

## ***Protectionism in Retrospect: Mihail Manoilescu (1891-1950?)***<sup>1</sup>

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RESUMO: Este artigo examina a Teoria do Protecionismo de Mihail Manoilescu. Seu ponto principal era a defesa de uma proteção permanente ou geral de setores de alta produtividade, contrastando com a proteção temporária de indústrias nascentes da List. O raciocínio de Manoilescu entra em contradição. Ele argumentou que a produtividade da agricultura e a produtividade da indústria se igualariam no longo prazo. Nesse caso, a proteção não seria mais necessária. Assim, seu argumento precisa de uma suposição adicional, ou seja, custos variáveis de produção. Manoilescu mencionou a presença de retornos crescentes na indústria e retornos decrescentes na agricultura em um apêndice. Essa suposição torna sua teoria muito semelhante com o argumento de Graham e a análise mainstream contemporânea de comércio e proteção (P. Krugman, I. Magaziner e R. Reich).

PALAVRAS-CHAVE: Protecionismo; comércio, produtividade, Manoilescu, Graham.

ABSTRACT: This paper examines Mihail Manoilescu's *Theory of Protectionism*. Its main point was the defense of a *permanent* or general protection of high productivity sectors, contrasting with List's *temporary* protection of infant industries. Manoilescu's reasoning goes into a contradiction. He argued that the productivity of agriculture and the productivity of industry would equalize in the long-term. In that case, protection would no longer be necessary. So, his argument needs an additional assumption, that is variable costs of production. Manoilescu mentioned the presence of increasing returns in industry and decreasing returns in agriculture in an appendix. This assumption renders his theory very similar with Graham's argument and contemporary main-stream analysis of trade and protection (P. Krugman, I. Magaziner and R. Reich).

KEYWORDS: Protectionism, trade, productivity, Manoilescu; Graham.

JEL Classification: B27; F10; L52; O24.

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In the history of economic thought, ideas appear, and then vanish for a more or less long period until some skillful theorists resuscitate them and nourish them with improved vigor. Conflicting the dominance of free trade doctrine in the international trade theory (Smith, Ricardo), economists like F. List (*Political Economy National System*, 1841) defended protectionist policies for “infant industries”. List’s idea was to improve the national industrial development before getting a free trade policy between nations at comparable stages of industrial revolution. Since List the argument evolved. M. Manoilescu’s theory of “general protectionism” represents an important step further on this way. He used the term “general” to mark a difference with List’s “temporary protectionism” that Manoilescu criticized for being mostly a social and political argument instead of an economic one.

In Manoilescu’s *Theory of protectionism and international trade*<sup>2</sup>, the original defense of protectionism is only shadowed by some hesitating analytical developments. The interest of reconsidering his work is reinforced by the recent debates in favor or against protectionist policies and “win-lose” competition concepts, all this going along with a revision of the international trade theory. We will show that a startling connection will be enlightened between Manoilescu and some theorists who inspired Clinton’s trade policy at the White House and this renders the debate very fruitful and confirms our “spiral” conception of history of economic thought<sup>3</sup>.

The paper will analyze Manoilescu’s *Theory of protectionism and international trade*. In the first section, we will comment Manoilescu’s rejection of ricardian theory. In the second section we will examine its theory of protection and in the third and last section we will try to infer that an additional condition is to be taken into consideration for his protectionist argument to hold, that is the increasing return assumption for the industrial sector, which makes it seem much alike American Frank Graham’s theory of protection founded on variable costs of production. Contemporary mainstream analysis of international trade rediscovered Graham’s arguments, along with some political recommendations in favor of “strategic industries” or “increasing returns industries” protection, as we will see at the end of this paper, as a concluding remark.

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<sup>2</sup> We will study here the French edition (the first) of Manoilescu’s book (1929). In 1940, Manoilescu revised his work and published a second version in German, which was translated in Romanian and published in 1986. After comparing the two editions, we found out that Manoilescu’s arguments presented in our paper did not change from an edition to the other.

