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# The Evolution of the International Economic Order

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## INTRODUCTION

In international circles the topic of the day is the demand of the Third World for a new international economic order. My topic is the evolution of the existing economic order: how it came into existence not much more than a century ago, and how it has been changing.

The phrase "international economic order" is vague, but nothing would be gained by trying to define it precisely. I will discuss certain elements of the relationship between the developing and the developed countries that the developing countries find particularly irksome. These are:

First, the division of the world into exporters of primary products and exporters of manufactures.

Second, the adverse factorial terms of trade for the products of the developing countries.

Third, the dependence of the developing countries on the developed for finance.

Fourth, the dependence of the developing countries on the developed for their engine of growth.

My purpose in treating these topics is not to make recommendations, but to try to understand how we come to be where we are.



## THE DIVISION OF THE WORLD

How did the world come to be divided into industrial countries and agricultural countries? Did this result from geographical resources, economic forces, military forces, some international conspiracy, or what?

In talking about industrialization, we are talking about very recent times. England has seen many industrial revolutions since the thirteenth century, but the one that changed the world began at the end of the eighteenth century. It crossed rapidly to North America and to Western Europe, but even as late as 1850 it had not matured all that much. In 1850 Britain was the only country in the world where the agricultural population had fallen below 50 percent of the labor force. Today some 30 Third World countries already have agricultural populations equal to less than 50 percent of the labor force—17 in Latin America, 8 in Asia not including Japan, and 5 in Africa not counting South Africa. Thus, except for Britain, even the oldest of the industrial countries were in only the early stages of structural transformation in 1850.

At the end of the eighteenth century, trade between what are now the industrial countries and what is now the Third World was based on geog-

raphy rather than on structure; indeed India was the leading exporter of fine cotton fabrics. The trade was also trivially small in volume. It consisted of sugar, a few spices, precious metals, and luxury goods. It was then cloaked in much romance, and had caused much bloodshed, but it simply did not amount to much.

In the course of the first half of the nineteenth century industrialization changed the composition of the trade, since Britain captured world trade in iron and in cotton fabrics; but the volume of trade with the Third World continued to be small. Even as late as 1883, the first year for which we have a calculation, total imports into the United States and Western Europe from Asia, Africa, and tropical Latin America came only to about a dollar per head of the population of the exporting countries.\*

There are two reasons for this low volume of trade. One is that the leading industrial countries—Britain, the United States, France, and Germany—were, taken together, virtually self-sufficient. The raw materials of the industrial revolution were coal, iron ore, cotton, and wool, and the foodstuff was wheat. Between them, these core countries had all they needed except for wool. Although many writers have stated that the industrial revolution depended on the raw materials of the Third World, this is quite untrue. Not until what is

\* For the sources of this and other statistics used here, and generally for more detailed historical analysis, the reader may consult my book, *Growth and Fluctuations 1870-1913*, Allen and Unwin, London 1978.

sometimes called the second industrial revolution, at the end of the nineteenth century (Schumpeter's Third Kondratiev upswing based on electricity, the motor car and so on), did a big demand for rubber, copper, oil, bauxite, and such materials occur. The Third World's contribution to the industrial revolution of the first half of the nineteenth century was negligible.

The second reason why trade was so small is that the expansion of world trade, which created the international economic order that we are considering, is necessarily an offshoot of the transport revolutions. In this case, the railway was the major element. Before the railway the external trade of Africa or Asia or Latin America was virtually though not completely confined to the seacoasts and rivers; the railway altered this. Although the industrial countries were building railways from 1830 on, the railway did not reach the Third World until the 1860s. The principal reason for this was that, in most countries, railways were financed by borrowing in London—even the North American railways were financed in London—and the Third World did not begin to borrow substantially in London until after 1860. The other revolution in transport was the decline in ocean freights, which followed the substitution of iron for wooden hulls and of steam for sails. Freights began to fall after the middle of the century, but their spectacular downturn came after 1870, when they fell by two-thirds over thirty years.

For all these reasons, the phenomenon we are

exploring—the entry of the tropical countries significantly into world trade—really belongs only to the last quarter of the nineteenth century. It is then that tropical trade began to grow significantly—at about four percent a year in volume. And it is then that the international order that we know today established itself.

Now it is not obvious why the tropics reacted to the industrial revolution by becoming exporters of agricultural products.

As the industrial revolution developed in the leading countries in the first half of the nineteenth century it challenged the rest of the world in two ways. One challenge was to imitate it. The other challenge was to trade. As we have just seen, the trade opportunity was small and was delayed until late in the nineteenth century. But the challenge to imitate and have one's own industrial revolution was immediate. In North America and in Western Europe, a number of countries reacted immediately. Most countries, however, did not, even in Central Europe. This was the point at which the world began to divide into industrial and non-industrial countries.

Why did it happen this way? The example of industrialization would have been easy to follow. The industrial revolution started with the introduction of new technologies in making textiles, mining coal, smelting pig iron, and using steam. The new ideas were ingenious but simple and easy to apply. The capital requirement was remarkably small, except for the cost of building railways,

which could be had on loan. There were no great economies of scale, so the skills required for managing a factory or workshop were well within the competence and experience of what we now call the Third World. The technology was available to any country that wanted it, despite feeble British efforts to restrict the export of machinery (which ceased after 1850), and Englishmen and Frenchmen were willing to travel to the ends of the earth to set up and operate the new mills.

