Monopolies and Underdevelopment – some clarifications

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This note tries to establish a dialogue with Professor Abel Mateus review of my book (Monopolies and Underdevelopment, Edward Elgar, 2015). It is a pleasure to engage in this debate and try to respond to some of his comments and criticism.

First of all, I must say that I believe must of his criticism originates from the same source - Professor Mateus's concept of monopoly strictly based on the traditional neoclassical concept. While I acknowledge the importance of such concept for neoclassical microeconomic analysis, I consider that it is not able to fully grasp the main features of colonial monopolies and even of most present monopolies. For the reasons stated in the book under Professor Mateus' review, neoclassical concepts (ranging from market definition to the concept of monopolies) have to be refined to properly cope with monopolies actual meaning and economic effects. This initial element sets the tone for this response, that intends to go beyond theoretical (and, by definition, unrealistic) models to look at real-world evidence of the long-standing effects of colonial monopolies. I will address his critics to my book one by one.

Professor Mateus argues that it would be wrong to claim that the origins of underdevelopment are related to private monopolies in Asian economies (East Indian Company and Dutch East India Company) in the XVI to the XVIII centuries. In his view, there was rivalry among European colonies (and their respective private monopolistic companies) in the global trade and regional trade routes resulting in conflicts and war among them.

I acknowledge in my book the existence of some level of rivalry and conflict among colonies to monopolize a given area. The seas of south-east Asia were subject to intense competition among the Dutch, Spain, Portugal and especially England. This rivalry required the rejection of a purely commercial approach – like initially envisaged by the Dutch - and the development of a policy of higher insertion into the economy and the political power in the region to guarantee the monopoly. Furthermore, the resource to armed conflict was also required, resulting in the so-called *trade and war policy*.[1] Notwithstanding this level of warfare *competition for* the areas, the result was always the monopoly over a certain region, allowing an extensive control of demand and supply in such geographic dimension. Putting differently, there was *competition for the market* (for the monopoly over a specific area)[2], but different from Schumpeter's creative destruction view, such competition was purely based on destruction of productive arrangements and simple replacement by another without any actual development of the area[3].

This meant that the large colonial trade company had absolute control over exports and imports in the area monopolized[4,5]. This allowed the monopolist to be able to extract the largest possible value from its counterparties, either local manufacturers (selling products for export) or the final consumer (acquiring products imported from the metropolis)[6]. They had, as a rule, exclusive rights that guaranteed a monopoly on

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[1] See G. Maselman, 'Dutch colonial policy in the seventeenth century', in *The Journal of Economic History*, Vol. 21, No. 4, 1961, p.460.

[2] In Asia, monopoly was eminently private, exercised by the large colonial *trade companies* from England and the Netherlands. Their 'shares' belonged to private parties, their administration was done by elected managers (mainly aristocrats and bourgeois) but they depended on a royal grant (or concession) to exist. Their links to the interests of their states were, therefore, immense.

[3] The rise of the British East Indian Company and fall of the Dutch is described in Julia Adams, *Principals and Agents, Colonialists and Company Men: The Decay of Colonial Control in the Dutch East Indies*, in American Sociological Review, Vol. 61, No. 1 (Feb., 1996), pp. 12-28. An attempt to analyze whether these fluctuations reflected on stock prices of the colonial merchant organization can be seen in Larry Neal, *The Dutch and English East India companies compared: evidence from the stock and foreign exchange markets,* in James D. Tracy (ed.), *The Rise of Merchant Empires*, Cambridge University Press, 1990, p. 209.

[4] *"The leading motive for the discovery of America and the Good-Hope route to the East Indies, which marked the dawn of modern times, was the hope of material gain from the spice trade. It is inconceivable that any country would have willingly shared access to such fabulous riches as the spices of the Eastern seas or the gold and silver of Mexico and Peru. Following the example of the Iberian kings every other European monarch refused to permit any other power to trade with his colonies before the end of the eighteenth century. Furthermore, staple ports, convoyed fleets, prescribed routes, and special privileges-designed to extend and protect commerce and empire-closed most of the colonies to most of the subjects of most of the colonial powers most of the time."* (Earl. J. Hamilton, *The Role of Monopoly in the Overseas Expansion and Colonial Trade of Europe Before 1800,* in *The American Economic Review,* Vol. 38, No. 2, 1948, p. 51).

