balance of Trade in Surplus Goods

Take the export of surplus goods such as table saws, plows, transport trucks. When a country has a favourable balance of trade in surplus goods and services money is added to the exporting economy's surplus circuit interval by interval. Let's examine how this occurs. The diagram captures the flow of money in an economy exporting goods and services.



What are the consequences of adding money to the surplus circuit in this way? The additional pure surplus income (i.e. income over and above all outlay such as wages, rent,

[32] Bernard Lonergan, *For a New Political Economy*, Collected Works of Bernard Lonergan 21 (Toronto: University of Toronto Press, 1999), 197.

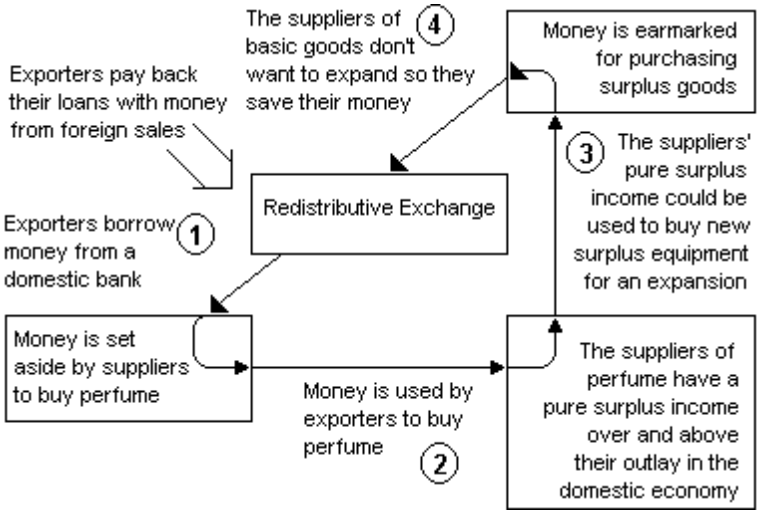
dividends, maintenance, repairs, replacements of machines) can be used to help solve the problem of finding ever-increasing amounts of money to invest during a surplus expansion. The pure surplus income can be invested in businesses devoted to the production of surplus goods and services.

The problem is that a surplus expansion could be prolonged by exporting the increment in surplus goods and services. In this scenario the basic expansion of the domestic economy would be inhibited or dodged. By selling abroad the surplus goods and services not needed by the domestic economy, it becomes unnecessary to lower higher incomes and raises lower incomes in order to enable lower income groups to purchase the increasing number of basic goods coming on the market during a basic expansion. In the exporting economy an increase in the production of basic goods would not occur because the surplus goods that ultimately lead to a basic expansion have been exported. To state it another way, the pure surplus income continues to flow to the owners of businesses. That pure surplus income, in turn, is saved by higher income groups, directed to the redistributive exchange, and ultimately invested (or spent) on surplus goods and services (invested) that are exported.

A Favourable Balance of Trade in Basic Goods and Services

Let's trace how the money circulates in an economy with a favourable balance of trade in basic goods.

Consider the export of bananas, coffee, perfume, spy novels, ski boots, yachts, etc., from the perspective of an exporting economy. The consequence of a favourable balance of trade in basic goods and services is that any income over and above what is needed for domestic outlay (wages, sinking funds, insurance, taxes) can be saved and ultimately used to expand businesses by purchasing surplus goods. Hence this additional flow of money is beneficial to a surplus expansion. However, the basic expansion may be inhibited or dodged by not lowering higher incomes and raising lower incomes when the production of surplus goods reaches its maximum. Like higher income truck manufacturers and suppliers during a



surplus expansion, higher income banana exporters can maintain their high salaries, savings, investments because pure surplus income is continuing to flow to them from the foreign economy.