<sup>3</sup> This connection with US theoretical developments distinguishes our approach from the one that Joseph Love remarkably presented. According to him: “As noted, Manoilescu [...] had implicitly assumed a model of the world economy consisting of an industrial core and an agrarian periphery. His chief contribution, though seriously flawed, was to offer a formal model of unequal exchange, similar in many — but not in all — ways to that developed by Latin American structuralists and dependency analysts in the postwar era” (Love, 1999: 8). Love considered that dependency economists as Argentinean Raul Prebisch and Brazilian Celso Furtado were continuators of Manoilescu’s doctrine.

## REJECTION OF THE RICARDIAN THEORY OF INTERNATIONAL TRADE

Manoilescu built his theory by refuting Ricardo's principle of comparative advantage, along with the ricardian labor theory of value. As we will see in this section, the lack of a theory of price affected Manoilescu's argument.

He tried to demonstrate that the famous example of wine and cloth trade between Portugal and England is less general than Ricardo pretended. He defined the following terms:  $V_p$  = wine's productivity in Portugal,  $V_e$  = wine's productivity in England,  $D_p$  = cloth's productivity in Portugal,  $D_e$  = cloth's productivity in England.

Productivity is given by the ratio of net product<sup>4</sup> (or added value) and the quantity of labor. Manoilescu calculated net product in two ways. First on the basis of internal prices and second, by considering external prices, i. e. world prices determined by international trade.

Using these terms and assuming net product calculated on the basis of external prices (prices have the same monetary unit), he formulated the principle of comparative advantage of Ricardo like this:

$$V_p / V_e > D_p / D_e$$

According to him, there are three possible cases for this relation to hold:

- 1)  $D_p > D_e$  ( $>$ )  $V_p > V_e$
- 2)  $V_p > D_p > D_e > V_e$
- 3)  $V_p > V_e$  ( $>$ )  $D_p > D_e$

Ricardo concluded that Portugal should export wine and England cloth, which corresponds here to the second case (2). However, according to Manoilescu, it is erroneous to explain this specialization pattern by comparative advantages (in wine for Portugal and cloth for England). It is only due to the fact that in Portugal, the wine industry is more productive than the cloth manufacture ( $V_p > D_p$ ). In the first case (1), Portugal should specialize in cloth (its cloth productivity outweighs its wine productivity) and England should do the same choice for the same reason. In the last case (3), there is a symmetric result: both of the countries should produce wine ( $V_p > D_p$  and  $V_e > D_e$ ).

Manoilescu inferred from this the following conclusion:

“Hence it follows that the existence of some comparative advantage in the production of a good may not be a sufficient condition for Ricardo's argument to hold. It is also necessary that the other good's productivity amount between the extreme values of the first good's productivity. [...] Ricardo was right in assuming the concentration of national production

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<sup>4</sup> The net product is calculated by deducting from gross product the primary goods, combustibles, tools, maintenance and absorption of depreciation amounts written off.

in the most profitable sectors, but he wrongly believed that that concentration was directed by a comparative superiority. Our point of view is that it is advantageous to specialize in activities with higher absolute productivity.” (Manoilescu, 1929: 123-126)<sup>5</sup>

He called it “the law of concentration of national activities in maximal productivity sectors”<sup>6</sup>.

Manoilescu’s argument is based on the rejection of Ricardo’s value theory:

“But all this construction [i. e. the ricardian theory] is built upon a wrong statement: it assumes that goods in a same country are traded according to the following principle: only equal labor quantities are exchanged. This assumption means that a quantity of wine is traded within the country (first in England, then in Portugal) with a quantity of cloth so as the quantities of incorporated labor are identical.” (Manoilescu, 1929: 137)

Rejecting this assumption means rejecting Ricardo’s theory, unless disequilibrium conditions prevail in the economy. Manoilescu’s argument modifies value theory:

“Then, instead of exchanging goods according to equivalent quantities of labor, trade occurs within the same country according to the quantities of labor *and labor’s productivity* (we underline)” (Manoilescu, 1929: 137)

The first problem with Manoilescu’s definition of value is the measure of productivity. At the beginning of his book, productivity is measured by prices (fixed at equilibrium). Given this definition, value theory means that prices are defined by incorporated labor quantities and... by prices!

Another problem is that differences of productivity between sectors in the same country involve the existence of “non-competing groups” (Ohlin) in that country. Immobility of labor between nations is transferred within the nation, i. e. between agriculture and industry. Like Ohlin argued, moving production factors to the most productive sectors might then reduce comparative disadvantages of some sectors (measured by their productivity).

