Volume Title: Globalization in Historical Perspective

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Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-06598-7

Volume URL: http://www.nber.org/books/bord03-1

Conference Date: May 3-6, 2001

Publication Date: January 2003

Title: Introduction to "Globalization in Historical Perspective"

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URL: http://www.nber.org/chapters/c9583

Introduction

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Overview

Modern globalization has been a recognized force around the world for at least three decades. Academic journals, newspapers, television specials, and political discourse are dominated by globalization events, and their impact seems to be ubiquitous. For most it is a good force, but for a very angry minority it appears to be a bad force. One would have thought that the terms of a force so important would be well defined, its impact understood, and its historical evolution appreciated. This hardly seems to be the case, especially concerning the economic dimensions of globalization, and so this collection of essays attempts to fill an important gap.

Defining Terms

We should begin at the beginning. What do economists mean by the term *globalization*? What is included on their agenda when they debate globalization issues? Typically, their agenda is defined by between-country integration in three markets.

First, there are commodity markets. Here, the debate is about the cause of trade, the impact of trade, and the political determinants of trade policy. As for causes, what determines how much is traded between partners? What are the political, geographic, language, and institutional barriers to trade? What have been the relative contributions of more liberal trade policies and

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transport revolutions to lowering the barriers to trade? How much of the ongoing trade boom is simply due to fast world economic growth since 1950? As for impact, the questions revolve around specialization, structural adjustment, and distribution. Since the whole point of trade is specialization, the key question here is which industries advance and which retreat in the face of foreign competition. Are the trade gains big or small, and how are they manifested by cheaper and better goods for consumers? How do economies make the supply-side adjustment? Who gains and who loses? What happens to resources thrown out of work by the collapse of a domestic industry that cannot withstand the winds of foreign competition, and do they find alternative employment quickly? Do institutions and government policies tend to minimize the losses by transferring some of the gains from the winners to the losers? Finally, what about the political determinants of trade policy? How do constituents communicate to their political representatives, how do politicians interpret that information, and how do they act on it? Under what conditions would one expect political backlash to globalization?

Second, there are labor markets. When migration is open and free, who does the migrating and why? What are the economic and demographic conditions that matter most in source and destination? What impact does the migration have on the sending and receiving economies? Which residents gain and which lose with a rise of foreign immigration and domestic emigration? What happens to migration flows when restricted by policy? And what is the source of the policy restriction? It should be clear that many of the questions raised about trade and commodity market integration apply here to migration and labor market integration. Indeed, how do the two interact? Is trade a substitute for or a complement to migration?

Third, there are capital markets, where the same questions apply that were just posed for labor markets. In addition, however, global capital market integration raises even more questions. Here are some: What causes global capital market crises? Does integration cause contagion between markets, so that one country's irresponsible policies spread more easily to another country, no matter how responsible? Does a globally integrated world economy ensure that capital flows to poor countries? Do borrowing countries then lose their ability to control their economies? Alternatively, is there a "race to the bottom" as countries try to attract more capital by offering tax advantages and eliminating social welfare programs? Do foreign investors then extract all the gains, or do the host countries get their fair share?

These are the issues that define globalization in this volume. We are aware that this definition excludes much that also matters. It ignores the transmission of disease by traders, so it cannot speak to the twenty-first-century AIDS/HIV epidemic sweeping Africa and Asia. Nor can it address the fourteenth-century European plagues that arrived on ships plying the Asia trade, or the destruction of fifteenth- and sixteenth-century native American populations by smallpox, syphilis, and other European diseases. It pays little attention to the transmission of technology, and thus may miss one of the more important determinants of modern economic growth. It ignores any environmental damage thought to be the result of globalization. It fails to value any loss of native language and culture thought to be the result of globalization. We do not assert that these events are unrelated to globalization, or that they are unimportant. We simply think that, as economists, we are better equipped to resolve the other issues first.

