INTERNATIONAL TRADE THEORIES and the EVOLVING INTERNATIONAL ECONOMY

R. A. Johns

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Preface

> The literature on comparative advantage is so valuable and fascinating that it ought to be part of everyone's education.
>
> Olson (1982: 137)

> I must give notice that we are now in the region of the most complicated questions which political economy affords; that the subject is one which cannot possibly be made elementary; and that a ... continuous effort of attention ... will be necessary to follow the series of deductions. The thread, however ... is in itself very simple and manageable; the only difficulty is in following it through the windings and entanglements of complex international transactions.
>
> J.S. Mill (1909: 396)

Traditional orthodox textbooks on international trade theory often beg more questions than they answer and ignore other central questions. This book does not claim to be superior to such texts, but seeks to provide a much needed wider focus and complementary framework from which to approach and extend the often narrow outlook of formal textbook studies. It is also intended to give a self-contained introduction to the subject for non-specialist but interested social scientists and lay readers alike. Its 'originality', if that is the right word, is in the wider than usual range of field-relevant knowledge it attempts to communicate to the student in Part I; the concentration in Part II on a discussion and critique of the ideas and concepts that have evolved in this subject area, rather than the technical nuts and bolts to be found in textbooks, and the additional consideration of some of the methodological aspects of international trade theory; and, in Part III, the inclusion of material that has not as yet commanded attention in textbooks, either because the more recent approaches outlined are still confined to fairly inaccessible professional journals, or because it has traditionally been thought to be the province of other sub-areas of economics or related subject disciplines. It is hoped that as a result of these inclusions, the student will receive a more rounded view of the subject than has been conventional, though it is stressed that this book is only an introduction and does not purport to include all field-relevant elements.

Some words are perhaps required in support of the above innovations. I would justify the contents of Part I and the discursive ideas of Part II by the fact that most students unfortunately tend either to have little knowledge of economic history, or little facility for its exemplar use in international trade discussions; and, additionally, do not have a retained view of the methodological aspects of theorising that condition the effectiveness of the subject's scientific pretensions and circumscribe the significance of the end product as social science fiction, social science fact, or some indeterminable mixture of the two, social science 'faction'. I would further justify these inclusions by reference to a recent statement by Kindleberger (1983: 9) to the effect that:

> Mathematical economic theory and econometric testing have been crowding conventional economic history out of undergraduate and graduate economic curricula, and economic intuition has been sidetracked at the expense of elegance in the manipulation of Greek-letter symbols and number-crunching.

The intention behind the inclusion of Chapter 3 is not the provision of a complete world economic history as such, but an eclectic outline of the changing parameters of external trade and their differing implications for national industrial structuring and the international division of labour. It is hoped that this contextual schema may be used by students as a mental frame of reference when they attempt to evaluate for themselves the efforts made by theorists to simulate the forces that may underlie, or indeed undermine, international exchange, whether such theories are ideologically biased, empirically oriented or rooted in introspective imagination. In this respect I am attempting to respond to the exhortation made by Phelps Brown in his classic, but little heeded, article 'The Underdevelopment of Economics' (1972: 7,9) that 'the economist's studies should be field-determined, not discipline-determined . . . [and that] the economist is not trained who is not numerate but neither is he trained if he is not historiate'.

The effective success of trade economists and their grasp of the extent and complexity of global activities depend upon the degree of empirical content they seek to project into their theories and the rigour of the methodology they apply thereto to reveal the nature of their determination accurately. The analytical relevance of the latter is necessarily limited by the extent to which awareness of the current state of the universe is being maintained and the processes of change which it is undergoing are being monitored. Part III seeks to outline how the academic subject has evolved as a result of particular detected structural changes in the international economy since the 1950s. Harry Johnson (1970: 9–10) once made the point that:

> it is . . . important and necessary to recognize a crucial difference between the role of theory in the context of empirical research, and its role in economics generally. In the context of economics as an empirical science, the function of theory is to cast up empirically testable and refutable explanatory hypotheses, and the value of a theory is to be judged by its explanatory power in comparison with its rivals. In the broader context of economics as a systematic approach to the understanding of economic phenomena and as the organization of disciplined thinking about these phenomena and about policies relating to them, however, the purpose of theory is to abstract from the complexity of the real world a simplified model of the key relationships between dependent and independent variables, and to explore the positive and normative implications of changes in the 'givens' of this hypothetical system . . . The theory of international trade has always been primarily theory in the second sense.