[5] An interesting description of the Dutch's monopolist ambition is reported by Julia Adams: "One striking aspect of the Dutch East Indies system was the VOC's ambitious defense of a triple monopoly. That the Company laid claim to a world monopoly on certain spices is well known, as are its state-sanctioned claims to all Dutch trade east of the Cape of Good Hope. But the VOC also asserted dominion over what was dubbed the "country trade," intra-Asian commerce in key commodities, and tried to impose this on its own servants as well as on indigenous and European merchants" (*Principals and Agents, Colonialists and Company Men: The Decay of Colonial Control in the Dutch East Indies*, op. cit., p. 18).

[6] *"The monopolistic trading companies depressed the prices of exports and raised those of imports in Europe and the Eastern colonies. In the short run producers suffered, and consumers were permanently oppressed. The high prices paid for imports in colonial and metropolitan markets went to monopolistic middlemen instead of to producers in the exporting countries, who, under perfect competition, could have been expected to increase their output. Factors of production were diverted from their most fruitful use and were underemployed during the transition."* (Earl. J. Hamilton, *The Role of Monopoly in the Overseas Expansion and Colonial Trade of Europe Before 1800,* in *The American Economic Review,* Vol. 38, No. 2, 1948, p. 52).

acquisition of colonial products (therefore, a monopsony). Furthermore, commercial concern with extraction coincided with the need to create a consumer market for goods offered by the monopolistic trading companies. Thus, these companies intend not only to build a monopsony (monopolistic access to valuable spices and agricultural products produced by the colony), but also privileged access to the consumer market (a sales monopoly over products the metropole produced and wanted to export)[7].

This observation is directly linked to Professor Mateus' view that, regardless the colonization, Asia would not have reached alone a pattern of development equivalent to that experienced in Europe with the industrial revolution. First, it is questionable whether this is the appropriate counter-factual. Asian colonies would not need to experience on their own the "early spread of Industrial Revolution" to actually achieve comparatively superior development standards. At a minimum, provided Asian colonies had not been subject of colonial monopolies and suffered the triple draining effects, they would probably be better positioned to later catch-up with industrialization and so achieve better development standards.

In fact, some regions in Asia had not only a vibrant agrarian economy but also a flourishing manufacturing industry. Such thriving economic environment at an early stage could have formed favorable conditions for Asian economies to evolve into actual rivals of the European industry in the nineteenth century. For instance, in India, the regional trade of agricultural and manufactured products, especially woollen and cotton, reached significant levels in the eighteenth century[8]. This regional trade could have

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[7] Colonial exploitation in Asia was limited to products that it respectively wished to buy and sell. Other traders coexisted with the monopolistic colonial company, which could send to the Indies products that the colonial company did not export. (See H.V. Bowen, 'Sinews of trade and empire: the supply of commodity exports to the East India Company during the late eighteenth century', in *Economic History Review*, Vol. 55, No. 3, 2002, p.466 et seq). Also in relation to local production, there was tolerance. Production and intra-regional trade in goods that the English did not want to exploit and that could generate income for the population were tolerated and even stimulated. The sale of products to the colonies was essential to finance the increasing purchases of spices and agricultural products essential to supply the increasing demand specially from the British. This led the metropoles to increasingly allow and encourage the formation of independent economic sectors, parallel to the core business of import and export. See R. Brenner, *Merchants and revolution – commercial change, political conflict and London's overseas traders, 1550–1653*, op cit., p.28 et seq.

