

POLITICS AND TRADE: LESSONS FROM PAST GLOBALISATIONS

by
Kevin O'Rourke

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FOREWORD

It was in 1990 that McKinsey's Kenichi Ohmae published *The Borderless World*, one of the first books to popularise the notion of globalisation. We have been so accustomed to the concept that we tend to forget that less than two decades has elapsed since it started to shape our lives and to make its way into our vocabulary.

Historians, however, have repeatedly warned us against short memories, they have reminded us that there have been other periods of globalisation before, and they have highlighted how fragile what we had come to consider the normal state of the world economy could be. But somehow we have remained unconvinced: perhaps the first world war was too big a catastrophe for us to imagine that the current wave of globalisation could end in the similar way as that of the late nineteenth century.

Drawing on joint work with Ronald Finlay, Kevin O'Rourke broadens the scope of comparison through time and space. Having systematically explored the relationship between politics and trade over a millennium, he offers in this essay some lessons that do not rely on the analysis of a particular episode but rather on what he thinks are permanent features of international economic relations.

In a nutshell, his conclusion is that politics matters much more than economists tend to believe. In his words, 'the pattern of trade could only be understood as being the outcome of some military or political equilibrium between contending powers'.

This lesson comes at the right time. Within the space of a few months, the crisis has significantly altered the balance of power both within and across countries. Within countries governments have suddenly

become the essential players again, while seemingly mighty transnational firms suddenly look perilously fragile. Across countries, all the power projections based on the extrapolation of past trends have suddenly been called into question.

No one can predict how the new chemistry will shape the world of tomorrow, but what is clear is that, both domestically and internationally, politics is bound to play a much larger role than commonly assumed before autumn 2008. Whatever their intentions, governments are accountable to the people and this must have profound implications for their attitude towards globalisation: when taxpayers' money is injected into ailing banks or struggling companies, citizens naturally ask that this money serve to alleviate their pain, rather than that of another country's taxpayers. As to the cross-country dimension, the sudden rise of the G20 in place of the old G7 has already indicated how the crisis is accelerating the shift in the world power balance.

Talleyrand reportedly said that you can do everything with bayonets, except sit on them. O'Rourke suggests, in the same vein, that you can do many things with politics, except ignore it. In other words it is only by taking into account the interaction between economics and politics that the future of globalisation can be properly thought through. It is a lesson worth remembering.

*Jean Pisani-Ferry, Director, Bruegel
Brussels, February 2009*

POLITICS AND TRADE: LESSONS FROM PAST GLOBALISATIONS¹

The world has been experiencing a golden economic age in recent years. This may seem less obvious today than a year or two ago to the citizens of rich countries, worried about the consequences of their financial institutions' reckless behaviour. But those citizens constitute only a minority of the world's population, and the real action is elsewhere. Although the Crash of 2008 is now a worldwide phenomenon, it should not blind us to the rapid convergence towards the world's technological frontier which China has been experiencing since the 1980s, which spread to India in the 1990s, and which has improved the lives of countless millions of people elsewhere in the developing world. This convergence surely represents the greatest improvement ever in worldwide economic welfare. It is a phenomenon intimately linked with the worldwide spread of technology, and with the existence of a relatively open international trading system: in other words, with that much over-analysed and overhyped phenomenon, globalisation.

To many observers of the world economy, globalisation is a largely technological phenomenon, the product of new transportation and communication technologies, such as containers or the Internet. Once learned, new technologies are typically not forgotten, which is why globalisation can seem an irresistible force, destined to bind us ever more tightly together for the foreseeable future. History, however, suggests that globalisation is as much a political as a technological phenomenon, which can thus be easily reversed, and has been so in the past.

The short run threat to the international economy is obvious. As the

world moves deeper into recession, the way in which we view exports is turned on its head. From being a necessary evil, required to pay for imports, they now become a valuable source of demand, while imports become a threat to local employment. Even worse, when governments consider reflating their economies through fiscal stimuli, they may worry that their own expenditures will merely serve to boost incomes elsewhere by sucking in imports. As the Irish Minister for Defence put it on 4 January 2009²:

'We tried the fiscal stimulus approach in response to the oil shock in the late seventies. The increased spending power given to the Irish consumer largely leaked out on increased imports and left us in an even worse position. There is absolutely no evidence to suggest that the same thing would not happen again. [...] From Ireland's point of view, the best sort of fiscal stimulus are [sic] those being put in place by our trading partners. Ultimately these will boost demand for our exports without costing us anything.'

The incentive for individual countries to pursue protectionist policies is obvious, and a lot of the available historical evidence suggests that interwar protectionists were not completely irrational. For example, Clemens and Williamson (2004) find that in countries particularly badly hit by the Crash, high tariffs were associated with faster rather than with slower growth, other things being equal. One can well imagine that policymakers of the time would have been aware of this, without the benefit of regression analysis, and reacted accordingly.

However, the historical record also gives policymakers at least three compelling reasons not to give in to protectionist temptation. The first is that interwar protection was beggar-thy-neighbour, and that what might have been individually rational was collectively catastrophic, even in the short term. The second is that these beggar-thy-neighbour policies had disastrous political consequences, for example undermining the more liberal elements in Japanese politics, and strengthening militarism there. The third is that interwar tariffs and quotas created or strengthened powerful import-competing interests in many countries,

which often succeeded in locking in protectionism well into the late twentieth century, when it was certainly a long time past its sell-by date, whatever its impact on individual economies when pursued in isolation in the 1930s.

The main lesson of the interwar period is that if these dire consequences are not to come about, then getting the macroeconomics right is crucially important. Given the spillovers involved, this will involve effective, coordinated, multilateral action to stimulate the world economy, especially in surplus countries such as Germany and China, while avoiding the exchange rate misalignments and payments imbalances that have historically been such a cause of trade restrictions.

This paper is not about these short-run challenges, vitally important though they are. Rather, my aim is to point out that even if these challenges are successfully surmounted, which at the time of writing is not yet certain, there will still be powerful longer-run pressures which are also threatening the maintenance of a reasonably open international trading system. The goal of this paper is to provide some insights into these longer-run pressures by drawing on the history of international trade over the past one thousand years.