Example was reinforced by what we now call "backwash." A number of Third World countries were exporting manufactures in 1800, notably India. Cheap British exports of textiles and of iron destroyed such trade, and provided these countries an incentive to adopt the new British techniques. India built its first modern textile mill in 1853, and by the end of the century was not only self-sufficient in the cheaper cottons, but had also driven British yarn out of many Far Eastern markets. Why then did not the whole world immediately adopt the techniques of the industrial revolution?

The favorite answer to this question is political, but it will not wash. It is true that imperial powers were hostile to industrialization in their colonies. The British tried to stop the cotton industry in India by taxing it. They failed because the Indian cotton industry had the protection of lower wages and of lower transportation costs. But they did succeed in holding off iron and steel production in India till as late as 1912. The hostility of imperial powers to industrialization in their colonies and in

the "open door" countries is beyond dispute. But the world was not all colonial in the middle of the nineteenth century. When the coffee industry began to expand rapidly in Brazil around 1850, there was no external political force from Europe or North America that made Brazil develop as a coffee exporter instead of as an industrial nation. Brazil, Argentina, and all the rest of Latin America were free to industrialize, but did not. India, Ceylon, Java, and the Philippines were colonies, but in 1850 there were still no signs of industrialization in Thailand or Japan or China, Indo-China or the rest of the Indonesian archipelago. The partition of Africa did not come until 1880, when the industrial revolution was already a hundred years old. We cannot escape the fact that Eastern and Southern Europe were just as backward in industrializing as South Asia or Latin America. Political independence alone is an insufficient basis for industrialization.

We must therefore turn to economic explanations. The most important of these, and the most neglected, is the dependence of an industrial revolution on a prior or simultaneous agricultural revolution. This argument was already familiar to eighteenth-century economists, including Sir James Steuart and Adam Smith.

In a closed economy, the size of the industrial sector is a function of agricultural productivity. Agriculture has to be capable of producing the surplus food and raw materials consumed in the industrial sector, and it is the affluent state of the

farmers that enables them to be a market for industrial products. If the domestic market is too small, it is still possible to support an industrial sector by exporting manufactures and importing food and raw materials. But it is hard to begin industrialization by exporting manufactures. Usually one begins by selling in a familiar and protected home market and moves on to exporting only after one has learnt to make one's costs competitive.

The distinguishing feature of the industrial revolution at the end of the eighteenth century is that it began in the country with the highest agricultural productivity—Great Britain—which therefore already had a large industrial sector. The industrial revolution did not create an industrial sector where none had been before. It transformed an industrial sector that already existed by introducing new ways of making the same old things. The revolution spread rapidly in other countries that were also revolutionizing their agriculture, especially in Western Europe and North America. But countries of low agricultural productivity, such as Central and Southern Europe, or Latin America, or China had rather small industrial sectors, and there it made rather slow progress.

If the smallness of the market was one constraint on industrialization, because of low agricultural productivity, the absence of an investment climate was another. Western Europe had been creating a capitalist environment for at least a century; thus a whole new set of people, ideas and institutions was established that did not exist in Asia or Africa,

or even for the most part in Latin America, despite the closer cultural heritage. Power in these countries—as also in Central and Southern Europe—was still concentrated in the hands of landed classes, who benefited from cheap imports and saw no reason to support the emergence of a new industrial class. There was no industrial entrepreneurship. Of course the agricultural countries were just as capable of sprouting an industrial complex of skills, institutions, and ideas, but this would take time. In the meantime it was relatively easy for them to respond to the other opportunity the industrial revolution now opened up, namely to export agricultural products, especially as transport costs came down. There was no lack of traders to travel through the countryside collecting small parcels of produce from thousands of small farmers, or of landowners, domestic or foreign, ready to man plantations with imported Indian or Chinese labor.

And so the world divided: countries that industrialized and exported manufactures, and the other countries that exported agricultural products. The speed of this adjustment, especially in the second half of the nineteenth century, created an illusion. It came to be an article of faith in Western Europe that the tropical countries had a comparative advantage in agriculture. In fact, as Indian textile production soon began to show, between the tropical and temperate countries, the differences in food production per head were much greater than in modern industrial production per head.

Now we come to another problem. I stated earlier that the industrial revolution presented two alternative challenges—an opportunity to industrialize by example and an opportunity to trade. But an opportunity to trade is also an opportunity to industrialize. For trade increases the national income, and therefore increases the domestic market for manufactures. Import substitution becomes possible, and industrialization can start off from there. This for example is what happened to Australia, whose development did not begin until the gold rush of the 1850s, and was then based on exporting primary products. Nevertheless by 1913 the proportion of Australia's labor force in agriculture had fallen to 25 percent, and Australia was producing more manufactures per head than France or Germany. Why did this not happen to all the other agricultural countries?

The absence of industrialization in these countries was not due to any failure of international trade to expand. The volume of trade of the tropical countries increased at a rate of about 4 percent per annum over the thirty years before the first world war. So if trade was the engine of growth of the tropics, and industry the engine of growth of the industrial countries, we can say that the tropical engine was beating as fast as the industrial engine. The relative failure of India tends to overshadow developments elsewhere, but countries such as Ceylon, Thailand, Burma, Brazil, Colombia, Ghana, or Uganda were transformed during these thirty years before the First World War. They

built themselves roads, schools, water supplies, and other essential infrastructure. But they did not become industrial nations.

There are several reasons for this, of which the most important is their terms of trade. Thus, we must spend a little time analyzing what determined the terms of trade.