However, since the above was written, the body of theory and knowledge of actual trade structures have been significantly expanded, as Part III will show, such that this judgement now requires some modification.

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Contents

	List of Tables	vi
	List of Figures	viii
	Acknowledgements	ix
	Preface	xi
Part I: Trade and the International Economy		**1**
1	Boundary-transcending technologies, trade development and the micro-structural activities of firms	4
2	Borders, national industrial structures and international trade relations	25
3	The changing parameters of external trade: the integration and growth of the international economy in historical perspective	51
Part II: General Theoretical Approaches to the Explanation of Trade Flows		**127**
4	Methodological aspects of conventional explanations of international trade flows	130
5	The classical concept of comparative advantage: the cosmopolitan model of national industrial specialisation and international exchange	149
6	The neo-classical Heckscher-Ohlin theory	178
7	Post-Leontief orthodox trade explanations and models	203
Part III: The Structural Transformation of the International Trading System and Analyses of Specific Economic Relationships		**225**
8	International 'competitiveness' and 'revealed' comparative advantage	229
9	Modern industrial trade structures and their new orientations for trade theory	242
10	The analysis of dependent trade relationships as an outcome of international exchange	259
Appendix	The fragmentation of sovereignty: countries of the world by region, year of independence, and size of population	283
	Bibliography	287
	Index	317

All italics used in quotations are original to their respective authors.

Tables

1	Cost of round trip voyage per 1,000 tons of cargo capacity by steam and sail, various dates and trades	11
2	A comparison of the savings in marine miles effected by the Suez and Panama routes between specified destinations	13
3	The international locations, acreages and types of cultivation undertaken by the United Fruit Company, as on 30 September, 1913	19
4	Approximate dates of the principal leading industrial sectors in Great Britain and the United States, 1783–1972	21
5	Trade ratios of 121 countries in 1975 as measured by the rounded averaged percentages of their exports and imports to their GDP	30
6	Principles of a power policy using foreign trade as its instrument	35
7	Central government current expenditure on goods, services and transfers as a percentage of GDP for 15 industrial countries, 1950 and 1977	36
8	Subsidies as a percentage of GDP as shown in the national income accounts of seven industrial countries	37
9	The international economic structure, 1870–1977	43
10	The number of colonies established and terminated per year and the net change during the upswings and downswings of the first and second waves of colonialism, 1415–1969	44
11	Intra-area British Empire trade as a percentage of total trade, 1892–6	48
12	Real GNP per capita trends of major economic regions of the world and intra-group gaps, 1750–1977	49
13	Estimated slave imports into the Americas by importing region, 1451–1870	59
14	A comparison of the extent of intercontinental trade by century, 1500–1800	67
15	Approximate geographic distribution in 1860 of exports from selected countries	70
16	World railway mileage opened per decade, 1840–80	72
17	World intercontinental migration, 1821–1932	74
18	Principal nations participating in world trade in 1820, 1840 and 1860	76
19	Nineteenth-century trade and the less-developed countries (a) Percentage of total imports accounted for by the largest product in selected countries in 1860 (b) Selected exports of various countries	79
20	World exports by geogaphical region, 1876–1913	85
21	Exports from the undeveloped world, 1883–1913	93