History Matters

The essays in this volume take the long view. Globalization is not a new phenomenon. It pays to seek explanations that can account for more than just global events since 1950; they should also explain global events between 1820 and 1914, and even during the three centuries after Columbus and da Gama started their voyages from the Mediterranean. The long view has another value: The impact of globalization simply cannot be assessed over a year, a decade, or even two. Furthermore, if we fear that the violent political reaction to globalization seen recently in Seattle, Ottawa, Gothenberg, and Genoa might cause a political retreat from liberal policy, then it would pay to look carefully at the twenty years or so before World War I. Then, under popular pressure, immigration restrictions were passed eventually by both houses of the United States Congress, and tariffs were on the rise almost everywhere in the economies of the periphery and also in parts of the core. It would also pay to look carefully at the interwar years when the world moved sharply away from openness and toward self-sufficient autarky, with expanded trade protection everywhere, increased barriers to labor and capital mobility, and widespread monetary and financial dysfunction. Presumably, these experiences might speak to the future possibility of another globalization backlash.

The Papers

The essays in this volume fall into three parts. The first asks how the progress of globalization should be measured. Three chapters document the extent of market integration across time and space in goods, labor, and capital markets. The second places this knowledge into a wider context. Two chapters look at the relationship of globalization to the convergent and divergent outcomes that have occurred within and between nations. Divergence having been the more predominant outcome, two more chapters look globally at the nonuniformity of technological efficiency and the agglomerative forces of economic geography. The third part of the book examines the role of the financial sector in globalization. These essays explore world exchange rate regimes, financial development, financial crises, and the architecture of the international financial system.

Part I: The Rise and Fall (and Rise) of Market Integration

Ronald Findlay and Kevin O'Rourke (chap. 1) examine five hundred years of trade in goods markets to assess the state of integration today in light of history. Their focus is on intercontinental commodity trade, for this is the trade that distinguished post-Columbian globalization from earlier epochs, and it is also the source of the most consistent data with which to assess changes over time. Volumes of trade and prices of trade goods can both tell stories about market integration under different auxiliary assumptions, but here each tells a coherent and complementary story. Trade grew slowly from 1500 to 1800, and price gaps between markets remained large. If transport costs did decline then, it was only a little and was likely offset by the mercantilist bent of the imperial trade regimes.

The nineteenth and twentieth centuries represent a marked break with the past, when trade's weight in the world economy scaled new heights and prices converged dramatically, with the process reaching its first crescendo around 1913. On that basis we can date the globalization of trade as a modern phenomenon of the last two centuries, a statement that may seem unremarkable but will stir some controversy among early modern historians. Perhaps the more remarkable finding for economists, however, is the suggestion that, after an interwar hiatus, the postwar reintegration may have brought us to a point where transport cost and tariff barriers together still impede the flow of goods more than they did on the eve of World War I.

Barry R. Chiswick and Timothy J. Hatton (chap. 2) face a lesser challenge in trying to convince us that today's global labor market is less integrated than its pre-1914 predecessor. Drawing on 400 years of global labor market history, they focus on the causes and consequences of migration in five different eras: (a) the migrations of mostly coerced slave and contracted indentured labor between 1600 and 1790; (b) the early free migrations up to 1850; (c) the mass migrations between 1850 and 1913; (d) the cessation of international migrations during the World Wars and in between; and (e) the modern era of "constrained" mass migration since 1945.

Opportunities for improving living standards drive the migration decision. The trick for the analyst, however, is to isolate the economic, social, and demographic fundamentals that underlie those decisions. Chiswick and Hatton identify those fundamentals and then note that changes in the structure of the world economy have radically altered the direction of the flows since 1945: European outflows dwindled, Latin America switched from destination to source, and new emigrants increasingly flowed out of Africa, Asia, and Eastern Europe. The likely complementarity of migration to globalization in goods and factor markets, and the "permissive" slant given to policy during times of rapid wage growth and labor scarcity in the Organization for Economic Cooperation and Development (OECD), may explain the recent resumption of flows on a scale not seen since 1914. Even so, the current efforts by rich receiving countries to stem the tide of low-skilled immigrants—since they pose the greatest threat to domestic inequality—are likely to continue. Given the size of global disparities, however, the OECD is likely to have limited success.

Maurice Obstfeld and Alan M. Taylor (chap. 3) survey the development of international capital mobility since the mid-nineteenth century. They document the long U traced out by the creation of a well-integrated global capital market by 1914, its collapse during the interwar years, and its resurrection since 1970. This description is enhanced by reference to the open-economy "trilemma" faced by policymakers when choosing between capital markets, domestic monetary targets, and exchange rate regimes.