GEOGRAPHY, POLITICS AND TRADE

Economists have invested much time examining one major way in which globalisation can be undermined politically, even when macroeconomic conditions are favourable. The standard theory of international trade tells us that while trade may raise incomes generally, it produces both winners and losers. If the losers are sufficiently politically powerful, they may convince governments to impose protection. As we will see, this has happened in the past, and one of the major challenges facing today's policymakers is to ensure that it does not happen again in the future.

However, history also tells us that politics matters for globalisation in a far more fundamental way. In 2000, Ronald Findlay and I started work

on a history of international trade in the second millennium. We soon found that understanding this history was impossible without taking account of the geopolitical context within which trade occurred. Indeed, for much of our period we realised that the pattern of trade could only be understood as being the outcome of some military or political equilibrium between contending powers. The result was a book with a sustained emphasis on warfare, imperialism and slavery, which was finally reflected in its title (*Power and Plenty: Trade, War, and the World Economy in the Second Millennium*, Princeton University Press, 2007). Such an emphasis might strike some economists as odd or surprising, but would probably be regarded by most historians as a statement of the obvious. Much more importantly, it has implications for the way in which we think about the future sustainability of today's globalisation. International relations, it turns out, may be a more relevant discipline than economics for those wishing to understand what lies ahead for the world economy in the long run, once the present crisis is over.

The theory of comparative advantage tells us that regions trade with each other because they are different. At the start of the second millennium, different climatic conditions and resource endowments across Eurasia and Africa gave rise to a powerful basis for trade. To the west, the less developed regions of Europe and Africa had a comparative advantage in exporting that most labour-intensive of all 'commodities', slaves. They also had abundant forest products available, such as furs or amber in Europe, or ivory in Africa (which also had important gold reserves). To the east, China had a highly evolved and ancient civilisation, producing tea, but also a variety of industrial luxury goods such as porcelain and silk. The Indian subcontinent grew pepper, and had a well-developed cotton textile industry, while the spices, perfumes and exotic woods of Southeast Asia were greatly valued overseas. The land-abundant steppes of central Asia were the source of horses, while the Islamic lands of North Africa and Southwest Asia were highly diversified, productive and sophisticated economies.

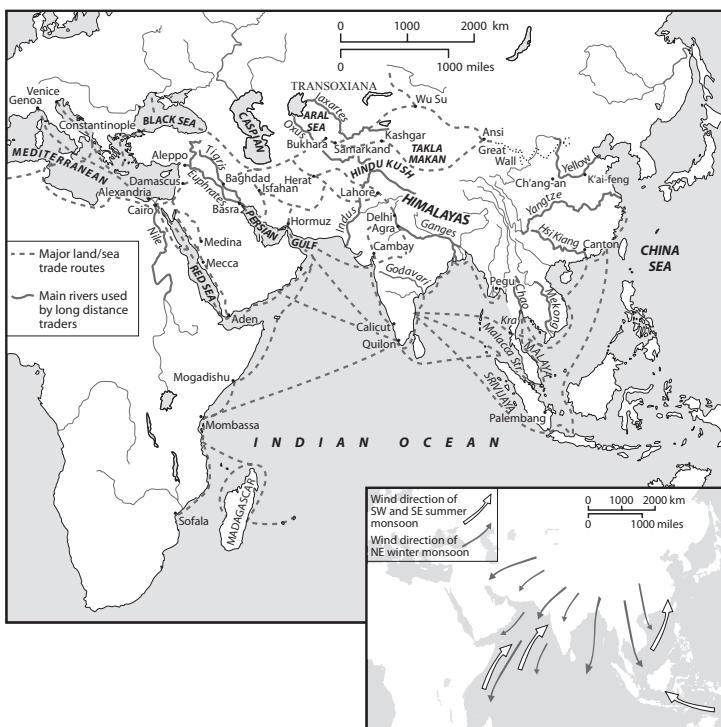
Clearly, all regions would potentially gain from trade, but the extent of trade depended on its cost, and for most of history trade costs were so high that they severely impeded interregional commerce. These trade

costs came – and still come – in two parts. First, there is the component defined by the available technology of the time. Transportation technology was so primitive at the start of the second millennium that none but the most valuable commodities could plausibly have been transported between the major Eurasian regions, even under the best of circumstances. In the early fourteenth century, for example, it took between eight and 11 months for merchants to travel from Crimea to China [Phillips 1998, p100]. However, for most of history it was the second, political and security component of transport costs which was the main constraint on long-distance trade.

A glance at the map makes it clear why (Figure 1, overleaf). There were two routes which could in principle connect the eastern and western extremities of Eurasia, the first overland and the second by sea. There were specific problems associated with each route. The major problem regarding the overland route was how to provide security for merchants as they crossed the vast expanses of Central Asia. This was of course easier when centralised political control existed over the region, or at least when Chinese, European or Middle Eastern empires extended as far as possible into the interior. As Edward Gibbon put it, ‘the waters of the Oxus, the Caspian, the Volga, and the Don opened a rare and laborious passage for the gems and spices of India; [...] But this land or water carriage could only be practicable when Tartary was united under a wise and powerful monarch’ [Gibbon 1907, pp122-23]. It is thus not surprising that regular overland trade stretching from China to the Mediterranean emerged for the first time after China had been unified under the Han, and powerful Roman and Parthian empires had been established at the western end of the trade routes [Curtin 1984, p90].

There were two major problems associated with the sea route. The first problem was technical, and concerned the monsoon winds, which blew from the southwest during the summer and from the northeast during the winter. These winds encouraged seasonal sailing, but also specialisation across the three main legs of the journey, from the Middle East or East Africa to India, from India to Malaya, and from Southeast Asia to China or Japan. The second problem was political, since as can be seen from the map there were two bottlenecks which impeded merchants

Figure 1. Eurasian trade: the land and sea routes



Source: Findlay and O'Rourke (2007).

wishing to sail between east and west. The first of these was the Malayan peninsula and Indonesian archipelago, and the second was the Arabian peninsula. Control over either bottleneck yielded substantial monopoly rents, and thus regimes in both regions used military power to levy substantial taxes on trade. These taxes could be avoided by trading along the land route, which was however only possible when the political conditions were right, or by circumnavigating Africa. The latter continent's north-south orientation, however, meant that European navigational techniques would have to be highly developed if they were to find a way around the Arabian bottleneck.