22 World trade composition, 1913 and 1953 97
23 Relative changes in average tariff levels in certain European countries, 1927 and 1931 101
24 Proportions (by value) of imports in 1937 subject to quota restrictions or licences in certain European countries 104
25 The foreign trade of less-developed countries, 1900–70 108
26 Imported intermediate good content of production and exports, 1959 and 1970 109
27 Distribution by area of the increase in industrial countries' trade in manufactures, 1955–1973 110
28 International trade by commodity groups, 1972 111
29 Networks of foreign manufacturing subsidiaries of 315 multinational companies, 1950 and 1975 114
30 Managed trade by country, 1974 and 1980 118
31 US textile quotas for selected exporters, 1956–75 119
32 NIC manufactured exports, 1973–9 121
33 A Ricardian comparative advantage example in terms of the number of labour hours required to produce one unit of cloth and one unit of wine in England and Portugal 157
34 Domestic capital and labour requirements per million dollars of US exports and competitive import replacements 200
35 Intra-regional trade as a percentage of total trade, 1958 218
36 Distribution of export commodities by growth category, 1955–1968 233
37 Consistency of the relative market share and export/import ratio indicators of comparative advantage 237
38 OLI characteristics that may vary according to country, industry, and firm-specific considerations 256

Figures

1	Production functions per million ton-miles, voyage 5,000 miles length, 1855, 1865, 1872, 1881, and 1891	11
2	The multilateral nature of the world trade settlement pattern, 1910	86
3	The pattern of African colonisation	89
4	The zone of profitable international exchange	158
5	The determination of the terms of international exchange	161
6	Hyperpolic exchange	172
7	Product factor intensity	183
8	Factor intensity reversal	184
9	The Edgeworth box of production	186
10	The derivation of national production possibility curves from national Edgeworth boxes of production	187
11	Community indifference curves	188
12	The closed economy general equilibrium product-mix	189
13	International trade equilibrium	191
14	Factor price equalisation	196
15	The dynamic expansion path of the production possibility curve and its trade implications	199
16	The product-cycle curve, and the characteristics of its phases	211
17	Two-way trade as determined by reciprocal export price ranges	248

PART I

Trade and the international economy

> Distinctive economic structural strengths and weaknesses as well as political ideologies and even cultures give the major individual players in international trade policy differing objectives, approaches, and domestic constraints on foreign commitments.
>
> Cline (1983: 220)

> A nation is a political unit, but it is only as a consequence of its political unity that it becomes an economic unit
>
> Hicks (1959: 162)

> International economic intercourse . . . confines the freedom of countries . . . by embedding each country in a matrix of constraints.
>
> Cooper (1968: 45)

> The state . . . is not an isolated unit, but lives in an environment of other political organisms, and its external activity is conditioned by this fact.
>
> Beer (1908: 1)

The study of international exchange involves the causal investigation of particular activities which necessitate the crossing of national territorial borders and an assessment of their geographical impact. These activities include:

On the production OUTPUT side the inter-country transfer of goods and services, of which:
(a) *Visible trade* constitutes trade in primary (raw material) and secondary (manufactures/processed) industrial products; and,
(b) *Invisible trade* includes the provision of services (such as transport, insurance and banking) to promote visible exchange; unilateral financial transfers (aid and migrants' remittances); and international tourism.

On the production INPUT side the international circulation of the means of production as a result of:
(a) labour migration, whether at the managerial, skilled or unskilled levels; and
(b) inter-country capital movements and investment flows.

Orthodox trade theories specifically exclude the latter types of international transfer and concentrate on the former, thereby ignoring the possibility that such resource transfers may promote or substitute for visible and invisible exchange. As Kojima (1975: 4) has generalised with respect to capital flows:

> if foreign investment is complementary to product trade, it creates and/or expands the opportunity to import one product and to export the other product ... [and] is trade-creating or trade-oriented.
>
> Symmetrically, if the initial capital outflow decreases or eliminates the opportunity to import one product and to export the other product ... foreign investment 'substitutes' for product trade and is thus 'trade-destroying' or 'anti-trade-oriented'. This is the case ... when ... foreign investment induces ... competitive production in the host country.