Obstfeld and Taylor examine a wide array of new evidence, including data on gross asset stocks, interest rate arbitrage, real interest differentials, and equity-return differentials. On all measures examined, the degree of international capital mobility appears to follow this U pattern, being high before World War I, low in the Great Depression, and high today. The debate over whether global capital mobility is greater today than it was on the eve of World War I may never be resolved, and no such attempt is made in the chapter. However, the authors do suggest that world capital may have flowed more easily to the poorer countries before 1914 than it does today.

Part II: The Great Divergence, Geography, and Technology

J. Bradford DeLong and Steve Dowrick (chap. 4) examine the relationship between the persistence of global disparities and the rising forces of globalization. Specifically, they examine inequality in technology, capital intensity, and per capita incomes at the national level, a place where enormous gaps have opened up. Although one or another subgroup of economies has from time to time enjoyed convergence in all these dimensions—notably the poorest countries within the OECD—much of the world has remained stubbornly outside the process.

Mapping the "convergence club" over two centuries shows how its membership has changed over time and also how it correlates with the major ups and downs in globalization. The "great divergence" in incomes that began with the uneven spread of industrialization in the nineteenth century has only intensified on a global scale in the last one hundred years, and nations today occupy "the most unequal world ever seen." However, levels and trends tell different stories, and recent positive news, especially from China and India, suggests that more countries are now closing the gap, or climbing on the "escalator of modern economic growth." The explanation of these recent trends is still contested, but the authors conclude that a combination of poverty traps and antigrowth policies held back the poorest countries, and that openness was a positive but by no means uniform brake on between-country inequality.

Peter H. Lindert and Jeffrey G. Williamson (chap. 5) expand the debate over global disparities by adding globalization's impact on within-country inequality. Over the very long run, they find no comparable divergence within countries associated with globalization. At the global level, international productivity disparities tell most of the long-run story. They also show, however, how changing within-country inequality in the short run has had important political influences in the past.

The nineteenth century offers some good examples. In the 1840s, the Anti–Corn Law League found vociferous support from working-class protests starting on the streets of Manchester. For labor-abundant, land-scarce European countries, free trade in that era meant cheaper foodstuffs from overseas, and this acted as an income-equalizing force by raising real wages of the laboring poor while reducing the land rents of the rich aristocracy. Conversely, the trade boom among land-abundant trading partners, like the United States, raised land rents relative to wages, moving income distribution in the opposite direction. By analogy we can expect offsetting movements in within-country inequality in different regions of the world at all times, whether trade is on the rise or not, and this helps us understand the flat within-country inequality trend worldwide and the important cross-country tensions it masks. For both proponents and opponents of globalization, the importance of the inequality question may depend on whether one's egalitarian philosophy stretches beyond one's national border. Since open countries seem to grow faster, and since growth seems to be shared equally among those in poor countries, there is every reason to believe that globalization is good, and good for the poor, too. However, that conclusion is strongest where the definition of global participation is most comprehensive.

Gregory Clark and Robert C. Feenstra (chap. 6) ponder the role of technology in the "great divergence" between nations. Various factors can combine to cause one country's level of productivity to be low relative to another: a low capital intensity, a scarcity of other resource inputs, or a low level of technology. Although capital, both physical and human, has been shown to play a role, the authors place technology at center stage.

Measured by total factor productivity, this factor varies enormously across countries, and explains most of the dispersion in productivity levels. Moreover, under assumptions of an open capital market, technological differences might also endogenously determine equilibrium capital intensities, which will also then be lower. Evidence can be adduced from a variety of sources across the twentieth century to make the case, such as sector studies of textile mills and railroads. More aggregative studies using trade flows to reveal the inherent differences in country-specific factor productivity provide independent confirmation, but whereas these differences are known to exist, their precise channels of operation and underlying sources remain mysterious.

Nicholas Crafts and Anthony J. Venables (chap. 7) examine another possible source of divergence in the world economy, the effect of increasing returns. The new economic geography has turned space into anything but a homogeneous area of evenly spread industries, inputs, outputs, and incomes. Initial conditions, transaction costs, and location matter a great deal in the new economic geography, and the power of cumulative causation can generate persistently unequal outcomes.