FROM THE PAX MONGOLICA TO THE PAX AMERICANA: A BRIEF GEOPOLITICAL HISTORY OF GLOBALISATION

It was in this context that the unification of the Mongol tribes of Inner Asia under Genghis Khan was so significant for the history of international trade. To the east, Genghis invaded China in 1211, although it took decades for Mongol rule to be established over the whole country. To the west, his descendants attacked Iran, Iraq and Russia, taking Kiev in 1240, and Hungary the following year. The result was a vast empire stretching across most of northern Eurasia, and which could therefore provide the security needed for long-distance trade to flourish.

According to a manual for businessmen published in the early 1340s, the *Practica della Mercatura*, the land route from Crimea to Beijing was ‘perfectly safe, whether by day or by night’ (Rossabi 1990, p356). Italian merchants took full advantage of the opportunities that this presented. This was the era not just of Marco Polo, and his Muslim counterpart Ibn Battuta, but of many other Italian merchants who settled in Persia and as far east as China. The Franciscan order built a *fondaco* in Quanzhou to house Catholic merchants, and a bishopric was established in the same town in 1323. Very strikingly, it seems that Europeans came to China not just to purchase traditional Chinese luxury exports such as silk, but Southeast Asian spices as well. This is a testament to just how efficient the overland route was during this period

(Abulafia 1987, pp447-48). According to Lopez (1987, p353), Chinese silk retailed in Italy at this time for no more than three times its purchase price in China, which if true is an extraordinary measure of just how well integrated the Eurasian economy had become.

Around the middle of the fourteenth century, the *Pax Mongolica* disintegrated. European merchants were expelled from China and the intervening lands. Eventually, the overland Asian caravan trade went into a steep decline. European scholars have tended to interpret this decline in technological terms, seeing it as reflecting the diminished competitiveness of overland trade when compared with the new Cape route pioneered by Vasco da Gama in 1498. However, Rossabi (1990) has argued persuasively that geopolitical turmoil in Asia was responsible, not any supposed lack of competitiveness on the part of the caravan trade *per se*. A disastrous series of events – the disintegration of the Timurid Empire, violent conflict between the Persians and Ottomans, the decline and fall of the Ming dynasty in China, and the subsequent struggle between its Manchu successors and the Zunghar Mongols – made trade extremely difficult. By contrast, once the Russians had succeeded in reaching the Pacific, thus establishing stable political conditions across the northernmost parts of Eurasia, the caravan trade once again became viable there. Geopolitics, not technology, remained the fundamental determinant of overland trade during this period.

The *Pax Mongolica* was a classic case of international economic integration that came about because of geopolitical factors and that unravelled once those factors were no longer present. Later globalisations may have had technological underpinnings, but favourable geopolitical circumstances continued to play an indispensable supporting role. To be sure, the century prior to Vasco da Gama's exploits saw a dramatic improvement in European shipbuilding techniques, with a burst of innovation combining the best aspects of northern European square-rigged ships and Arabian triangular lateen sails. Major advances in astronomy, geography, cartography and other fields relevant to navigation were also indispensable for the Iberian pioneers of the turn of the sixteenth century. However, another condition necessary for the expansion of European trade in South and Southeast Asia was the

European ‘comparative advantage in violence’, and particularly the effective use of cannon on board ships, as well as the disunity and rivalry that characterised the Indian subcontinent at the time. Nor can one discuss the expansion of early modern international trade sensibly without taking account of Latin American silver, which played such an important role in financing Eurasian trade. The success of the Iberians in extracting this silver obviously had everything to do with politics and military might, rather than being a benign and passive reflection of Latin America’s undoubted comparative advantage in silver production.

Furthermore, the *nature* of early modern globalisation was fundamentally influenced by the international politics of the day, and more particularly by the mercantilism which characterised the policies of all the major trading nations. A key feature of the period was the ‘Military Revolution’, involving a complex and interlocking set of developments in strategy, tactics, equipment, weaponry, fortifications, recruitment, training, and organisation of armies and navies. This gave rise to substantial military economies of scale, and placed enormous demands on governments to raise the revenue needed to remain militarily competitive. States who failed to do so risked not only falling behind their rivals, but disappearing altogether. ‘Plenty’ was thus necessary for ‘Power’, but ‘Power’ was also thought to be necessary in order to obtain ‘Plenty’.

In order to see why this was so, one needs to understand that during this period, for which we have no evidence of continuous improvements in maritime technologies after the achievements of the fifteenth century, international freight rates remained extremely high. It followed that it was only economical to transport very expensive commodities, with a high value-to-weight ratio, across the oceans of the world. More than a century after Vasco da Gama, no less than 80 percent of Portuguese imports from Asia consisted of pepper and other spices [Table 1, overleaf]. As late as the middle of the eighteenth century, the majority of English and Dutch imports from Asia and the Americas consisted of spices, tea, coffee, sugar, tobacco, and other commodities that either could not be produced in Europe at all, or could only be produced there with considerable difficulty. And the major export from Latin America during the early modern period was of course, as already noted, silver.