Built on different assumptions, Ricardo’s and Manoilescu’s theories led them to divergent political recommendations.

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<sup>5</sup> All translations in English of Manoilescu’s book are ours.

<sup>6</sup> This conclusion reveals the fact that competition fails to maximize productivity and might be due, according to Condliffe, to his “particular” definition of productivity, using only a “net product”: “Added value per worker employed is not, however, an adequate test of true productivity and the subsiding of those industries which show the greatest added value per worker would not lead to the greatest aggregate production” (Condliffe, 1933: 144).

## THEORY OF PROTECTION

Manoilescu defined a quality or efficiency coefficient including labor and capital:

$$q = P / (TC)^{1/2}$$

with P = net product, T = labor quantity, C = capital employed.

He evacuated the capital from it, as “man is the only valid unit for production and consumption, being the only consumer for products. A higher per capita productivity means a higher per capita consumption [...] It is then a concrete prosperity sign of human society” (Manoilescu, 1929: 38). The productivity is given by the labor productivity:  $p = P / T$ .

He elaborated diagrams for labor productivity in each sector and for many countries' data, and then he compared diagrams of industrialized and agrarian countries. He empirically obtained (by calculating average national productivity) a proof of productive superiority of industrialized countries over the agrarian or mixed ones. This result has two causes:

— intrinsic relative inferiority of agriculture, based on calculus of labor productivity;

— industrial productivity fluctuates less than agriculture's, being “less dependent on country's development stage” (Manoilescu, 1929: 61).

It might be then advantageous for agrarian countries (like Romania) to transfer their productive activities to industry. Suppose two countries with different specialization; one of them is agrarian, the other industrialized. They both produce an agricultural and a manufactured good. The agrarian country faces the choice either to import the manufactured good or to produce it at home. The necessary and sufficient condition for trade to be preferred to production is that “comparative superiority of agriculture” (i. e. superiority in production of exported good relative to the foreign country) *exceeds* “intrinsic superiority of industry” (i. e. of the manufactured imported good over the agricultural exported one). According to him, this condition can hardly be satisfied:

“A remarkable and crucial point of our conclusions is that (due to the determinant position of intrinsic (qualitative) productive superiority of industry over agriculture) national agriculture needs an enormous superiority over foreign agriculture in order to be considered economically advantageous. Inversely, home industry would present an advantage even if it had a productive inferiority relative to foreign industry.” (Manoilescu, 1929: 168)

Manoilescu confers protection a long-lasting economic advantage. No matter how costly it may be, all sectors with productivity values higher than the national average value should benefit from it. Protection means freedom, free trade is constraint. Political action is necessary to encourage *higher per capita added value* sectors in order to improve international purchasing power of the nation. Contrast-

ing List's argument for "infant industries" protection, Manoilescu recommended *permanent* protectionist policies. This long-term perspective is explained by the impossible perfect equalization of productivity values in agriculture and industry. But this is not convincing.

## PERMANENT PROTECTION

The long-term protectionism advocated by Manoilescu goes along with the industrialization process and is given a dynamic character. In proportion as industrial output increases, relative prices and relative productivity of sectors modify. However, the productivity of each sector being calculated with equilibrium static prices, it is possible to conceive protection in an exclusively static frame.

Manoilescu's theory of protection is built on a first assumption — static — that one should consider a nation trading with the rest of the world and which is too small to control international prices. In this situation, prices are fixed:

“Then in this small country's production and trade, all prices are *fixed* at a given moment in time, and this whatever the output or goods' transfer, whatever the abundance of a good and the scarcity of another.” (Manoilescu, 1929: 88)

This static method is prized up by Manoilescu as it avoids “the risks of value theory” (Manoilescu, 1929: 89). At equilibrium, goods' values are purely and simply their fixed prices:

“If we use this static method it is no longer necessary, like for other authors, to explain international prices and their primary causes. In my opinion, it is useless to estimate relative utility of goods (or their ‘ophelimity’ given by present demand of markets, determined by tastes, education, wealth and purchasing power distribution,...) [...] We remark at one moment an equilibrium for all international goods and between all demands and to this equilibrium corresponds a certain price.” (Manoilescu, 1929: 90)

International values are given and do not consist in quantities of incorporated labor. They are determined by a sum of factors like international demand and supply. There is only one international equilibrium price for every product. Policy recommendations are made in this static frame and given the assumption of the small country.