Actual inter-country product flows and resource shifts occur within a real world context of five populated continental land masses (Europe, Asia, Africa, the Americas and Oceania) set in seven seas (the Arctic, North and South Atlantic, North and South Pacific, Indian and Antarctic Oceans) each continent being differently arranged by latitude within a specific spectrum of natural climates that ranges from the polar, the cool temperate, the warm temperate, to the dry climes of steppe and desert, and the differing tropical climates of the savannah and the equatorial rain forest. Each interstitial country is further differentiated by its individual topography, historical heritage and degree of economic development.

Economists as contemporary theorists, applied technicians, historians or policy advisors are necessarily interested in many separate, but interrelated, levels of analysis of the interregional international exchanges within and between the above continental land masses, whether such interchanges are given a historical, contemporary or futurist focus. As theorists, they are interested in the notional abstract properties of isolate, pre-trade, 'closed' economies, as compared with the alleged theoretical niceties, both positive and negative, that arise when economies are 'open' to trade. As applied technicians and/or historians, they desire to examine empirically propositions that purport to relate to the reality of why trade has taken place, either in general or in particular, in the past and why it is taking place in the present. As policy advisers, they seek to provide, from the viewpoint of a particular national interest, *ex ante* guidelines for the establishment of trade and development strategy objectives. Finally, from the cosmopolitan supranationalist viewpoint, economists need to provide a paradigm model of international political economy towards which attempts may be mounted at a multinational level to correct, by interventionist engineering, 'unfair' competitive differentials, trade asymmetries and other market imperfections in satisfaction of some proposed world welfare criterion.

Whatever the focus of the analysis attempted, the operational significance of geo-political boundaries and the potential geo-economic domains of production activity, within which internal patriate and externally owned economic resources may circulate, cannot be ignored. Their importance and degree of conflict of interest are conditioned by the net impact of three basic groups of factors enumerated in Chapters 1 and 2: facilitative boundary-transcending technologies; basic micro-structural forces that shape the actual gains from trade; and circumstantial macro-structural factors that determine any country's particular trading propensity.

The above factors have to be appreciated within the changing context of international economic history to which theories must relate, and, according to which, be refined. Chapter 3 attempts to outline the changing parameters in which external trade has taken place. While some quantitative aspects of each phase of that history are included and some qualitative features highlighted, the outline provided is not intended as a complete economic history, but as a thought-orienting framework, from which the various theories of exchange discussed in Parts II and III may be approached, and to which their particularities of outlook and interpretation may be subsequently related. The outline is eclectic and adopts neither a 'presentist' (see Seidman 1983) reconstructive perspective, in which events are asserted to be organised in a continuously cumulative systematic way, nor a 'historicist' perspective that assumes discontinuities between each time-phase as a result of changing problems and subject matter.

1 Boundary-transcending technologies, trade development, and the micro-structural activities of firms

> An industrial system comprises the operating units i.e. the actors, the functional relationships between those units, and the interactions between the units and the external environment.
>
> Hamilton and Linge (1979: 6)

Given that the oceans of the world 'cover nearly three-fourths of the earth's surface [and that] when from the remainder are subtracted those sections which are entirely unsuitable for economic development because of unfavourable relief ... the agricultural, extractive, and manufacturing industries [are confined] to approximately a tenth of the earth's total area' (Donaldson 1928: 10), it is evident that improvements in transport and communication technology are a *sine qua non* for trade development. The internal integration of geographical areas that became countries and their development of external trade relations required the conquest of the oceanic and terrestrious frictions of time and space that otherwise isolate land areas and continents, and circumscribe both their capacity for trade and the effective, but separate, operational domains of governments and economic actors. Every improvement in transport and communication technology promotes an effective geographical extension of the market area that can be supplied with goods and services and the area from which raw material and other production inputs can be sourced. Each new discounting of the above-mentioned frictions makes trade technically more feasible in terms of ease of business operation and a lowering of the associated transaction and information costs involved. Every such development, whether it results from greater transport accessibility on or through land, by sea or in the air; or personal contact via postal, telegraphic, telephonic or telecommunications; or changes in allied technologies, such as cargo-packaging and preservation techniques, becomes an invariable prelude to changes in the territorial division and specialisation of labour; the volume, ubiquity and variety of trade; and the geographical extent of supportive multi-country commercial networks that are established. These improvements encompass a series of economy mutations now discussed.