Table 1. Composition of European overseas imports, 1513-1780

Panel A. Imports from Asia to Lisbon, 1513-1610 [percent by weight]						
	1513-19	1523-31	1547-8	1587-8	1600-3	1608-10
Pepper	80	84	89	68	65	69
Other spices	18.4	15.6	9.6	11.6	16.2	10.9
Indigo		0	0	8.4	4.4	7.7
Textiles	0.2	0	0	10.5	12.2	7.8
Misc.	1.4	0.4	1.4	1.5	2.2	4.6
Total	100	100	100	100	100	100
Panel B. Imports of VOC into Europe, 1619-1780 [percent by invoice value]						
	1619-21	1648-50	1668-70	1698-1700	1738-40	1778-80
Pepper	56.5	50.4	30.5	11.2	8.1	9
Other spices	17.6	17.9	12.1	11.7	6.1	3.1
Textiles	16.1	14.2	36.5	54.7	41.1	49.5
Tea and coffee				4.2	32.2	27.2
Drugs, perfumes and dye-stuffs	9.8	8.5	5.8	8.3	2.8	1.8
Sugar		6.4	4.2	0.2	3.7	0.6
Saltpetre		2.1	5.1	3.9	2.6	4.4
Metals	0.1	0.5	5.7	5.3	1.1	2.7
Misc.		0.2	0.1	0.4	2.3	1.7
Total	100	100	100	100	100	100
Panel C. Imports of English East India Company into Europe, 1668-1760 [percent of invoice value]						
	1668-70	1698-1700	1738-40	1758-60		
Pepper	25.25	7.02	3.37	4.37		
Textiles	56.61	73.98	69.58	53.51		
Raw silk	0.6	7.09	10.89	12.27		
Tea	0.03	1.13	10.22	25.23		
Coffee	0.44	1.93	2.65			
Indigo	4.25	2.82				
Saltpetre	7.67	1.51	1.85	2.97		
Misc.	5.15	4.52	1.44	1.65		
Total	100	100	100	100		
Panel D. Estimated annual sales of colonial imports, England and Netherlands, 1751-4						
	Total sales (1000 pesos)		Percentage of sales			
			From Asia		Of total	
Textiles	6750		41.7		21.1	
Pepper	1100		6.8		3.4	
Tea	2800		17.3		8.7	
Coffee	1000		6.2		3.1	
Spices	1850		11.4		5.8	
Misc.	2700		16.7		8.4	
Total from Asia	16200		100		50.5	
			From America		Of total	
Sugar	8050		50.8		25.1	
Tobacco	3700		23.3		11.5	
Misc.	4100		25.9		12.8	
Total from America	15850		100		49.5	
Total overseas imports	32050				100	

Sources: Prakash (1998), pp36, 115, 120; Steensgaard (1990), p12.

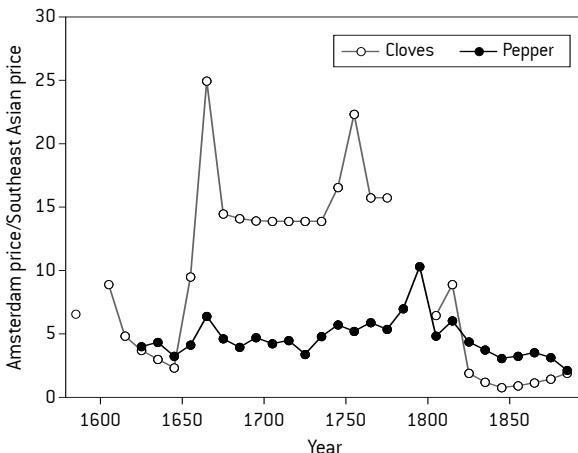
These commodities could bear the cost of transoceanic transport because of their high price – and thus ultimately because of their scarcity – in Europe. It followed that if a nation succeeded in monopolising the trade routes that were used to bring these commodities to Europe, or better yet the sources of supply themselves (as the Dutch succeeded in doing in the case of certain Southeast Asian spices), that nation could in principle earn vast monopoly rents by selling on these commodities to other European consumers at inflated prices. The Mamluk and Ottoman rulers of Arabia had been able to earn monopoly trading rents by virtue of geography, as had the early Sumatran state of Srivijaya. European nations, on the other hand, had to earn such monopoly rents by force of arms.

As Figure 2 [overleaf] shows, the rewards could be large. In the 1580s, when Asian spices still reached Amsterdam via Portuguese ships, or the traditional overland routes, clove prices were 6.5 times higher in Amsterdam than in Southeast Asia. The end of the war against the Habsburgs in 1648 enabled the Dutch to fulfil their long-standing ambition to completely control the production of this spice, with the result that the price margin rose to 9.5 in the 1650s and no less than 25 in the 1660s, before falling back to a level of around 14 or 15, where it would stay until the 1770s. As can be seen from the figure, these margins were far higher than Euro-Asian price gaps for pepper, a commodity that was grown across such a wide geographical area that no one nation could ever hope to monopolise its supply.

Of course, the Dutch Republic incurred high military costs in order to obtain these monopoly profits. One can certainly debate whether or not the benefits exceeded the costs. One might, for example, speculate that the existence of such profits induced military investment on the part of many European nations, with the extent of that investment depending upon the profits, and that on balance mercantilism was a losing proposition for the continent as a whole, and perhaps even for those countries which emerged successful in the struggle for markets and trades³.

A more important point, however, is that such a state of affairs was probably inevitable in the context of a competitive and unambiguously

Figure 2. Spice markups, Amsterdam versus Southeast Asia, 1580-1890



Source: Bulbeck *et al* (1998).

multipolar world, lacking anything even remotely resembling a collective security mechanism. One has to ask what the relevant counterfactual was for an individual European country contemplating a unilateral move to a peaceful free trading stance. Forceful exclusion from the colonial trades would seem to have been the most likely outcome. The result was a period of almost continual fighting between the major European powers, which systematically disrupted international commodity markets. Figure 2 shows the Euro-Asian clove price gap rising during the first and second Anglo-Dutch Wars, as well as the Seven Years' War. There is also widespread evidence of international market disintegration during other mercantilist conflicts, as well as during the world war which ended this period of world history, namely the Revolutionary and Napoleonic Wars of 1792-1815 (O'Rourke 2006).

The geopolitical system of the early modern period, based on European military superiority, thus implied that Europeans extended their trading activities around the world, and that maritime transport across the Atlantic and Pacific oceans gained in relative importance. It also meant, however, that international commodity markets were constantly being impeded by violent conflict. In this light, the great globalisation boom of

1815-1914 can be seen as being in large part due to the establishment of a new geopolitical order as a result of Britain's military triumphs over its main Western European rival, France, and the establishment of British naval hegemony over the oceans of the world.

