Globalization in historical perspective

Charting the future from the past

For three days in August, Rutgers University Professor Michael Bordo and a group of noted academics provided senior officials from 30 countries and a number of IMF staff with a historical context for the often contentious issue of globalization. Sponsored by the IMF Institute, "Globalization in Historical Perspective" reprised an earlier National Bureau of Economic Research conference. The seminar focused, in particular, on the forces unleashed in the nineteenth century and the ensuing backlash and looked for insights into today's policy debates.


Michael Bordo


Ronald Findlay


Alan Taylor

"We all know," IMF First Deputy Managing Director Anne Krueger observed in her opening remarks, "that globalization is not a new phenomenon." While much of the current debate has been framed within developments since 1950, a "long view" can offer a fuller understanding of the forces that have shaped the modern world. If we fear that the recent violent political reaction to globalization might cause a political retreat from liberal policy, she said, "it would pay to look carefully at the twenty or so years before World War I." During that period, and under popular pressure, the United States passed immigration restrictions, and tariffs rose almost everywhere. "It would also pay," Krueger added, "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."

Globalization's long history

If globalization is about intensifying integration, this breaking down of barriers has a long history. Where and how did it begin? That is still the subject of considerable debate. Some cite Marco Polo's travels as the first step in the globalization process, but Columbia University's Ronald Findlay argued at the seminar that the voyages of Christopher Columbus and Vasco da Gama, which broke the Venetian-Egyptian monopoly over trade with Asia, marked the true beginning. In the three centuries following Columbus's voyages, trade grew by about 1 percent a year—well above the average of 0.3 percent income growth.

Harvard University's Jeffrey Williamson, however, expressed the view at the seminar that the sixteenth through eighteenth centuries constituted a period of antiglobalization mercantilist policies and growing income inequality. Swelling populations raised the scarcity value of land, and the incomes of wealthy landowners, relative to the farm wage. The rising trade share in GDP consisted almost entirely of luxury goods that the rich—alone—could increasingly afford.

True globalization, Williamson suggested, began only during the nineteenth century, with the unleashing of the economic forces of trade, migration, and capital flows. Britain's nineteenth-century free-trade leadership was critical. In 1846, for example, the country effectively reduced its import tariff on grain from 70 percent to 20 percent and distributed income away from the British landed classes and toward the rest of the world. As the leading industrial power of the day, its rapid shift to a liberal trade regime had a powerful demonstration effect, especially in Europe.

Labor flows rose dramatically in the nineteenth century. Between 1870 and 1910, migration increased the U.S. labor force by one-fourth (and by far more in Canada, Australia, and Argentina) while reducing it throughout Western Europe, yielding labor force declines approaching one-half in Italy and Ireland. These enormous labor flows had a big impact on wages and income distribution.

At the same time, capital, too, became much more mobile. Alan Taylor of the University of California at Davis, in his presentation, traced the rise of international capital markets, with the Dutch providing the British with large-scale financing for military expenditures during the Napoleonic Wars. New York University Professor Richard Sylla noted that Dutch bankers also offered their services to the French—filling Napoleon's war chest by placing U.S. bonds, received in payment for the Louisiana Territories, with British investors.

Capital flows played a vital role in U.S. economic development—arguably the first successful emerging market. Sylla postulated that Alexander Hamilton's financial reforms, including the settlement at par of Revolutionary War debt, permitted a rapid expansion of the country's banking sector. Despite the slowness of trans-Atlantic communications, there was growing integration between New York and London markets as early as 1816, and, by 1850, foreign investors held around 40 percent of all U.S. bonds, many of which were actively quoted in European markets.

These developments, taken together, are now seen as a golden age of globalization. But the period between 1870 and World War I is also known as the golden age of the classical gold standard. Did gold afford greater stability than floating rates can in the present period? Michael Bordo contrasted the workings of the two systems and found that the same basic rules apply. Financial maturity and credible policies are more important for a country's stability than its exchange regime. Under the gold standard, countries with credibility could depart temporarily from their parity in response to shocks. Since 1973, financially developed countries have been able to make a credible commitment to a domestic nominal anchor and enjoy the flexibility of a floating exchange rate.

Of course, Bordo added, the dynamic is entirely different for less financially mature economies. Such countries, then and now, must borrow abroad in foreign currencies. They faced the same policy credibility problems under the gold standard as they do today, even while attempting to signal sound policies through adherence to gold. With foreign currency indebtedness, shocks in the earlier period could also lead to capital flight and financial distress. In this sense, the 1890s looked very much like the 1990s—a string of financial crises, followed by moves either to very hard pegs (including gold cover in excess of 100 percent) or to free floating. The long and the short of it, Bordo concluded, is that financial crises have been, and remain, an unfortunate but inevitable part of "growing up" for emerging markets.