ECONOMY TYPES, TRADE DEVELOPMENT AND THE OPERATIONAL DOMAIN OF PRODUCTION

With respect to the main geographic progression of bounded economy operation contained in the historical sequence of trade development, Bücher (1893) has outlined three basic mutations, to which Donaldson (1928: 68–73) has added a fourth, each stage describing the largely self-contained domain within which the circulatory process of production, exchange and consumption is normally completed:

1. *The independent domestic economy*: where the family, or extended family such as the tribe, limits the circulation process.
2. *The town economy*: where there is some functional division of labour on an inter-industry basis, but where it remains largely absent at the intra-industry level.
3. *The national economy*: where, following the advent of what is generally referred to as the Industrial Revolution, industrial specialisation takes place between regions and division of labour occurs within industries. Areas necessarily produce more of their specialized product than they can consume locally. The economy is based upon an intra-national, inter-regional interchange of products. It must be emphasized that the boundaries relevent to this economy type are not necessarily always those of the national state, for economic life within geographically large states may be regionalised to the extent that they envelop more than one effective economic system. So it is that the economy of Brazil is thus segmented, and the Pacific seaboard of the United States partially segmented from the centre and east by mountains, deserts and arid plains (Edwards 1980: 117–8). Indeed, these circumstances often obtain in federal states, where the policies of provincial governments may make 'the discontinuity of economic relations ... as marked, or even more clearly marked, at the borders of each state as at the borders of the federation (Svennilson 1960: 3).
4. *The world economy*: where there is such a degree of 'industrial interdependence of nations' that few of them 'could long subsist, at least without radical and even violent rearrangement of their entire economic structures, and [would suffer] general economic decline, were their foreign trade totally stopped' (Donaldson 1928: 69). It is, of course, possible for 'enclave economies' to exist within a country largely separate from its surrounding area that are world economy directed: for example, free trade zones, free ports, and colonial economic bases.

At each progressive stage of economy development, according to North (1984: 263), the resources devoted to the organisation and integration of the production and marketing of goods and services to 'capture the gains from trade' will tend to become a growing proportion of total costs and increase the size of the transaction sector for three main reasons:

> First, growing specialization and division of labor means an ever-increasing number of exchanges, each of which requires specification and enforcement, necessary whether across markets or within firms. Second, the cost per exchange tends to rise as impersonal exchange replaces personal exchange. And third, government's increasing control over property rights enables groups that acquire influence over decision-making governmental bodies to *raise* the cost of transacting to other parties to exchange and thereby redistribute income to themselves.

The transaction sector includes not only the wholesale and retail trades, banking, finance and insurance, but also 'the expansion of legal, accounting, personnel and marketing departments'. Much, however, depends on 'the role of government as an impersonal third party to specify and enforce contracts' (North 1984: 255).

Naturally, the stages of evolutionary progression outlined are neither completely discrete nor spatially synchronic within or between countries: a lack of 'perfect morphological coordination' of territorial development (Donaldson 1928: 619) is necessarily to be found at any one time. Indeed, the initial process of world economy formation began in some countries while their town economies still predominated, because internal topographical difficulties made it much easier for coastal trade and certain types of high-value low-bulk oceanic trade to develop prior to the unification (and even the settlement) of their geographical interiors and the creation of national markets by inter-regional linkage of local markets. The internal frontier of trade development tended to remain difficult to extend until the advent of railways, until which time economic frontiers were often technically more significant between provinces and towns within countries, rather than around countries.