It is also true that the main driving force behind the unprecedented nineteenth-century integration of international commodity and labour markets was the development of new steam-based transportation technologies as a result of the Industrial Revolution. In this respect, as in many others, nineteenth-century globalisation was an unprecedented phenomenon. The two crucial inventions were the steamship and railroad. Steamships were crossing the Atlantic by the 1830s, and regular services between all the continents had been developed within a decade or two. Moreover, the introduction of steamships was not a one-off shock to transport costs, but set off a continual decline in freight rates that would last for the remainder of the century, as a result of constant incremental improvements. Railroads were probably an even more important contributor to globalisation, given the fact that overland transportation had always been more expensive than transportation by water. Crucially, railroads linked farmers in the interiors of such vast continental economies as the United States, India and Russia with ports on the coast, from which their output could be exported to consumers on other continents. Between 1866 and 1870 it cost 17.2 percent of the Chicago wheat price to ship a bushel of wheat to New York, and 11.6 percent of the Chicago price to ship it on to Liverpool. By 1909-13, these transport costs had declined to 5.5 percent and 4.7 percent respectively [Harley 1980, 1990].

On the other hand, these new technologies would never have had the impact upon the world economy that they did had it not been for the favourable geopolitical conditions of the time. The establishment of a maritime *Pax Britannica* has already been mentioned, with the Royal Navy committed to keeping the oceans of the world free for all commerce. The mercantilist conflicts of the seventeenth and eighteenth centuries were now a thing of the past. At the same time, the Industrial Revolution implied a far more asymmetric world than in the past, with Europeans gaining an insuperable military advantage, in addition to

their economic one, over non-European rivals. The proportion of the earth's surface controlled by Europeans increased from 37 percent in 1800 to 67 percent in 1878, and 84 percent in 1914, as a result of such innovations as the shallow-draft armed steamboat, the breech-loading rifle, the machine-gun, and quinine. Broadly speaking, the European colonisers imposed free trade, or freer trade, upon their new possessions, and also invested in railroads and other transportation infrastructure. Indeed, their military dominance was so great that they were able to impose free trade even upon countries which remained independent, such as China and Japan. Imperialism was an important driver of globalisation during this period.

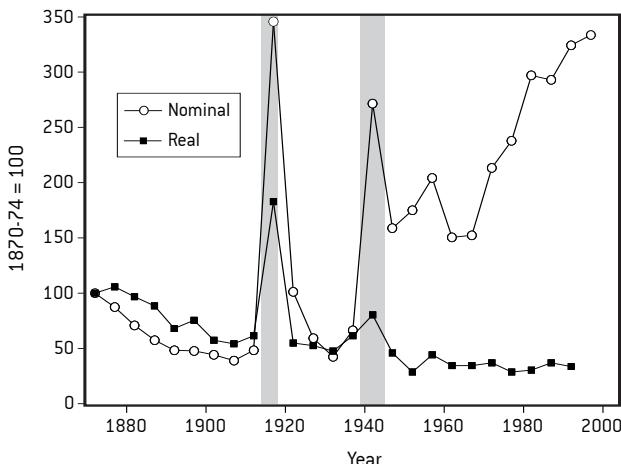
Nineteenth-century globalisation was thus a geopolitical as well as a technological phenomenon. The proof of this can be seen in the speed and extent of its dismantlement in the wake of 1914. Technological change did not grind to a halt in the aftermath of the first world war – quite the opposite. As Alexander Field (2003) has emphasised, the interwar period was one of unusual technological progress. The deglobalisation of the period was uniquely due to political factors: to the protectionist responses to the Great Depression alluded to earlier, and more broadly to the many domestic and international ramifications of the Great War. That calamity created protectionist constituencies in many countries by distorting the world economy so that particular sectors expanded in a manner that would be unsustainable in peacetime. For example, the wartime collapse of food production in Europe encouraged the expansion of food supplies overseas, which in turn would lead to oversupply and continual downward pressure on agricultural prices during the 1920s, causing widespread demands for agricultural protection. The belligerent economies expanded their heavy industries during the war, only to find themselves with overcapacity afterwards. And new industries outside Europe, which had emerged to provide substitutes for missing imports of European manufactures, often found themselves in trouble once normal conditions re-emerged.

There were thus many potential domestic sources of protectionist pressure around the world after the war, and the governments facing these pressures inhabited a world where the geopolitical situation was much

more complicated than it had been during the nineteenth century. The war led to inter-Allied war debts, and reparations owed by Germany to the victors, poisoning international relations and making economic co-operation between the major powers much more difficult. The breakup of the Austro-Hungarian Empire and the western fringes of the Russian empire led to the creation of new nation states which typically used their legislative independence to pursue nationalist economic goals. The Russian Revolution of 1917 led directly to a remarkable reduction in that country's economic engagement with the rest of the world, and would in the long run imply the spread of revolution across much of Eurasia, with anti-globalisation consequences which would persist for much of the century. Finally, the postwar settlement never provided the geopolitical stability which the Congress of Vienna had given Europe after 1815, leaving a legacy of bitterness and resentment among the defeated powers which would play an important role in moving the world towards war in the 1930s. The sort of coordinated macro-economic response to the Great Depression which the situation demands today, and was required then also, would for geopolitical reasons alone have been difficult or impossible to achieve during the 1930s, even if all policymakers had agreed on the correct course of action to take [which was in fact not the case]. A catastrophic descent into protection was in the circumstances inevitable.

In turn, the second world war gave an important boost to nationalist opponents of imperialism across the developing world, as well as to the spread of communism. Both developments helped to ensure that when attempts began to be made after 1945 to reconstruct the international economy, these were largely limited to Western Europe and North America. Most of the rest of the world, where the majority of mankind lives, pursued anti-globalisation policies which would persist in many cases until the 1980s or 1990s.

