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THE INTERNATIONAL POLITICAL ECONOMY AND THE DEVELOPING COUNTRIES

VOLUME II

Stephan Haggard

The International Political Economy and the Developing Countries Volume II

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THE CANADIAN JOURNAL OF
Economics and Political Science

Volume XXIX MAY, 1963 Number 2

A STAPLE THEORY OF ECONOMIC GROWTH*

MELVILLE H. WATKINS
University of Toronto

THE staple approach to the study of economic history is primarily a Canadian innovation; indeed, it is Canada's most distinctive contribution to political economy. It is undeveloped in any explicit form in most countries where the export sector of the economy is or was dominant.[1] The specific terminology—staple or staples approach, or theory, or thesis—is Canadian, and the persistence with which the theory has been applied by Canadian social scientists and historians is unique.

The leading innovator was the late Harold Innis in his brilliant pioneering historical studies, notably of the cod fisheries and the fur trade;[2] others tilled the same vineyard[3] but it is his work that has stamped the "school." His concern was with the general impact on the economy and society of staple production. His method was to cast the net widely. The staple approach became a unifying theme of diffuse application rather than an analytic tool fashioned for specific uses. There was little attempt to limit its application by the use of an explicit framework.[4] Methodologically, Innis' staple approach was more technological history writ large than a theory of economic growth in the conventional sense.[5]

*Financial assistance for the summer of 1961 is gratefully acknowledged from the Ford Foundation. For helpful comments on earlier drafts of this paper, I am indebted to J. H. Dales, W. T. Easterbrook, J. I. McDonald, A. Rotstein, and S. G. Triantis of the University of Toronto and C. P. Kindleberger of the Massachusetts Institute of Technology.

[1]The American economic historian, Guy S. Callender, however, devoted considerable attention to the importance of international and interregional trade in staples in the United States, an aspect of American growth which has been much neglected but has recently been revived by Douglass C. North. See Callender, *Selections from the Economic History of the United States, 1765–1860* (Boston, 1909), and North, *The Economic Growth of the United States, 1790–1860* (Englewood Cliffs, NJ, 1961).

[2]See his *The Fur Trade in Canada: An Introduction to Canadian Economic History* (Toronto, 1930; 2nd ed., 1956); *The Cod Fisheries: The History of an International Economy* (Toronto, 1940; 2nd ed., 1954). For a collection of his writings in the Canadian field, see *Essays in Canadian Economic History* (Toronto, 1957). For a complete bibliography of his writings, see Jane Ward, this JOURNAL, XIX, May, 1953, 236–44.

[3]W. A. Mackintosh is sometimes given credit as a co-founder of the staple theory; see his "Economic Factors in Canadian History," *Canadian Historical Review*, IV, March, 1923, 12–25, and "Some Aspects of a Pioneer Economy," this JOURNAL, II, Nov., 1936, 457–63.

[4]This point has often been noted; see, for example, Richard E. Caves and Richard H. Holton, *The Canadian Economy: Prospect and Retrospect* (Cambridge, Mass., 1959), 30; and W. T. Easterbrook, "Problems in the Relationship of Communication and Economic History," *Journal of Economic History*, XX, Dec., 1960, 563.

[5]Kenneth Buckley makes this point strongly; see his "The Role of Staple Industries in Canada's Economic Development," *Journal of Economic History*, XVIII, Dec., 1958, 442.

Once solidly entrenched in Canadian studies, the staple approach has now fallen on more uncertain days as its relevance has come to be questioned by Canadian economic historians.[6] The strongest attack has come from Kenneth Buckley who maintains that it is "practical and efficacious" as a theory of economic growth to 1820, but that thereafter "other sources of national economic growth and change" are impossible to ignore; he concludes that Canadian economic historians should "replace the notion of an opportunity structure determined by geography and natural resources with a general concept of economic opportunity without specifying determinants."[7] Vernon C. Fowke's emphasis on agriculture serving the domestic market as an impetus to investment and hence to economic growth in central Canada prior to Confederation involves a devaluation of the role of staple exports.[8] W. T. Easterbrook has argued, after extensive review of the literature, that the staple theory no longer constitutes—and apparently ought not to—an adequate unifying theme for the study of Canadian development.[9] On the other hand, Hugh G. J. Aitken has remained satisfied with the approach. His own recent writings have been focused on the new resource industries of the twentieth century;[10] in commenting on Buckley's paper he suggested that the staple approach was relevant at least to 1914,[11] and he has subsequently maintained that "it is still true that the pace of development in Canada is determined fundamentally by the exports that enable Canada to pay its way in the world."[12]