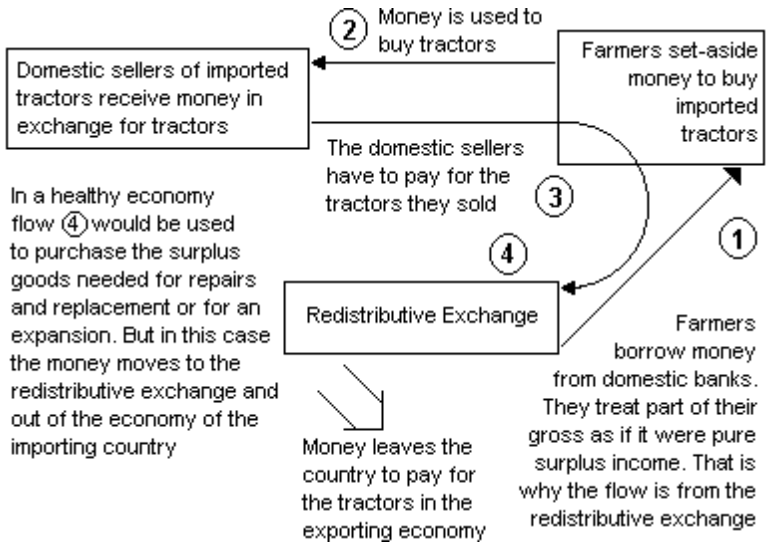
An Unfavourable Balance of Trade in Surplus Goods and Services

Now consider an unfavourable balance of trade in surplus goods and services from the point of view of an economy receiving the imports. Let's follow the monetary circulation of an economy which is maintaining a steady import of tractors, machine tools, assembly lines, printing presses, tractors, etc., interval after interval.

The problem with an unfavourable balance of trade in surplus goods and services lies in precisely locating where the money for buying the imported goods such as tractors comes from. If the importing economy uses the money received from domestic sales of surplus or basic goods, the monetary circulation corresponding to the production and sale of surplus and basic goods will be squeezed and their production and sales adversely affected. On the other hand, in order not to squeeze the domestic economy money must be borrowed from abroad at a steady rate. Here the problem is a growing foreign debt

that requires ever growing interest payments.

But the situation becomes even more precarious when you consider how the borrowed money could be spent. The money borrowed from foreign sources could be used to import surplus goods to be used for repairing worn out surplus goods and replacing surplus goods that are worn out. In this scenario, there is no surplus expansion and hence the phase required if a basic expansion is to get underway will not occur.



If the borrowed money is used to encourage a surplus expansion, the amount borrowed must increase at an ever-increasing rate, thereby creating a substantial foreign debt and proportionate interest payments.

In either scenario the economy is weak. An 'importing' domestic economy borrowing to buy replacements of surplus goods cannot maintain itself. An economy borrowing to fund a surplus expansion cannot accelerate itself. Investing in the 'importing' domestic economy would be unattractive, since any hope of returns on investments would depend on ever-increasing capital inflows, i.e., more foreign debt.

An Unfavourable Balance of Trade in Basic Goods and Services

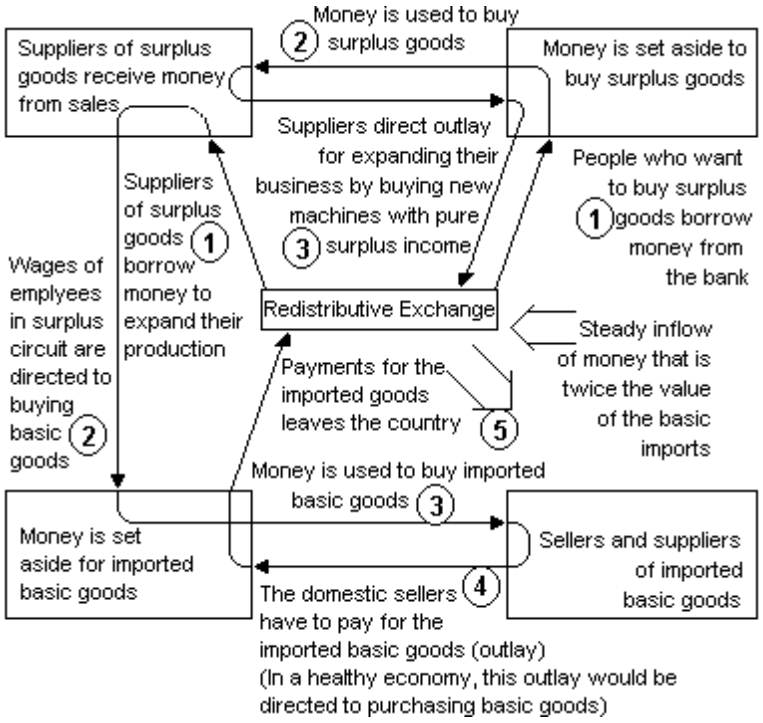
If an economy has an excess import of basic goods such as bananas, perfume, roses, and spy novels the problem is to precisely locate where the money to purchase these goods comes from. If money from the surplus circuit is diverted and used to purchase these goods then the production and sale of surplus goods is squeezed. Of course, if the economy is in the surplus expansion phase, pure surplus income could be used to buy these imported basic goods. But the problem is that the surplus expansion would be prematurely curtailed by not allowing it to reach its maximum.