Within the OECD, which did see a gradual dismantling of trade barriers and a return to international economic integration, American military and economic superiority, combined with the disciplines of the Cold War, implied an effective US hegemony, and the Americans used their power to advocate economic integration among western economies. It

Figure 3. *Tramp freight rates, 1870-1997*

Source: Shah Mohammed and Williamson (2004).

should be noted that although there were important technological advances during the *Pax Americana*, such freight rate indices as we have suggest that breakthroughs like the container made less of a difference to transport costs during that period than is often thought (Figure 3). In contrast with the late nineteenth- century experience, trade liberalisation (that is to say, politics) was a key driver of late twentieth-century globalisation, and liberalisation only occurred in regions of the world where the geopolitical conditions were right. In this light, the key distinguishing feature of the 1990s was the collapse of the Soviet Union, and the embrace of the market across the world, as much as or even more than technological developments such as the Internet.

COMPETING VERSUS NON-COMPETING TRADE

Look again at Table 1 (page 14). As can be seen, the commodities which Europeans imported from the rest of the world during the early modern period were largely commodities which either could not be produced in Europe at all, or which could only be produced there at great

difficulty and expense. This is what made these commodities so scarce and expensive in Europe, and what made it economical to ship them across vast distances using the costly transport technologies of the time. It followed that there were few or no domestic producers of these 'non-competing' commodities who would be displaced if imports increased. The big exception to this general rule was Indian cotton textiles, and not surprisingly the British protected their cotton textiles sector until the Industrial Revolution had lowered costs sufficiently that the British industry was competitive vis-à-vis its Asian rivals.

From the 1840s onwards however, as we have seen, the transport revolutions of the nineteenth century led to a historic and dramatic decline in international transport costs. For the first time in history, it now became economical to transport such bulky and low-value commodities as wheat between continents on a regular basis. Such 'competing' commodities could be produced worldwide, on continents with very different endowments of land, labour and capital. European landowners now found themselves in direct competition with farmers on the Great Plains, the Argentine pampas, Russia, Australia and the Punjab. Not surprisingly, European rents and land prices plummeted, in Britain (which remained open to free trade) by roughly 50 percent. O'Rourke and Williamson (1994, 1999) show that almost all of this decline can be directly attributed to falling transport costs, which in turn led to falling agricultural prices.

Equally unsurprisingly, in most European countries there was a protectionist backlash, with countries such as France and Germany imposing high agricultural tariffs, which were typically extended to the industrial sector as well. What is striking is how quickly this backlash occurred. It was well underway by the late 1870s, only three or four decades after the decline in international transport costs had really got underway. The tariffs that were imposed were sufficiently high that they seriously impeded the integration of international agricultural markets. Moreover, this European switch to agricultural protection has proved to be more or less permanent, with today's EU Common Agricultural Policy the direct successor to the protectionist policies of Bismarck, Meline, and other continental statesmen.

Where the early modern period had seen *international* struggles concerning who would obtain the monopoly rents thought to be associated with trade in scarce, non-competing commodities, the nineteenth century ushered in a modern era of competing trade in which trade politics largely involved *intra-national* disputes about income distribution. Indeed, the standard Heckscher-Ohlin theory of international trade, which explains why such disputes might arise, was an explicit attempt to understand the late nineteenth-century experience. That experience suggests that globalisation can come under severe political pressure when it links together continents with very different factor endowments. Nor does the post-1945 period offer any particular reassurance in this regard. As mentioned earlier, until the 1980s and 1990s post-war globalisation was a largely regional phenomenon, linking together OECD economies which were very similar in terms of economic development, capital-labour ratios, and living standards. Trade between them was largely intra-industry in nature, rather than being driven by strong factor endowment differences between trading partners. It thus involved fewer distributional consequences than late nineteenth-century trade, which made it politically easier to sustain. Strikingly, OECD economies were endowed with very different ratios of labour to land, and agriculture was conspicuously absent from the waves of trade liberalisation achieved under the auspices of the GATT. This suggests that potential losers from free trade remained as powerful politically as they had been a century earlier.

In recent decades the nature of globalisation has changed radically. We have seen China's decision to open itself to international trade in the late 1970s and 1980s, with India following suit a decade later; the collapse of communism in Central and Eastern Europe as well as the former Soviet Union; and countries across the developing world abandoning post-independence experiments with autarky. The spread of industrialisation across the Third World has meant an increase in the South's share of manufactured exports, and a dramatic switch in the composition of North-South trade, with the South shifting from an almost exclusive reliance on exporting primary products to exporting larger volumes and a wider range of manufactured goods. As in the nineteenth century, globalisation is once again linking together continents

with very different factor proportions, the South having lower capital-labour ratios and less skilled workforces than the North. Rather than exporting complementary, and often non-competing, primary commodities, the South is now exporting potentially competing manufactured goods⁴. The obvious question which arises is whether the present-day equivalent of late nineteenth-century European farmers, namely unskilled workers in the OECD economies, will eventually press for and obtain a rolling back of international economic integration.

It is certainly true that there has been a dramatic and well-documented distributional shift against unskilled workers and in favour of the more highly skilled in many OECD economies. The extent to which this shift is due to globalisation, rather than to biased technological change, remains an extremely controversial topic. What is not in doubt, however, is that voters appear to hold views about trade (and other dimensions of globalisation as well, notably immigration) that are exactly what would be predicted if trade were hurting northern unskilled workers in classic Heckscher-Ohlin fashion. A considerable political science literature, building on the important contribution of Scheve and Slaughter (2001), has shown that individual voter attitudes towards trade are indeed consistent with Heckscher-Ohlin theory. That is, in rich (skill-abundant) countries, unskilled workers are much more protectionist than skilled workers, but this effect weakens in poorer countries, and disappears or even reverses in the poorest countries. Perceptions matter in politics: if unskilled workers in rich countries believe that they are being hurt by globalisation, this could be sufficient to produce an anti-trade backlash, regardless of the accuracy of these beliefs.