The sample is small, but so too is the number of practising Canadian economic historians. There would appear to be declining confidence in the relevance of the staple approach, especially if consideration is given to what has been said as well as what has been written. But, curiously, the decline has been paralleled by rising interest among non-Canadians who may or may not refer to Innis and Canada. The leading advocate of the staple approach today is Douglass C. North, whose work may well have set the stage for a reconsideration of the causes of American economic growth from the American Revolution to the Civil War.[13] Two American economists, Richard E. Caves

6For its use in communications study—where, following the later Innis, the media become the resource or staple—see Marshall McLuhan, "Effects of the Improvements of Communication Media," *Journal of Economic History*, XX, Dec., 1960, 566–75; and *The Gutenberg Galaxy* (Toronto, 1962), particularly 164–6.

7"The Role of Staple Industries," 444, 445.

8Fowke, *The National Policy and the Wheat Economy* (Toronto, 1957), chap. 2.

9Easterbrook, "Trends in Canadian Economic Thought," *South Atlantic Quarterly*, LVIII, Winter, 1959, 91–107; and "Recent Contributions to Economic History: Canada," *Journal of Economic History*, XIX, March, 1959, 76–102.

10Aitken, "The Changing Structure of the Canadian Economy" in Aitken *et al.*, *The American Economic Impact on Canada* (Durham, N.C., 1959), and *American Capital and Canadian Resources* (Cambridge, Mass., 1961).

11"Discussion," *Journal of Economic History*, XVIII, Dec., 1958, 451.

12*American Capital and Canadian Resources*, 74.

13North, "Location Theory and Regional Economic Growth," *Journal of Political Economy*, LXII, June, 1955, 243–58; "International Capital Flows and the Development of the American West," *Journal of Economic History*, XVI, Dec., 1956, 493–505; "A Note on Professor Rostow's 'Take-off' into Self-sustained Growth," *Manchester School of Economic and Social Studies*, XXVI, Jan., 1958, 68–75; "Agriculture and Regional Economic Growth," *Journal of Farm Economics*, XLI, Dec., 1959, 943–51; *The Economic Growth of the United States, 1790–1860.*

and Richard H. Holton, have critically re-examined the staple approach from the viewpoint of modern economic theory as a prelude to forecasting the state of the Canadian economy in 1970, and have given it a surprisingly clean bill of health.[14] R. E. Baldwin has provided a brilliant theoretical article on the impact of staple production on an economy, and both North and Caves and Holton have acknowledged their indebtedness to him.[15] Mention must also be made of the analytical approach used by Jonathan V. Levin in his study of the role of primary product exports in Peru and Burma,[16] of the implications for the staple approach of the application of modern income and growth theory to the classic problem of the transfer mechanism for capital imports in the Canadian balance of payments, particularly in the great boom before the First World War,[17] and of the distinction made by Harvey S. Perloff and Lowdon Wingo, Jr., between "good" and "bad" resource exports in the context of American regional growth.[18]

The simultaneous waning of the reputation of the staple approach among Canadians and its rise elsewhere has created a gap in the literature which this paper will attempt to bridge. It will argue that the staple theory can fruitfully be limited to a distinct type of economic growth; restate a staple theory so constrained in more rigorous form, primarily by drawing on the literature cited in the paragraph above; contrast this staple theory with other models of economic development; and finally, consider again the relevance of a staple approach to the Canadian case.

I

The linking of economic history and the theory of economic growth is a prerequisite to further advance in both fields. One obvious link lies in the development of theories appropriate to particular types of economic growth. The staple theory is presented here not as a general theory of economic growth, nor even a general theory about the growth of export-oriented economies, but rather as applicable to the atypical case of the new country.

The phenomenon of the new country, of the "empty" land or region overrun by the white man in the past four centuries, is, of course, well known. The leading examples are the United States and the British dominions. These countries had two distinctive characteristics as they began their economic growth: a favourable man/land ratio and an absence of inhibiting traditions.[19]

[14] Caves and Holton, *The Canadian Economy*, Part I.

