

# An Historical Perspective on Technological Shocks, Political Shocks and Globalization

Michael D Bordo

Rutgers University

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# Introduction

- The recent rise of populist anti globalization political movements has led to concerns that the current wave of globalization may end in turmoil like the first era which ended after WWI
- Globalization defined as the integration of markets for goods, labor and financial capital displayed a U-shaped pattern from 1870 to the present
- It was high in the late nineteenth century and early twentieth century, dropped significantly after WWI and then recovered post WWII
- The first era of globalization ended because of a backlash by the losers of globalization in Europe and the US
- Leading to an increase in tariff barriers, capital controls, restrictions on immigration and political instability
- Many argue that the repeat backlash is happening now seen in a flattening in world trade and capital flows since the GFC

# Introduction

- I argue that it is too soon to tell
- The drastic decline in trade and capital flows reflects the Great Recession
- The flattening since 2010 reflects the slowdown in growth of China and the reversal of the extended supply chains developed since the 1990s as well as increased financial regulation
- This suggests either a pause in the pace of integration or more likely a slowdown

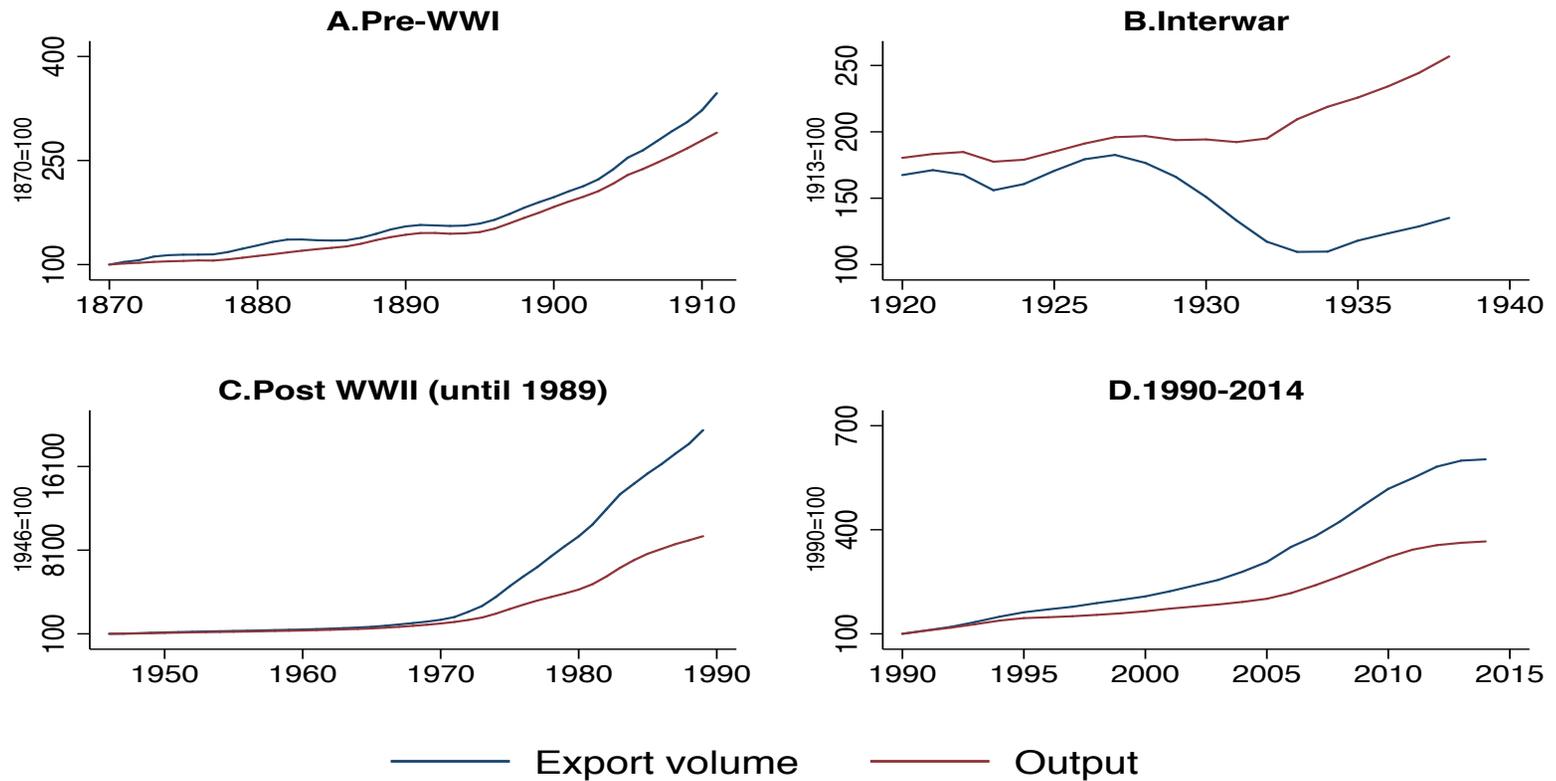
# The First Era of Globalization

- The first era of globalization was preceded by major political and technological changes
- The setting is the Glorious Revolution of 1688, which created property rights and the rule of law, both needed for the financial revolution
- The backdrop to the industrial revolution in England
- The framework was backstopped by political stability in Europe: Congress of Vienna and *Pax Britannica*
- Key technological changes: steamship, telegraph, transatlantic cable

# The First Era of Globalization: International Trade

- The opening up of trade began with the Age of Discovery in 1500 but really rapid globalization doesn't occur until after 1815, exports grow by 3.5% p.a versus real growth of 2.7%
- Twentieth century trade growth similar to nineteenth in aggregate but less relative to real growth (See Figure 1)
- Globalization in trade spurred by big reductions in tariffs, especially following Britain's abolition of the Corn Laws in 1846 and the Cobden Chevalier Treaty of 1860 between GB and France which led to a network of MFN Treaties