The 2005 French referendum on the so-called European Constitution, when unskilled workers voted against what they saw as a pro-market, pro-globalisation accord, may serve as a straw in the wind in this regard. Precisely the same cleavage between middle-class and working-class voters appeared in the 2008 Irish referendum on the Lisbon Treaty, with blue-collar workers yet again being overwhelmingly opposed to further European integration. Even more tellingly, opinion polls taken in the week following the vote found that no less than 58 percent of those opposed to the treaty thought that it would have

caused more unemployment, compared with just 14 percent of those who had voted in favour of it. The great lesson of the late nineteenth century, which resonates strongly today, is that income distribution matters not just for its own sake - which of course it does - but also because of its importance for the political sustainability of liberal international trade regimes. The possibility of a populist backlash against globalisation seems to be rising all the time now, as voters discover more and more facts about the operation of tax havens, the consequences of 'regulatory arbitrage', and the risks of unrestricted international capital flows. The obvious danger is that the additional pressures created by the macroeconomic crisis will be exploited by interests which have been becoming increasingly hostile to 'globalisation' in any case. If the leaders of democratic societies wish to retain the undoubted benefits of open international markets, they will need to take greater notice of the interests of those who are being left behind.

This is especially so since, unlike in the nineteenth century, we cannot assume that continually declining transport costs will come to the rescue of international markets, offsetting the impact of rising tariff barriers. If anything, it seems the opposite is likely to be the case, because of rising oil prices. These are likely in the long run for at least two reasons, notwithstanding the price collapse created by the crisis in the latter half of 2008. The first is that world oil production will peak, and then start to decline, as has been argued by several prominent scientists (eg Deffeyes 2001). Such a trend, in combination with rapid southern industrialisation, would clearly lead to a long-run and steep upward trend in prices. The second is that concerns about global warming will lead governments to impose high carbon taxes. Since current transportation technologies are heavily oil-intensive, the implication for transport costs is clear, although the extent of the increase will depend upon how rapidly technologies evolve in response. While in the nineteenth century falling freight rates meant that rising tariffs in particular sectors could coincide with an overall increase in globalisation, in the twenty first century no such free lunch will be available.

However, the late nineteenth century offers another, more positive lesson for today's policymakers: they are not powerless when confronted

with anti-globalisation political pressures. Rather, by adopting appropriate domestic economic policies, they can defuse such pressures and maintain a political consensus in favour of free trade. The late nineteenth and early twentieth centuries saw the widespread adoption across European countries of a range of regulations and insurance schemes designed to protect ordinary workers, especially in those countries more open to international trade. For example, a range of labour market regulations was introduced across Europe, prohibiting night work for women and children, prohibiting child labour below certain ages, and introducing factory inspections. The period also saw the widespread introduction of old age, sickness and unemployment insurance schemes. In countries such as Belgium, governments incorporating both labour and business interests reached agreements whereby business would support the introduction of such a 'labour compact', in return for labour supporting the maintenance of free trade. Similarly, post-1945 economic growth in Europe and elsewhere was largely based on an implicit 'grand bargain' between labour, capital and government, involving the provision of modern welfare states to insulate workers from the risks of the market economy.

The lesson for today is that if workers feel that their interests are being furthered by governments implementing appropriate domestic economic policies, then they are not necessarily hostile to international trade. This is an important lesson from history, since western economies are now at a critical juncture as regards the political legitimacy of the market. In the past year we have seen public anger in Germany and elsewhere regarding tax evasion in Liechtenstein and other tax havens, growing concern about executive pay and bonuses, and large tax bailouts to financial institutions as a result of a financial crisis that originated in the US but has spread around the world, causing economic devastation. The fact that these bailouts will in many jurisdictions coincide with cutbacks in the public services on which poorer people disproportionately rely will also arouse justifiable anger. Some of this has nothing to do with globalisation, while some is linked at least in part with the consequences of international capital mobility in its current form. Taken together with longer-run concerns about competition from China and elsewhere, and a deteriorating economy that

will increase protectionist sentiment, it seems clear that we could be headed for a political ‘perfect storm’, unless governments can provide voters with reassurances that the market economy in general, and the international market economy in particular, can be made to work for them. Intelligent supporters of the market will welcome, rather than oppose, appropriate initiatives by governments, acting on their own or collectively, to reflate, regulate and redistribute in the months and years ahead.

GEOPOLITICS AND THE FUTURE OF GLOBALISATION

Even more fundamentally, however, the continuation of a broadly liberal international trading environment in the longer run will require that the geopolitical system adapt to the rise of China, India and other ‘Third World’ giants. In a historical context, this represents of course the restoration of the *status quo ante*, the end of a ‘Great Asymmetry’ in international economic and political affairs caused by the Industrial Revolution. But that is not to say that such an adjustment will be easy. The international system has historically done a poor job of accommodating newcomers to the Great Power club. German unification and industrialisation during the late nineteenth century led to tensions with Britain and France over colonial and armament policy, while Japan’s rise to regional prominence during the interwar period, and its search for secure sources of raw materials, ended in war against the US and its allies.

Both precedents are worrying, in that similar questions are posed today, both in terms of the rights of emerging nations to rival the established powers’ military capabilities (notably with regard to nuclear weapons), and in terms of the strategic importance to countries like China of ready access to oil supplies and other natural resources. History suggests that, Cobden and Montesquieu notwithstanding, interdependence and trade do not necessarily guarantee peace. The world economy of the late nineteenth century was extremely interdependent, and as Norman Angell famously pointed out, on the eve of the first world war, this implied that international financial interests

constituted a formidable ‘peace lobby’. Unfortunately, as we know, that lobby was unable to prevent the outbreak of a devastating war which set back the integration of the world economy for most of the twentieth century. Interdependence implies vulnerability, and vulnerability can lead to fear, with unpredictable consequences.

When the British population exploded during the late eighteenth and nineteenth centuries, Britain found itself having to pay for net imports of food and raw materials with net exports of manufactured goods. It thus had a vital strategic interest in the maintenance of an open, multi-lateral international trading system, and the Royal Navy provided it with the means of ensuring this. But ultimately, as Avner Offer (1989) has argued, the fact that by the early twentieth century, both Britain and an increasingly powerful Germany were reliant on overseas imports of primary products, meant that military planners in the two rivals started focusing on their own and their adversary’s vulnerability to blockades, with destabilising consequences.