[8] There is evidence of regional integration and early development of a domestic market in India. Se e T. Raychaudhuri, 'The mid-eighteenth century background', in *Cambridge economic history of India*, Vol. 2, Cambridge, Cambridge University Press, 1983, 3 (28). Evidence of this development is the existence of a fairly complex tax system in place. See Eric Stokes, *The First Century of British Colonial Rule in India: Social Revolution or Social Stagnation?*, in *Past & Present*, No. 58, 1973, p. 154. The description by Irfan Habib is very illustrative of the development of pre-colonial India: *"If it were possible to have statistics of the volume of internal and external commerce around the year 1600 for different regions of the globe, it is fairly certain that India, with an estimated population of from 125 to 150 million, would at least have*

expanded to other territories, due to the existence of powerful merchant communities[9]. If India had not become a colony, it would probably have had higher level of development at the time of the industrialization and could have expanded commerce[10].

Professor Mateus proposes yet another counter-factual to challenge the causation between colonial monopolies and underdevelopment. He contends that a competitive market structure in global trade would not be feasible due to the large sunk costs required for infrastructure transport. While Professor Mateus is right that a diluted market structure would be very unlikely to work under the conditions at the time and the need of high fixed and sunk investments[11], the central point in my book was not to propose fierce and fragmented global competition. My main argument was that colonial monopolies were very negative because they caused the "triple draining effects", preventing both the colonies internal growth and foreign expansion.

Seeking to uncover common features of underdevelopment due to economic structures originated in the colonial past, my book shows that the existence of monopolies and the complete draining of social and economic spheres are the main historical common signs that led to underdevelopment. The status of 'colony' created internal power structures that deeply influenced the process of development in these societies. The structural concentration of economic power resulted in the concentration of income among industries and social classes. The colonial monopolies submitted the peripheral economies to a 'triple draining effect', draining resources and concentrating income from the consumer, the labour force and other sectors (dependent sectors). This concentration

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claimed a share proportionate to its population. The land-tax accounted for the larger portion of the surplus in India, and in most areas taxes were collected in money. This alone generated extensive trade in agricultural produce. The ruling classes were largely town-based, and an urban economy flourished, with craft production for both local and distant markets. India was undoubtedly the greatest cotton-textile producer of the world, and the finer qualities of cotton cloth sustained brisk long-distance commerce. The country exported calicoes, indigo, pepper, silk, and numerous other commodities over sea and over land, in return for which it absorbed large quantities of silver. The coinage of the Mughal Empire, issued from numerous mints all over India, was of wonderful fineness and uniformity." (*Merchant communities in precolonial India*, in James D. Tracy (ed.), *The Rise of Merchant Empires,* Cambridge University Press, 1990, p. 371).

[9] The assumption that India could have reached higher development is further supported by the analysis of the conditions of commerce, and the existence of powerful merchant communities with the potential to expand commerce outside the domestic territory. See Irfan Habib, *op. cit.*, p. 398.

[10] Negative effects of colonization in investments even after the colonial period in India are discussed in Matthew Lange, James Mahoney and Matthias vom Hau, *Colonialism and Development: A Comparative Analysis of Spanish and British Colonies*, in *American Journal of Sociology*, Vol. 111, No. 5, 2006, p. 1444.

[11] For an interesting discussion of technological developments of shipping and estimates of costs and productivity of the Dutch maritime fleet, see Jaap R. Bruijn, *Productivity, profitability, and costs of private and corporate Dutch ship owning in the seventeenth and eighteenth centuries*, in James D. Tracy (ed.), *The Rise of Merchant Empires*, Cambridge University Press, 1990, pp. 174-194.

of power and income caused the pattern of economic growth in these areas to change substantially.