The authors use this thinking to explore the first great era of globalization, applying those historical lessons to the present. Looking first at the "Atlantic economy" of the late nineteenth century, they see benefits to explaining the rise of industry in the New World economies, particularly the United States, in this framework. Simple classical competitive models cannot account for the American "overtaking" in industry, which somehow overcame an initial comparative advantage that favored agriculture in 1800 to create a springboard for overall economic superiority in the "American Century" after 1900. However, in a new economic geography model—with monopolistic competition and positive feedback in manufacturing—economic scale and size of market are the keys to "Smithian" growth and agglomeration. This model helps us understand the seeming oddities of changing economic leadership in the short run, and it thus yields deeper insight into patterns of divergence in the long run.

Part III: Financial Institutions, Regimes, and Crises

Peter L. Rousseau and Richard Sylla (chap. 8) explore the links between domestic financial development, domestic growth, and international financial market integration. Historical accounts of the Dutch Republic, England, the United States, France, Germany, and Japan demonstrate that in each case the emergence of a domestic financial system jump-started modern economic growth. Indeed, using a cross-country panel of seventeen countries covering the 1850–1997 period, they uncover a robust correlation between financial factors and economic growth that is consistent with a leading role for finance, and, moreover, these effects were strongest over the eighty years prior to the 1930s.

By identifying roles for both finance and trade in the convergence of interest rates among Atlantic economies in the prewar period, Rousseau and Sylla show that countries with more sophisticated financial systems tended to engage in more trade and appeared to be better integrated with other economies. Their results suggest that both the growth and the increasing globalization of these economies depended on improvements in their financial systems.

Michael D. Bordo and Marc Flandreau (chap. 9) focus on international monetary regimes. They distinguish between the experience of core (advanced countries) and periphery (emerging countries). Before 1914, the core adhered to gold, while the periphery either emulated the core or floated. Some periphery countries were especially vulnerable to financial crises and debt default, in large part because of their extensive external debt obligations denominated in core-country currencies. This left them with the difficult choice of floating but restricting external borrowing or devoting considerable resources to maintaining an extra hard peg. Although advanced countries can successfully float today, emerging countries that are less financially mature are likely to fear floating: To obtain access to foreign capital, they may need a hard peg to core-country currencies.

Thus, the authors emphasize that the key distinction between core and periphery both then and now with respect to the exchange rate choice is financial maturity, making their approach complementary to the growth findings in chapter 9. They then develop their financial maturity hypothesis and present narrative evidence for the pre-1914 period of the different experiences of core and periphery in adhering to the gold standard and offer evidence from the past and present that suggests a strong link between financial maturity and the exchange rate regime.

Larry Neal and Marc Weidenmier (chap. 10) examine the history of financial crisis that accompanied the first phase of international financial integration laid out in chapter 8. Using a newly compiled high frequency database of short-term interest rates in the pre-World War I gold standard decades, the authors explore the interdependencies between financial markets in both the core and the periphery in periods of financial crisis. They interpret evidence of a weaker response of periphery countries to core-country shocks as being consistent with the presence of credit rationing. They test the effects of both increased interdependence that accompanied globalization and contagion that occurs independent of increased interdependence. They find little evidence for contagion in the crisis of 1873, but more in the crises of 1893 and 1907. They attribute this pattern of contagion to the presence of implicit capital controls.

Barry Eichengreen and Harold James (chap. 11) review the history of international monetary and financial reform in two eras of globalization, the late nineteenth century and the late twentieth century, and in the period in between. Their narrative is organized around the hypothesis that a consensus on the need for monetary and financial reform is apt to develop when such reform is seen as essential for the defense of the global trading system. In most periods, the international monetary and financial system evolves in a gradual and decentralized manner, largely in response to market forces. The shift toward greater exchange rate flexibility and capital account convertibility since 1973 is the most recent and therefore most obvious illustration of what is a more general point.

Throughout the period they consider, there has existed an abiding faith in the advantages of trade for economic growth, the principal exception being the 1930s. In contrast, there has never existed a comparable consensus on the benefits of open international capital markets for stability, efficiency, and growth. It follows that disruptions to capital markets that do not also threaten the trading system have had less of a tendency to catalyze reform. They test this hypothesis by confronting it with evidence from major attempts—successful, such as Bretton Woods in 1944, and unsuccessful, such as the London Economic Conference 1933—to reform the international monetary system.