Manoilescu stated that protectionism should be permanent. For this he embraced a dynamic view and assumed price variations and changes in output and trade. Though, dynamics is only partial — demand conditions are completely left aside.

He assumed that:

- productivity is calculated by per capita added value (in terms of international prices);
- it is advantageous to protect sectors with productivity value higher than national average;
- all countries engage protectionism.

How would prices evolve if all countries applied the recommended protectionism?

- after a while, overproduction of manufactured highly productive goods will appear;
- agricultural goods will become scarce;
- the relative industrial prices will decrease;
- industrial and agricultural productivity will tend to equalize (if production costs in terms of labor quantities remain constant).

There is a contradiction rising up between the equalization of productivity values inferred from the previous argument and a permanent protectionist action. Manoilescu assumed that this equalization was practically impossible; in his opinion, agriculture could never completely catch up with industry. He abandoned production costs explanation in order to avoid price theory, but that left him helpless to provide a logical solution to the contradiction contained in his argument. He seemed aware of that difficulty and tried to call back production conditions by a short reference to physical productivity, but did not go deeply into it.

In our opinion, the solution is to find an impediment to productivity' equalization. This could be the assumption of different cost conditions in agriculture and industry. Price changes might be offset by production costs long term variations. The following example will clear this matter:

Suppose a rise in unitary price of an agricultural good, from  $P_1$  to  $P_2$ ,  $P_2 > P_1$ . The physical productivity of agriculture is  $X / T$ ,  $X$  being the quantity of good produced and  $T$  the number of workers necessary to produce it.

The productivity<sup>7</sup> expressed in monetary units is then  $PX / T$ . Price evolution of the agricultural good will result in a rise of the productivity proportional to price increase:  $P_2X / T > P_1X / T$ .

Suppose now a decrease in *physical* productivity of the agricultural good (or an increase in production costs, measured by labor quantity):  $T_2 > T_1$  workers produce  $X$ . This might offset the price increase: if the physical productivity decrease is proportional to price rise, than monetary productivity will remain constant ( $P_2X / T_2 = P_1X / T_1$ ). The same reasoning applies to industrial goods (we could have directly use relative prices and productivity values, without a numéraire).

From this we infer that Manoilescu's protectionism theory needs a supplementary condition that is the existence of non-proportional production costs (quantities

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<sup>7</sup> We assume here that the changes in prices do not affect the relation between gross and net product. Indeed, we expressed productivity in terms of total product per worker, which does not correspond with Manoilescu's definition.

of labor incorporated) or, according to the assumption of productive industrial superiority, that production costs in agriculture should rise at least as fast as the industrial costs decrease. The condition holds if industrial costs decrease and agricultural costs increase. At this point, Manoilescu's argument reaches Frank Graham's (1923) theory of protection. Graham explained the advantages of countries to specialize in decreasing costs industries. Graham's model has fixed international prices and variable costs of production (or physical productivity), while Manoilescu's reasoning imply varying prices and constant costs. By introducing variable costs in Manoilescu's assumptions his permanent protection argument becomes a variant of Graham's argument. Like Manoilescu, Graham defended a long-term protectionist policy for decreasing costs industries. As Viner pointed out:

“Haberler has characterized Graham's argument as but a variant of the infant-industry argument for protection. But the validity of Graham's thesis, if it is valid at all, is not dependent upon short-run considerations. Decreasing marginal costs are not necessarily nor typically a short-run phenomenon, and it is Graham's contention that if an industry is operating under decreasing costs it may pay to protect it even if it has a permanent and irremovable comparative disadvantage in costs.” (Viner, 1937: 482)

Did Manoilescu know about Graham's theory? Probably not, given that Graham's name is completely missing from Manoilescu's book. The two authors have probably conceived their theories in the same time. However, Manoilescu introduced “non proportional returns” in an appendix, along with a reference to Kellenberger's paper<sup>8</sup> (1916), written before Graham (1923). In this appendix, Manoilescu argued that variable returns to scale do not invalidate his conclusions. Variable returns are, in fact, the necessary condition for his permanent protection argument.

