The growth of the international economy 1820–2000

Fourth edition

An introductory text

A.G. Kenwood and A.L. Lougheed

ROUTLEDGE

The Growth of the International Economy 1820–2000

Fully revised and brought up to date, *The Growth of the International Economy 1820–2000* remains the best available introduction to the study of the international economy as a mechanism for diffusing modern economic growth between nations. For the fourth edition, the authors have brought the story up to the year 2000, and have thoroughly revised the text by including new data and references.

Significant updates to the text include:

- globalization and the world economy
- the growth of regional trading blocs
- globalization and the financial crisis in Asia
- transition to the market in post-communist economies

Packed with new references and data, *The Growth of the International Economy* is an indispensable guide to the world economy as it enters the new millennium. This text is widely acknowledged as essential reading for first and second year undergraduates of economic history, international economics and applied economics.

A.G.Kenwood and **A.L.Lougheed** are Honorary Research Consultants in the Department of Economics at the University of Queensland.

The Growth of the International Economy 1820–2000

An introductory text

Fourth edition

A.G.Kenwood and A.L.Lougheed

London and New York

First published 1971
by George Allen & Unwin (Publishers) Ltd
Second edition 1983
Third edition 1992

Fourth edition published 1999
by Routledge
11 New Fetter Lane, London EC4P 4EE

Simultaneously published in the USA and Canada
by Routledge
29 West 35th Street, New York, NY 10001

Routledge is an imprint of the Taylor & Francis Group

This edition published in the Taylor & Francis e-Library, 2002.

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

Library of Congress Cataloging in Publication Data
Kenwood, A.G.
The growth of the international economy 1820–2000: an introductory text/George Kenwood and A L Lougheed. —4th ed.
p. cm.
Includes bibliographical references and index.
1. International economic relations—History—19th century.
2. International economic relations—History—20th century.
3. Economic history—1750–1918. 4. Economic history—1918–
I. Lougheed, A.L. II. Title.
HF1359.K465 1999
337–dc21 98–33134
CIP

ISBN 0-415-19930-1 (pbk)
ISBN 0-415-19929-8 (hbk)
ISBN 0-203-19935-9 Master e-book ISBN
ISBN 0-203-19938-3 (Glassbook Format)

Contents

Figures

Tables

List of Abbreviations

ACP	African, Caribbean and Pacific (countries)
AFTA	ASEAN Free Trade Area
APEC	Asian Pacific Economic Community
ASEAN	Association of South Eastern Asian Nations
BENELUX	Belgium, the Netherlands, and Luxembourg
BIS	Bank for International Settlements
BIT	Bilateral Investment Treaty
BSFF	Buffer Stock Financing Facility
CACM	Central American Common Market
CAP	Common Agricultural Policy
CCFF	Compensatory and Contingency Financing Facility
CEEC	Central and Eastern European Country
CER	Closer Economic Relations
CET	Common External Tariff
CIS	Commonwealth of Independent States
CIT	Country in Transition
CMEA	Council for Mutual Economic Assistance
CPE	Centrally Planned Economy
DAC	Development Assistance Committee
EAGGF	European Agricultural Guidance and Guarantee Fund
EBRD	European Bank for Reconstruction and Development
EC	European Community/European Economic Community
ECB	European Central Bank
ECSC	European Coal and Steel Community
ECU	European Currency Unit
EDF	European Development Fund
EEA	European Economic Area
EEC	European Economic Community
EFF	Extended Fund Facility
EFTA	European Free Trade Association
EIB	European Investment Bank
EIF	European Investment Fund

EMEA	European—Mediterranean Economic Area
EMU	European Monetary Union
EPU	European Payments Union
ERM	Exchange Rate Mechanism
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
FDI	Foreign Direct Investment
FEOGA	See EAGGF
FPEI	Foreign Portfolio Equity Investment
FPI	Foreign Portfolio Investment
GAB	General Arrangements to Borrow
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
G7	Group of Seven
GSP	Generalized System of Preferences
HIPC	Heavily Indebted Poor Country
IBEC	International Bank for Economic Co-operation
IBRD	International Bank for Reconstruction and Development (the World Bank)
IDA	International Development Association
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IIB	International Investment Bank
IMF	International Monetary Fund
IPC	Integrated Programme of Commodities
ITA	Information Technology Agreement
LAFTA	Latin American Free Trade Area
LDC	Less Developed Country
MFN	Most Favoured Nation
MTN	Multilateral Trade Negotiations
NAB	New Arrangements to Borrow
NAFTA	North American Free Trade Association
NIC	Newly Industrialized Country
NIE	Newly Industrialized Economy
ODA	Official Development Assistance
OMA	Orderly Marketing Arrangement
OECD	Organization for Economic Co-operation and Development
OEEC	Organization for European Economic Co-operation
OPEC	Organization of Petroleum Exporting Countries
R&D	Research and Development
SAF	Structural Assistance Facility
SDR	Special Drawing Right
SEA	Single European Act
SEM	Single European Market

SRF	Supplementary Reserve Facility
STF	Systemic Transformation Facility
TNC	Transnational Corporation
U.K.	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
U.S.	United States
U.S.S.R.	United Socialist Soviet Republics
VER	Voluntary Export Restraint
WTO	World Trade Organization

Introduction

The exchange of goods and services is the means through which independent economic units enter into economic relations with one another and become part of a local or national economic community. As exchange passes beyond a country's boundaries, national economic systems become parts of a broader regional, continental or world economy. Flows of commodity trade are not the only economic links forged between nations, however. People are also highly mobile, and the long evolution of trade from primitive barter to our modern worldwide network of commodity exchange has made necessary an intricate system of international credits, loans and investments. It is these flows of trade, labour and capital that constitute the vital processes of the international economy. Obviously, therefore, any study of the growth of the international economy must be concerned with the measurement and comparison of the rate at which these processes go on over time. It must also be concerned with examining the ways in which the international economic system is organized to carry out these vital processes, and how the structure, organization and functioning of these processes change as the international economy expands. In the final analysis, however, the international economy is studied not as an end in itself, but rather as a means to an end, for in studying its expansion in recent times, we are analysing one of the most potent causes of modern economic growth.