The impact of the various nineteenth-century transport, industrial and commercial revolutions and their twentieth-century consolidation has been to change the operational nature of the firm corresponding to the market extension from the independent domestic to the town, national and world economy stages, its evolutionary progression being from a single to a multiple unit/function/location/market production entity, as the 'industrial action space' within which it derives its inputs and undertakes its production activities and the 'commercial action space' (Hamilton and Linge 1979: 9) within which it markets its products are both extended. Economy stages 1 and 2 outlined above exemplify different levels of closed economy development, and stages 3 and 4 of open economy development. Production organisation in the former stages can be either on a single product, single-plant basis, where all the output of firms is sold to consumers in that economy who also purchase all their goods from these same firms (Dunning 1974: 577); or on a multi-plant, multi-product basis within the same overall geographical constraints. Stage 3 corresponds with Dunning's 'Open Economy Stage I' (which might be called the international stage), where 'the market for any given product can be supplied by firms producing outside [the economy] and ... firms located in the [economy] can export part of their output' – exchange is between different firms in different countries (Dunning 1974: 578). Stage 4 corresponds with Dunning's 'Open Economy Stage II' (which might be called the transnational stage (Dunning 1974: 579) when firms diversify not only their markets across national boundaries, but their production facilities as well: international exchange becomes denationalised, being essentially trade between parts of the same corporate body operating in two or more different country locations.

In practice, the organisational nature of the transnational firm in Stage 4 can become quite intricate, as Edwards (1960: 118) has indicated:

> One business undertaking may express itself in a considerable number of corporate entities bound together with varying degrees of tightness by ownership, common management, and communities of interest created by contractual arrangements. The linkage among these corporate entities is sometimes so complex as to arouse dispute as to where the boundaries of the undertaking are located.

World-wide integrated communication systems, once established, enable global intra-firm internationalisation of inter-country exchange to take place and 'economic and technical progress [to] burst through the narrow boundaries drawn by monarchs and nationalists in the eighteenth and nineteenth centuries' (Rustow 1967: 212). This has the consequence that:

> different aspects of production, once integrated within the same work unit and work place, are . . . 'emancipated' to be carried out in different places. . . Firms are not so limited . . . by the necessity of carrying out the entire production of a product in one country; further, they are not constrained to carry out within one workplace different processing phases which might profit from work at several different locations. [Caporaso 1981: 375–6.]

Thus world economy production involves an internationally dispersed network of plants, each owned by the same firm, within which production circulates often from the raw material stage, through the various processing and assembly stages to its end-product forms. Individual plant specialisation is based on a central management plan, rather than national factor endowments or competitive conditions. The prices of such inter-country exchanges are company-determined rather than market-determined, such transnational sector integration challenging the very significance of the nation-state as the focus for the analysis of external trade and resource transfers.

Furthermore, 'as in the case of the firm, there has been a transsubstantiation of the nation-state over the last century' (Paquet 1972: 7). Using the three-stage development of the nation-state proposed by Byé (1959: 4–9) – from the 'nation-as-a-firm', to the 'nation-as-a-block-of-factors-of-production', to the 'nation-as-a-group-of-groups' – Paquet emphasises how each stage corresponds to 'new partitionings, new links between parts, and new rights sanctioned by the social contract between individuals and the pact between the leaders and the led' to indicate that the state too is an essentially adaptive organisation:

> the Mercantilists identified the national community with the state and the state with the king: this simplified greatly the problem of reconciling individual wants with the public interest, since for all practical purposes, the valence of individuals was negligible. For a laissez faire ideology, the mercantilistic notion was unacceptable. The nation was a block of factors of production more or less immobile and subject to the same set of collective rules. However, the valence of the individual parts was heightened, and the pact between the national leaders and the citizens left the former with very limited rights.
>
> The modern notion of nation is more 'social': each transactor may pursue his goals alone, but he soon realizes that it would be highly inefficient. Consequently, in the same way as he found it useful to form production clubs like the firm, he also finds it convenient to enter into a number of other associations with other transacters. . . The nation-state constitutes only one of these clubs, although it is also simultaneously an envelope for families of smaller-size clubs. The nation is therefore subject to a dual series of pressures as a result of any revaluation of the importance of the national clubs, and their preferences or as a result of the restructuring of the component clubs [Byé (1959: 4–9), and see Olson 1965].

All the above mutations, however, were only possible as a result of the forging of and improvements in transport and communication links on a global scale.