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Manoilescu's protectionist argument can be reformulated by taking into consideration the additional assumption of increasing and decreasing returns in production. Protection would focus on increasing returns sectors and not only on high productivity sectors, as the author suggested. The appendix on “non proportional returns” proves that Manoilescu did not elude the case. But he did not see that it was essential to his argument in favor of a permanent protection of industrial sectors, assumed to have increasing returns to scale.

The recast of Manoilescu's protectionist argument in terms of variable returns to scale renders it very similar with modern arguments. The case of variable returns

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<sup>8</sup> Kellenberger prefigured Graham's argument by defending protection of decreasing costs (increasing returns) sectors, i. e. the industrial sectors, as he assumed that agriculture had decreasing costs.

to scale and the protectionist argument meant to foster the increasing returns sectors is one of the favorite subjects of the “new trade theory”. The contemporary analysis represents a serious challenge for the free trade doctrine. Economists like Elhanan Helpman and Paul Krugman (1985), Wilfred Ethier (1982), Arvind Panagariya (1981), James Brander and Barbara Spencer (1981) clearly stated that economic advantages could be obtained from protectionist policies. They established the conditions providing this result. Their arguments can be separated in two classes: *external economies* arguments and *strategic trade policy* arguments.

In the first class, increasing returns take the form of external economies in a given industry, inspired by Marshall’s “industrial districts”. In the second class, imperfect competition is assumed as a consequence of increasing returns in the form of internal economies.

In the case of external economies, Helpman and Krugman (1985), Ethier (1982) and Panagariya (1981) recommended the protection of the sectors in which these economies were present. The political implications of these resuscitated protectionist views were an embarrassing issue. Krugman tried to deal with political recommendations to be formulated for particular cases. His main preoccupation was US trade policy. In that sense, he considered “new trade theory” as a useful guide for industrial policy:

“The industrial policy can be made well (or at least not terribly) or it can be made badly; the new trade theory can, perhaps, help provide the guidelines for making policy that is not too bad.” (Krugman, 1992: 440)

The second argument that inspired Krugman’s protectionist view is strategic trade policy (see J. Brander, B. Spencer, 1981). Internal economies are opportunities for firms to increase output. Firms obtaining oligopoly rent are strategic firms.

Governments can decide to support potentially “strategic firms” in order to increase the rent share of domestic industry. Targeting candidates to subsidies according to given conditions of the models is the issue of strategic trade policy.

“Are there ‘strategic’ activities in the economy, where labor and capital either directly receive a higher return than they could elsewhere or generate special benefits for the rest of the economy?” (Krugman, 1986: 14)

This is the turning point initiated by the “new trade theory”. Political implications are to replace free trade by an active industrial and trade policy focusing on specific cases. Krugman admitted that a more active US trade policy could be better than free trade:

“What all this means is that the extreme pro-free-trade position — that market work so well as they cannot be improved on — has become untenable. In this sense the new approaches to international trade provide a potential rationale or a turn by the United States toward a more activist trade policy.” (Krugman, 1986: 15)

A related approach was given by *Minding America's Business* (1983). Its authors, Magaziner and Reich, defended the same point of view as Krugman in the early 80's — active industrial policy. The political recommendations of this book are surprisingly identical with those provided by Manoilescu in 1929, as this quotation indicates:

“Our standard of living can only rise if (i) capital and labor increasingly flow to industries with high value-added per worker and (ii) we maintain a position in those industries that is superior to that of our competitors.” (Magaziner and Reich cited by Krugman, 1996: 12)

In spite of some analytical failures, Manoilescu's topical conclusions are of great assistance to new theory's comprehension. His readers should keep in mind Economics was not his major specialization. He came to it from practical questions during the political responsibility he was given in the Romania's government. His intuitive reasoning and his engagement for Romania's rapid industrialization policy needed theoretical backgrounds<sup>9</sup>. Unsatisfied with the classical and neoclassical approaches, he moved towards his personal views and searched for their logical proof. An original and interesting work emerged, to which we owe the present paper.

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<sup>9</sup> Brazilian economic policy (the tariffs imposed in 1931, for example) was inspired by Manoilescu's ideas. “In São Paulo, Brazil's most industrialized state, his *Theory of Protectionism* was viewed as a scientific justification of systematic protection for manufacturing industries by the local industrialists' federation.” (Love 1999: 8)

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