The international economy encourages national economic growth in two ways: by providing opportunities for international specialization; and by acting as a mechanism for diffusing between nations the apparatus and/or benefits of modern industrial technology. Since specialization implies trade and cannot occur without it, and since specialization and division of labour are a major cause of increased productivity and rising per capita real incomes, some comment is called for on the nature of the basis of trade between countries before we say something briefly about the international economy as a means of spreading industrialization.

International trade arises simply because countries differ in their demand for goods and services and in their ability to supply them. So far as supply is concerned, the basis for trade is to be found in the uneven distribution of economic resources among the nations of the world, coupled with the fact that commodities and services require different proportions of these economic resources in their production. This uneven distribution of resources is partly a matter of climate and geography, and partly a result of each nation's historical development, which has left it with a certain stock of capital and a population trained and educated in numerous techniques and skills. Whatever their origin, however, each country's endowment of land, minerals, skills, and machinery equips it to produce certain goods and services more efficiently (cheaply) than others. For differences in the relative supplies of different productive resources within a country will mean differences in their relative prices and therefore differences in the costs of producing various goods and services.[1] Considering these elements alone, each country would tend to specialize upon those products best suited to its factor endowment, which means those using little of its scarce factors but drawing heavily upon the cheap and abundant ones. Thus, differences in relative factor prices based on the relative abundance or scarcity of economic resources within countries will mean differences in international costs of production and therefore differences in commodity prices. It is these differences in commodity prices that are a basic cause of trade between nations.

However, the international structure of commodity prices and the pattern of foreign trade based on it are not fixed for all time. Over time, changes occur in the distribution of economic resources between countries that alter the comparative cost structure and modify the pattern of world trade. Any one country's factor endowment can change radically from internal causes, as technological progress occurs, as population changes, as domestic capital is accumulated, and as the economic extent of the land is modified. It can also change from external causes, by virtue of international movements of labour and capital and the spread of technical knowledge. The effect of such changes on a nation's relative factor endowment should be obvious. The principal basis for its specialization and the character of its trade are altered. In analysing the growth of the international economy, therefore, we must consider how changes in factor supplies, technical progress, increasing productivity, and changes in demand can transform the structure of comparative costs. For changes in comparative costs affect the pattern of international trade, while developments in international trade in turn influence the economic growth processes in the world economy that bring about changes in the international distribution of economic resources.

Whatever the structure of comparative costs at any particular point in time, the size of the trade flows between nations will also depend upon the existing level of transport costs. Since trade is based mainly on international price differences, it may be severely limited in situations where transport costs largely offset the price advantage of low-cost producers. In other words, the basis for trade, whether international or interregional, lies in comparative cost differences which are not neutralized by transport costs. It follows therefore that any reduction of transport costs due to technical improvements in the carriage of goods enhances the opportunities for trade by allowing international cost and price differences to become more apparent in world markets.

One apparent failure of the factor proportions theorem just outlined is that it does not provide an adequate explanation for the comparative advantage which industrialized nations appear to possess in different industries. This is brought out clearly by the fact that, in this century, trade has tended to expand fastest between the advanced industrial nations, many of which have roughly similar factor endowments. The need to explain the trade advantage of industrial countries has led consequently to an emphasis being placed on factors other than simple resource scarcity. One approach to the problem stresses the importance of economies of scale. The technical superiority of certain large indivisible units of capital or the use of specialized labour, both of which depend on the existence of large markets, suggests that a large country, especially one with a big population and high per capita incomes, will be more fruitful for the development of large-scale industry than a smaller country with a similar level of income. Hence, the scale economy explanation essentially asserts that the country with the largest domestic market tends to specialize in those commodities which exhibit the *greatest* scale economies.

The growth of trade between industrial nations has also been explained in terms of the technological gap between nations created by the discovery of new products and new processes of production. According to this theory, trade consists of the impermanent commerce which originates solely in the temporary technological superiority gained by the nation making the industrial breakthrough. In other words, the innovating country's export trade in the new product will last until such time as other countries adopt the new techniques or produce the new product on a scale sufficient to supply their domestic markets and make them independent of imported supplies. The period it will take for the manufacture of a new product to spread from one country to another will obviously depend upon a variety of factors, including the threat which new products pose to existing goods and the lure of the high profits to be earned in the new line of production. At the same time, technological gap trade may be prolonged by the fact that the innovating country enjoys a peculiar advantage in harvesting scale economies. This advantage arises because the markets for new products expand rapidly at first. The innovator can thus more confidently erect a large plant and secure an entrenched position in domestic and export markets than can successor firms abroad. In this respect the technological gap theory is an improvement on the scale-economy theory, since according to the former a small country which innovates may yet build a large plant, whereas the latter theory simply asserts that the country with the largest home market builds the biggest plant, regardless of when it begins production. Finally, it should be noted that while the technological gap theory implies that trade between industrial nations is only a temporary thing, the fact that innovation and technical progress are continuous processes means that trade between advanced industrial nations may well persist and even grow over time.