I respectfully disagree with Professor Mateus interpretation of my proposal of a “neo structuralism” theory. He compared my thesis to mere replication of Celso Furtado’s historical analysis. While it is flattering to have Furtado’s company as subject of Professor Mateus’ critics, I actually tried to look much beyond Furtado’s theory. As I explain in my book, Furtado was right in pointing out the negative effects of colonial cycles over South American colonies. Nevertheless, his theory ignores the fact that such effects are not merely a product of colonial trade relations. My proposal of “neo structuralism” theory takes a step forward and highlights that the underdevelopment that followed is the product of the perverse social, economic and legal structures that were created and enshrined within colonial economies and societies (influencing deeply the formation of futures states). As explained above, such structures - the “colonial monopolies” - submitted the colonies to the ‘triple draining effect’ and were latter transformed in the industrial and post industrial dominating structures.

The reality and negative impact of colonial monopolies is not denied by references to recent stories of success in the world economy of China, Japan or Korea. Actually, the extent of European colonialism in such regions was relatively limited. First, other colonies had demanded so much energy and efforts from Western countries that they faced difficulties to reunite the necessary conditions to more intensely gain power over Japan or China. In addition, these nations, though technologically weak, had well-organized central authority and the ability to congregate manpower for disputes. These conditions actually led to a different approach from Western countries, not focused on turning those areas into colonies (but for a few city ports like Hong Kong) but on establishing trade and some level of diplomacy (though easily turned into war in the face of disputes).

In the case of Japan, for example, after centuries of self-imposed isolation, the imminent threat of domination by Western countries and the subservience Japan had experienced in trade relations fostered a “collective recognition of the nation’s vulnerability”[12]. Such recognition helped Japan to rapidly move from “concern with national survival toward national assertiveness beyond its own shoreline”. Japan

[12] See Ramon H. Myers and Mark. R. Peattie (ed.), *The Japanese Colonial Empire 1895-1945*, Princeton University Press, 1984, p. 7. 1895-1945

extended its reach over Korea and Taiwan, and defeated China and Russia in wars in the last and first decades of the nineteenth and twentieth centuries, respectively. From a nation that had been close to becoming a colony, it actually became a respectable player in the imperialism dynamics[13]. By its turn, China was extremely developed by the eighteenth century (China's internal market and overall commerce was more developed than all European countries together), but suffered a complex process of deterioration of its society and economy of which Western imperialism was just one component[14]. In fact, the development of the Chinese economy was such that Western (mainly the British) traders' and manufacturers' attempts to expand in China were mostly frustrated. During the first half of the nineteenth century, Western companies' presence was essentially limited to opium imported from India. This scenario was only reverted by war: after being defeated in conflicts against England and Japan, China's national unity went down and political chaos reigned, with repeated civil wars. Such collapse of the then strong Chinese state is probably a pivotal element in driving China to fall behind the development process in the decades that followed[15]. So in all of those cases, the present success in development seems to be more related to the cultural and social rejection of and fight against colonialism than to a positive impact of it.

Finally, I also disagree with Professor Mateus last point. I do not intend to compare or suggest that multinationals are equivalent to monopolies. In my book, I argued that colonialism has evolved into more sophisticated structures able to benefit from their comparative advantages (resulting from the triple draining effect) in underdeveloped countries to spread their power and intensify the triple draining effect (and its negative social impacts) on the entire planet. I believe this view is thoroughly developped in pages 125 - 143 of my book. As I mentioned in the very first paragraph of this comment, I believe that colonial monopoles and their followers in modern times cannot be fully understood under the lens of neoclassical microeconomic analysis, conceived for non-colonial economies in the nineteenth and twentieth century.

At last, I must say we find agreement on Professor Mateus´ very last comment, i.e in the recognition that my theory is not part of the mainstream economics (and does not

[13] See Giovanni Arrighi, *Adam Smith in Beijing: Lineages of the 21st Century*, Verso, 2007, p. 348.
[14] See Giovanni Arrighi, op. cit., p. 40.
[15] The fall of Chinese empire and its relation to the political chaos originated from repeated conflicts is discussed by Giovanni Arrighi, op. cit., pp. 342-349.

intend to be). I am indeed a proud critic of the neoclassical antitrust and neo-institutional analysis of the development process.