Backlash against the golden age

The far-reaching changes that characterized the nineteenth century brought with them significant changes in income distribution that contributed to a political backlash. In particular, the era saw a marked convergence of wages among the globalized economies of the Atlantic community. Only 30 percent of that convergence was the result of trade. The dominant source was the massive migration that occurred between 1870 and 1913. This is true even though the wage convergence was tempered by large flows of capital into the high-wage and labor-scarce countries of the New World.

Income distribution also shifted markedly within countries. Landowners in land-scarce, labor-abundant Europe saw their returns diminish, and income distribution worsened in the countries of new settlement, where waves of unskilled workers provided fierce competition for more established workers. And these shifts provoked resistance. In the Old World, landowners successfully lobbied for higher agricultural tariffs during the last decades of the nineteenth century. In the United States, Canada, Australia, and Argentina, labor ultimately succeeded in closing the door to further immigration by the 1920s.

Did this backlash fan the flames of nationalism and contribute to the outbreak of World War I? Clearly, the Great Depression in the 1930s intensified the backlash, prompting countries, in a misguided attempt to protect themselves, to raise tariff barriers,

The IMF Institute seminar on globalization drew senior officials from 30 countries.

restrict migration, and abandon the gold standard. A new book by historian Harold James argues that the Great Depression was caused by the backlash against nineteenth century–style globalization.

Lessons for the new century

Are similar economic forces contributing to the current backlash against globalization? Now, as before, there are winners and losers. Countries that do not open up to trade flows and capital movements fall behind; unskilled workers in advanced countries have seen a growing pay gap between themselves and the more highly skilled. In these circumstances, a political coalition of organized labor, protected industries, and new groups coalescing around such issues as the environment could derail the current progress of globalization.

Today, however, as Bordo noted in his summary of the seminar's discussions, the losses from trade may not be felt as keenly as they were in the nineteenth century. The growth of international trade is more widespread, and its benefits more widely shared. The institutional framework is different, too: there is more legal protection against unfair trade practices than before, and trade disputes can be resolved by the World Trade Organization or other bodies. In addition, countries have made important strides in assisting displaced workers through programs like unemployment insurance and targeted retraining.

International immigration remains an important issue, even if it is unlikely to return to nineteenth-century rates. New immigrants will now be entering technologically advanced societies and adding pressure to the already declining relative wages of low-skilled workers. The result, suggested Barry Chiswick of the University of Illinois at Chicago, may be greater convergence by skill level across the globe, while inequality rises within countries. He expected that pressure would rise in advanced economies to prevent illegal immigration, even as the declining costs of migration provide increased incentives to immigrate illegally. Chiswick predicted that aggressive enforcement of immigration laws would be politically unacceptable in liberal societies, while alternative policies would have limited effectiveness in stemming the tide of immigration.

A final but very important difference between the two eras is that most countries in recent years have learned to pursue stable macroeconomic policies, in sharp contrast to the very unstable environment that led to the shutdown of capital markets between the two World Wars. Central banks have come to understand their role as lenders of last resort, and the international financial architecture, of which the IMF is a part, now helps lessen the frequency and severity of financial crises.

Opportunity or tumult—where is globalization headed? Citing the lessons of history, Bordo, for one, was sanguine, concluding, "Other parts of the world are going to get rich." It is encouraging to think so. ■

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IMF approves record $30.4 billion loan for Brazil

On September 6, the IMF Executive Board approved Brazil's request for a new 15-month, $30.4 billion Stand-By credit to support the country's economic and financial program through December 2003. This new loan is the largest ever for the organization.

The Board's decision will enable Brazil to draw up to $3 billion from the IMF immediately. A second drawing of up to $3 billion will be made available upon completion of the first review, which is expected to take place before end-2002. The new loan with Brazil replaces the previous 15-month, $15.6 billion stand-by credit, which was approved on September 14, 2001.

After the Executive Board discussion on Brazil, IMF Managing Director Horst Köhler said: "Brazil has implemented strong and consistent macroeconomic policies in recent years that have improved fundamentals. Increases in the public sector primary surplus and the strengthening of fiscal institutions, along with the successful transition to a floating exchange rate regime and inflation targeting, have laid the foundation for sustainable growth with price stability.

"Despite these achievements, the uncertain international economic environment and some concerns about the course of economic policies following the upcoming presidential elections have put substantial pressure on financial variables, including the exchange rate and interest rates, and economic growth has slowed in recent months. In addition, the depreciation of the exchange rate has led to an increase in the ratio of debt to GDP.

"The authorities have responded to these developments proactively, announcing in June an increased primary surplus target for 2002–2003, and have maintained a firm monetary policy to limit the inflationary impact of the weakening *real*. In addition, the authorities have developed a macroeconomic framework for the medium term that underpins the new IMF-supported program covering the period through December 2003."

For further details, please see the full text of IMF Press Release 02/40, September 6, which is available on the IMF's website (www.imf.org).