At the other end of the Eurasian land mass, the Japanese population grew from 44 million in 1900 to 65 million in 1931, again in tandem with rapid industrialisation. As in the British case, this implied a reliance on imported primary products, and hence on exports to pay for these. Unlike in the British case, however, there was no twentieth century *Pax Britannica* to guarantee an open trading regime for all in the interwar period. When the Japanese found themselves excluded from American and British Empire markets during the Great Depression, the stage was set for the Japanese army gradually to take control of the country, since imperialism seemed like one way to secure adequate supplies of primary products in a world in which the international division of labour was breaking down. The implications for today seem obvious: as we head into an era of increasing raw materials scarcity, the importance of maintaining an open and multilateral world trading system is greater than ever before. This conclusion is reinforced by the re-emergence of age-old concerns about bottlenecks impeding the supply of commodities across the land routes of Eurasia. While the voyages of Vasco da Gama neutralised such concerns 500 years ago, they are coming to the fore again in debates about the pipelines linking

Russian and Central Asian oil and gas deposits with European markets. Unfortunately, the chances of maintaining such an open and multilateral trading system are not helped by the relative economic and political decline of the US, which seems set to become one of the defining features of the twenty first century. In part, this relative decline is simply the consequence of the spread of industrialisation and economic prosperity to the less developed parts of the world. As such it is both welcome and inevitable. However, it is also in part self-inflicted. Huge current-account deficits have meant that the US is now dependent on foreign capital inflows from countries such as China, while the failure of the US to tax gasoline and other oil-based products appropriately means that it is also heavily dependent on international markets for oil, to the benefit of Russia, Venezuela, the Middle East and other oil-producing regions. Thus, despite its undoubted military superiority and central role in the world economy, the US now finds its freedom of action severely constrained by its financial and energy dependence on rival powers. The disaster in Iraq has further eroded its strength abroad. This has been brutally illustrated by its inability to respond effectively either to Taliban advances in Afghanistan, or to Russia's invasion of Georgia in August of last year. In the latter case, the Americans found that they could not even talk with any credibility about the need to uphold international law.

Europeans would be foolish to cheer such developments. As the Russian invasion of Georgia demonstrated, Europe still needs an American security umbrella. More generally, as we have seen above, periods of sustained expansion in world trade have tended to coincide with dominant powers providing the infrastructure of law and order necessary to keep trade routes open, as in the cases of the *Pax Mongolica* or *Pax Britannica*. After 1945 this essential role was played by the US, at least in so far as the non-communist world was concerned. More broadly, the Cold War imposed a discipline of sorts not only on the leaders of the two main blocs, but also on their respective clients. This discipline no longer exists in a world with one superpower and its allies, surrounded by a potentially anarchic 'competitive fringe' that is not prepared to acknowledge its authority.

One important lesson of the late nineteenth and early twentieth centuries is that multipolarity is a dangerous and unstable state of affairs. According to Paul Schroeder (1994), the nineteenth-century geopolitical system worked as well as it did for as long as it did *not* because it ensured a balance of power between European states, as was traditionally thought. Rather, the system was based on Russian hegemony in the east, and British hegemony on the high seas. With the rise of Germany, the system became genuinely multipolar, with the consequences that we know. To wish for a multipolar international order seems the height of folly. But if we are headed towards such an order in any event, we need to be prepared for it.

All the long-run problems I have just mentioned – protectionist pressures in rich countries due to rising inequality, growing raw materials scarcity, the decline of American hegemony – as well as other problems such as environmental degradation and climate change, have their origins in part in the rise of Asia, as it regains its rightful place in the world order. The correct response to these problems is similar as well - in all cases, it will involve a growing commitment to the economic and political multilateral institutions which more than anything else distinguish our own period from that of a century ago. The need to avoid a mutually destructive descent into depression-fuelled protectionism in the immediate term obviously further strengthens this conclusion. Furthermore, because of the interdependence of geopolitical stability and globalisation, it would be foolish to assume that a commitment to economic multilateralism will be effective without a commitment to political multilateralism and international law more generally. However, these multilateral institutions will have to become more representative of the world as a whole, rather than reflecting, as at present, the unusually asymmetric distribution of power in 1945. It is no longer tenable that Europe holds three out of the five permanent seats at the UN Security Council, that the head of the World Bank continues to be American by tradition, or that the head of the IMF continues to be European.

Crises are by definition dangerous, but they also provide opportunities. The intellectual case for a coordinated macroeconomic response to

today's economic crisis is overwhelming, and this is already forcing European and North American leaders to deal with their Asian and Latin American partners as equals: we need their expenditure and markets as much as they need ours. If this provides the incentive needed to give the world more balanced multilateral institutions, and if these institutions provide a more effective check on the worst excesses of contemporary capitalism, this will go a long way to ensuring that the world economy remains relatively open in the decades ahead.

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NOTES

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- 2 O'Dea, W. [2009] 'Why our response to crisis isn't wrong', www.independent.ie, 4 January.
- 3 On the other hand, there seems little doubt that access to overseas raw materials and markets, as well as the slaves of Africa, was a crucial component explaining Western European economic success.
- 4 The extent to which this is actually the case is now one of the most interesting and important topics in applied research on international trade: see for example Schott 2008.

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POLITICS AND TRADE: LESSONS FROM PAST GLOBALISATIONS

by
Kevin O'Rourke

In this essay, the fourth in the Bruegel Essay and Lecture Series, Kevin O'Rourke provides us with a globalisation reality check. It is easy to forget that the current round of globalisation is barely two decades old. The last round, in the late-nineteenth century, ended in catastrophe. After tracing the link between politics and trade over a millennium, O'Rourke identifies certain permanent features of international economic relations. His timing is perfect. The crisis has switched the balance of power within and between countries. Government is back in the driving seat and corporations look fragile. No one can predict how the cards will fall, but politics is making a come-back and will inevitably play a bigger role in shaping our future than commonly assumed before autumn 2008.

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