Globalization in Interdisciplinary Perspective: A Panel

Following the papers, a round table on the Costs and Benefits of Globalization convened, chaired by Peter B. Kenen of Princeton University. Experts from different disciplines were invited to focus their attention on the themes raised by the conference papers in terms of the following questions: What are the benefits? What are the costs? Who wins and who loses? And what does the future look like?

The first panelist was Clive Crook, an editor of *The Economist*. Crook considered the possibility that globalization would be reversed by political forces in the advanced countries the way it was after 1914. He expressed concern that popular and political opinion had considerable support for the current crop of protestors. He discussed the fears, imaginary and real, that were capturing the popular imagination to some extent. These included falling real wages for the unskilled, general concern over economic security, and sympathy with the erroneous belief that globalization raises poverty in the Third World and undermines the capacity to pay for the welfare state. According to Crook, the evidence does not support most of these concerns. However, government officials do not generally acknowledge this evidence. Indeed, many have expressed sympathy for such views, offering inappropriate support for the proponents of political backlash.

Gerardo della Paolera, rector of Universidad Torcuato di Tella in Buenos Aires, reflected on the conference from the perspective of Argentina and other countries that are in transition toward opening up to the global trading and financial system. Della Paolera feels that it is crucial to understand the forces producing stop-go in those countries exploiting globalization as they try to catch up on the leaders. Thus, he makes a case for more research on the institutional development and political economy of globalization to understand why reforms became truncated and why such countries are led to import institutions wholesale from more successful countries.

Niall Ferguson, a historian at Jesus College, Oxford, considered some big issues not directly addressed by the conference papers. He argued that although the conference covered the flows of goods, labor, capital, and technology there was no discussion on the flows of knowledge, institutions, culture, and political systems. He stressed the importance of political globalization and its many dimensions, including the crucial role of empires and warfare in eighteenth- and nineteenth-century globalization experience. Ferguson noted that the global spread of democracy in our time has led to political fragmentation, civil wars, and corruption—forces that may act to impede globalization.

Anne O. Krueger, deputy managing director of the International Monetary Fund, reflected on the role of postwar U.S. economic policy in setting the stage for the last two decades of globalization. From World War II onward, policies toward developing countries that led to many successful outcomes were based on a consensus between cold warriors and humanists. This consensus has broken down with the end of the cold war, and Krueger worries about the influence of U.S. spokesmen and spokeswomen on the effectiveness of international financial institutions, nongovernmental organizations, and others who believe that globalization is hurting the poor countries. Krueger also contrasted the pre-1914 globalization era with the present one. For example, she argues that although the success of Germany in the pre-1914 era relied much less on access to the global economy, today's stars, as is illustrated by South Korea, have relied extensively on an open trading system to achieve rapid growth since the 1960s. Also in comparison to the earlier era of globalization, the high rates of per capita growth today in countries like Korea considerably minimized the losses borne by the groups of globalization losers.

Finally, Ronald Rogowski, a political scientist from the University of California, Los Angeles, assessing directly the costs and benefits and identifying the winners and losers. The benefits are global, whereas the costs are local. The key losers in today's advanced countries are unskilled workers. They are affected adversely by technological change, by international trade, by migration, by capital flows to emerging countries, and by their greater exposure to exogenous shocks. According to Rogowski, these are the groups that are increasingly turning to the political system in Europe and America to try to stop the global advance. However, he concludes that globalization in the advanced countries will not be derailed by such forces because median voters are net winners, and policies to compensate the losers will continue to be important.

Rogowski argues that the forces creating a divergence between winners and losers stressed in the conference—local economies of scale, human capital accumulation, technological change—may not be as important as bad institutions and bad policies. The fact that some major less developed countries, like China and India, are changing these policies raises hope for the future.

An Assessment

This book reveals just how much we now know about the globalization process, and it is impressive. It also reveals how much *more* we need to learn about the interaction of politics and economics. The better we understand the political economy of globalization, the better armed we will be to anticipate any future globalization backlash. History need not repeat itself if we understand the mistakes of the past.