If money in the basic monetary circuit is used to buy the imported basic goods, then the production and sale of domestic basic goods would be squeezed interval by interval. There are more basic goods and services than monetary income to pay for them at current prices. The consequence is a depression – prices fall, sales drop, production is curtailed, unemployment rises. Ultimately, people cannot afford to buy the imported or domestic basic goods. The economy crashes.

In order for a domestic economy not to contract in the face of importing more basic goods than it exports, Lonergan explores the consequences of a domestic economy borrowing money from abroad. Remember that the problem is to figure out how the excess basic imports can be paid for without upsetting the surplus and basic circuits. One possibility, letting basic credit grow rapidly, would only lead to a growing debt that would eventually have to be re-paid and hence the economy would be faced with the same problem – debt – except it would be larger this time around. To put it bluntly, borrowing money abroad and directing it to the basic circuit does not seem to be the answer.

An alternative is to borrow money from abroad and direct it to the production and sale of surplus goods and services. The idea is to jump-start a surplus expansion that would enable workers to spend a larger portion of their now larger wages on the imported basic goods. However, the problem is that in order to maintain a surplus expansion the amount of money needed per interval to purchase imported basic goods must be

borrowed and directed to the producers and suppliers of surplus goods who will expand their production. An additional equal amount of money must be borrowed and made available to people in the form of loans so they can purchase the newly produced surplus goods. Thus, *twice* the value of purchased imported basic goods must be borrowed and directed to the surplus circuit each interval in order to finance a surplus expansion and to finance the purchase of the imported basic goods.



When the surplus expansion reaches its maximum and a basic expansion follows we are back where we started – with an increasing production of basic goods relative to basic monetary income – the very problem we started with. The solution would be to export more basic goods than were imported. That would end the unfavourable balance of trade in basic goods and services. *But that is exactly the problem we started with.*

Lonergan's summary of the situation is that "…there is insufficient income derived from domestic production to purchase both domestic products and the excess import."[33]

General Conclusions

In the light of Lonergan's perspective on trade, what conclusions can we draw?

1. Without distinguishing between trade in surplus goods and trade in basic goods we really do not know what is actually going on in an economy.

2. Trade liberalisation will not necessarily make everyone better off. The exports of one country can upset the circuits of another country. Also, an economy with an unfavourable balance of trade in surplus or basic goods is an economy in trouble. Even an economy exporting surplus goods or basic goods may not be better off because the basic expansion could be dodged by prematurely curtailing a surplus expansion.

3. The investment-export nexus is far more complex than indicated by the UNCTAD Report. Not only is it crucial to distinguish favourable and unfavourable trade balances in surplus and basic goods but, it is also essential to distinguish different phases when discussing foreign trade and investments.

4. Increasing investments themselves (i.e., long-term capital flows and ODA from abroad and capital derived from exports) will not solve the problem of how to increase the standard of living in developing countries. Rather, the phases of an economic cycle must be managed intelligently. And this requires understanding economies in terms of three exchanges and their corresponding monetary circulations and respecting their needs.

Bruce Anderson is the author of *'Discovery' in Legal Decision Making*, and, with Philip McShane, *Beyond Establishment Economics.* He can be reached at axial@bellatlantic.net.

Comments on this article can be sent to jmda@mun.ca.

[33] *For a New Political Economy*, 199.