[15] Baldwin, "Patterns of Development in Newly Settled Regions," *Manchester School of Economic and Social Studies*, XXIV, May, 1956, 161–79.

[16] Levin, *The Export Economies: Their Pattern of Development in Historical Perspective* (Cambridge, Mass., 1960).

[17] G. M. Meier, "Economic Development and the Transfer Mechanism: Canada, 1895–1913," this JOURNAL, XIX, Feb., 1953, 1–19; J. C. Ingram, "Growth and Canada's Balance of Payments," *American Economic Review*, XLVII, March, 1957, 93–104; John A. Stovel, *Canada in the World Economy* (Cambridge, Mass., 1959).

[18] Perloff and Wingo, "Natural Resource Endowment and Regional Economic Growth" in Joseph J. Spengler, ed., *Natural Resources and Economic Growth* (Washington, 1961), 191–212; this article draws on Harvey S. Perloff, Edgar S. Dunn Jr., Eric E. Lampard, and Richard F. Muth, *Regions, Resources and Economic Growth* (Baltimore, 1960).

[19] Both features are recognized by W. W. Rostow in *The United States in the World Arena* (New York, 1960), 6; the first is also cited by Bert F. Hoselitz, "Patterns of Economic Growth," this JOURNAL, XXI, Nov., 1955, 416–31.

From these initial features flow some highly probable consequences for the growth process, at least in the early phase: staple exports are the leading sector, setting the pace for economic growth and leaving their peculiar imprint on economy and society; the importation of scarce factors of production is essential; and growth, if it is to be sustained, requires an ability to shift resources that may be hindered by excessive reliance on exports in general, and, in particular, on a small number of staple exports. These conditions and consequences are not customarily identified with underdeveloped countries, and hence are not the typical building blocks of a theory of economic growth. Rather, the theory derived from them is limited, but consciously so in order to cast light on a special type of economic growth. Because of the key role of staple exports it can be called a staple theory of economic growth.

II

The fundamental assumption of the staple theory is that staple exports are the leading sector of the economy and set the pace for economic growth. The limited—at first possibly non-existent—domestic market, and the factor proportions—an abundance of land relative to labour and capital—create a comparative advantage in resource-intensive exports, or staples. Economic development will be a process of diversification around an export base. The central concept of a staple theory, therefore, is the spread effects of the export sector, that is, the impact of export activity on domestic economy and society. To construct a staple theory, then, it is necessary to classify these spread effects and indicate their determinants.

Let us begin with the determinants. Assume to be given the resource base of the new country and the rest-of-the-world environment—the international demand for and supply of goods and factors, the international transportation and communication networks, the international power structure. The sole remaining determinant can then be isolated, namely, the character of the particular staple or staples being exported.

A focus on the character of the staple distinguished Innis' work. C. R. Fay expressed the point most succinctly: ". . . the emphasis is on the commodity itself: its significance for policy; the tying in of one activity with another; the way in which a basic commodity sets the general pace, creates new activities and is itself strengthened or perhaps dethroned, by its own creation."[20] The essence of the technique has been thrown into sharp relief by Baldwin. Using the method of ideal types, he contrasts the implications of reliance on a plantation crop and a family farm crop respectively for the economic development of an area exporting primary products. The important determinant is the technology of the industry, that is, the production function, which defines the degree of factor substitutability and the nature of returns to scale. With the production function specified and the necessary *ceteris paribus* assumptions—including the demand for goods and the supply of factors—a number of things

[20]Fay, "The Toronto School of Economic History," *Economic History*, III, Jan., 1934, 168–71. See also Easterbrook, "Problems in the Relationship of Communication and Economic History," 563.

follow: demand for factors; demand for intermediate inputs; possibility of further processing; and the distribution of income.

These determine the range of investment opportunities in domestic markets, or the extent of diversification around the export base. If the demand for the export staple increases, the quantity supplied by the new country will increase. This export expansion means a rise in income in the export sector. The spending of this income generates investment opportunities in other sectors, both at home and abroad. By classifying these income flows, we can state the staple theory in the form of a disaggregated multiplier-accelerator mechanism. In Hirschman's terms, the inducement to domestic investment resulting from the increased activity of the export sector can be broken down into three linkage effects: backward linkage, forward linkage, and what we shall call final demand linkage.[21] The staple theory then becomes a theory of capital formation; the suggestion has been made but not yet elaborated that it is such.

Backward linkage is a measure of the inducement to invest in the home-production of inputs, including capital goods, for the expanding export sector. The export good's production function and the relative prices of inputs will determine the types and quantities of inputs required. Diversification will be the greatest where the input requirements involve resources and technologies which permit of home-production. The emphasis usually placed in studies of economic development on barriers to entry into machinery production suggests a high import content for capital-intensive staples, and hence a small backward linkage effect. Caves and Holton, however, emphasize the importance of capital-intensive agriculture in supplying linkage to domestic agricultural machinery production. Theory and history suggest that the most important example of backward linkage is the building of transport systems for collection of the staple, for that can have further and powerful spread effects.

Forward linkage is a measure of the inducement to invest in industries using the output of the export industry as an input. The most obvious, and typically most important, example is the increasing value added in the export sector; the economic possibilities of further processing and the nature of foreign tariffs will be the prime determinants.

Final demand linkage is a measure of the inducement to invest in domestic industries producing consumer goods for factors in the export sector. Its prime determinant is the size of the domestic market, which is in turn dependent on the level of income—aggregate and average—and its distribution.

The size of the aggregate income will vary directly with the absolute size of the export sector. But a portion of the income may be received by what Levin has called "foreign factors"—factors which remit their income abroad—rather than "domestic factors." To the extent that income received by foreign factors is not taxed away domestically, final demand linkage will be lessened. The servicing of capital imports is a case in point. Primary producers are notoriously susceptible to indebtedness, and the burden will be greater the more capital-intensive the staple. Leakage can also result from wages paid to migratory labour and from immigrants' remittances.

[21] Albert O. Hirschman, *The Strategy of Economic Development* (New Haven, 1958), chap. 6.

The average level of income, that is, the *per capita* income of the domestic factors, depends on the productivity of "land" or the resource content of the staple export, for other factors are importable. The distribution of income, on present assumptions, is determined by the nature of the production function of the staple, in Baldwin's models being relatively unequal for the plantation crop and relatively equal for the family farm crop.

The impact of these two market dimensions on final demand linkage can be seen by classifying consumer spending in two ways. Firstly, consumer spending may be either on home-produced goods or on imports, and the higher the marginal propensity to import the lower the final demand linkage. Secondly, it may be either on subsistence goods and luxuries, or on a broad range of goods and services; the latter are more likely to lend themselves to those economies of mass production which lie at the heart of on-going industrialization, while luxury spending—other than for labour-intensive services—is likely, given the tendency to ape the tastes of more advanced countries, to be directed towards imported goods, that is, to create in Levin's terminology "luxury importers."

Final demand linkage will tend to be higher, the higher the average level of income and the more equal its distribution. At a higher level of income, consumers are likely to be able to buy a range of goods and services which lend themselves to domestic production by advanced industrial techniques. Where the distribution is relatively unequal, the demand will be for subsistence goods at the lower end of the income scales and for luxuries at the upper end. The more equal the distribution the less the likelihood of opulent luxury importers and the greater the likelihood of a broadly based market for mass-produced goods.

The discussion of the linkages so far has assumed that investment is induced solely by demand factors. But on the supply side the expansion of the export sector creates opportunities for domestic investment which may or may not be exploited. Consideration must be given to the relationship between staple production and the supply of entrepreneurship and complementary inputs, including technology.

The key factor is entrepreneurship, the ability to perceive and exploit market opportunities. Entrepreneurial functions can be fulfilled by foreigners, and to the extent that this makes available technical and marketing skills the result can be advantageous to the new country. But the literature on economic development, and particularly on the dual economy, raises many doubts as to the adequacy of foreign entrepreneurship. It may flow freely into the export and import trades, but fail to exploit domestic opportunities. Exports may be regarded as safer, in part because they earn directly the foreign exchange necessary to reimburse foreign factors, but largely because export markets are better organized and better known than domestic markets. Foreign domination of entrepreneurship may militate against its general diffusion.

An adequate supply of domestic entrepreneurship, both private and governmental, is crucial. Its existence depends on the institutions and values of society, about which the economist generalizes at his peril. But the character of the staple is clearly relevant. Consider, for example, Baldwin's polar cases.