# Figure 1. World Trade and Output



Source: Fouquin & Hugot (2016)

# The First Era of Globalization: International Trade

- The Liberalization process was partly reversed after 1879 reflecting a backlash by landowners in Europe
- Trade collapsed with WWI and Great Depression in face of rising tariffs and quotas
- After WWII GATT based on the principle of multilateral cooperation rolled back tariffs in successive rounds and WTO since 1994 reduces non tariff barriers
- By the 1970s the ratio of Trade to GDP reached the level of the earlier era of globalization

# The First Era of Globalization: Capital Flows

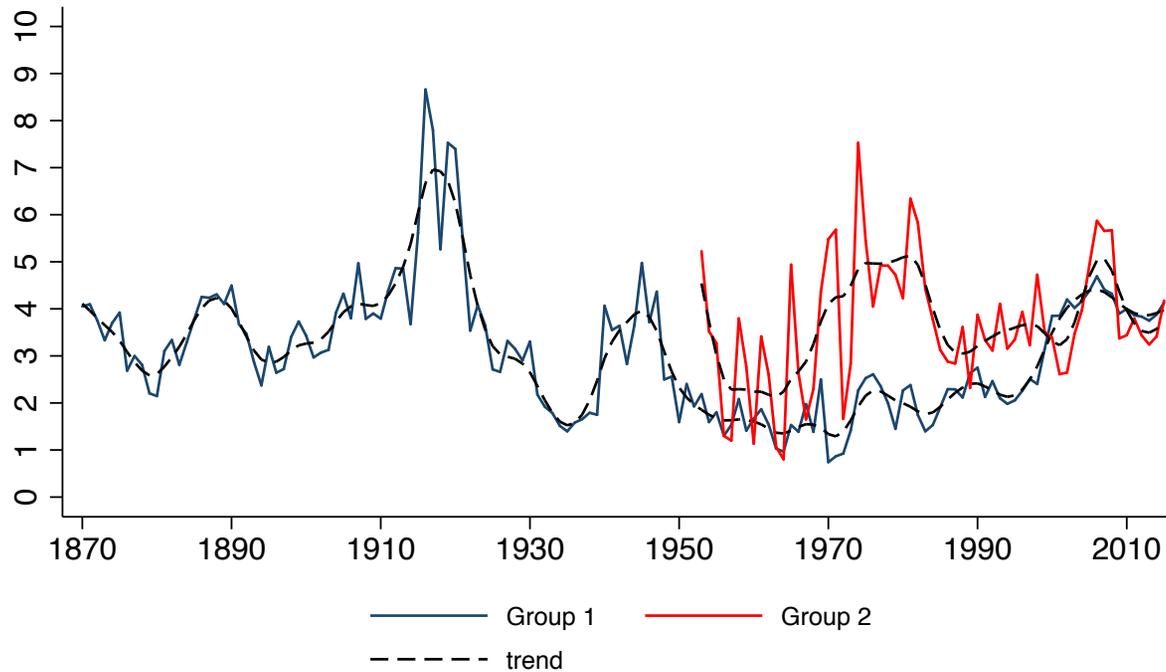
- The pace of international integration of financial capital followed a U shaped pattern with integration interrupted by the imposition of capital controls in the era of the WWs, the Great Depression and Bretton Woods
- Figure 2 shows the ratio of the current account balance to GDP for a panel of advanced and emerging countries from 1870 to present
- Four episodes: 1870-1914 gold standard and fixed exchange rates encourages massive K flows and convergence of interest rates

# Figure 2. Current Account Balance to GDP

Mean of Absolute Values

### Figure 3. Current Account Balance to GDP

Mean of absolute values



Group 1: Argentina, Australia, Canada, Denmark, Finland, France, Germany Italy, Japan, Norway, Sweden, UK and USA  
Group 2: Algeria, Brazil, Chile, China, Columbia, Egypt, Hungary, India, Israel, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Romania, South Africa, Thailand, Turkey and Venezuela  
Note: trend estimated with HP filter  
Sources: Jordá, Schularick & Taylor (2017), WB World Development Indicators (2017), IMF International Financial Statistics (2017)

# The First Era of Globalization: Capital Flows

- 1914 to 1945 WW I Great Depression and WW II disrupts financial globalization with capital and exchange controls
- 1945 to 1973 trade resumed under Bretton Woods but capital controls instituted
- 1973 to GFC floating exchange rates removal of capital controls financial globalization returns
- Obstfeld and Taylor (2004) explain the U-shaped pattern by Mundell's trilemma between open capital markets , pegged exchange rates and independent monetary policy
- Only two of the three can hold at the same time

# The Backlash

- The first era of globalization ended with WWI, The Great Depression and WWII.
- The demise was preceded by a backlash
- O'Rourke and Williamson (1998) document how pre 1914 globalization led to convergence of real wages and real incomes between Western Europe and the periphery via factor and trade flows
- Adverse effects on the distribution of income; reduced returns to land owners in Europe and worsening income distribution in the New world led to a backlash in the form of tariffs on agriculture in Europe and restrictions on immigration in the New World
- The backlash to globalization fanned the flames of nationalism.

# The Backlash

- Competition between the old and new industrial powers led to increased political tension, culminating in WWI
- The interwar witnessed the end of capital mobility and the shutting down of trade
- Accelerated by the shocks of the Great Depression, culminating in 1931
- The breakdown of the international economic order contributed to the tensions leading to WWII
- After WWII, UN, BWS and GATT represented a return to the global order
- It served as the backdrop to the second era of globalization

# The Backlash

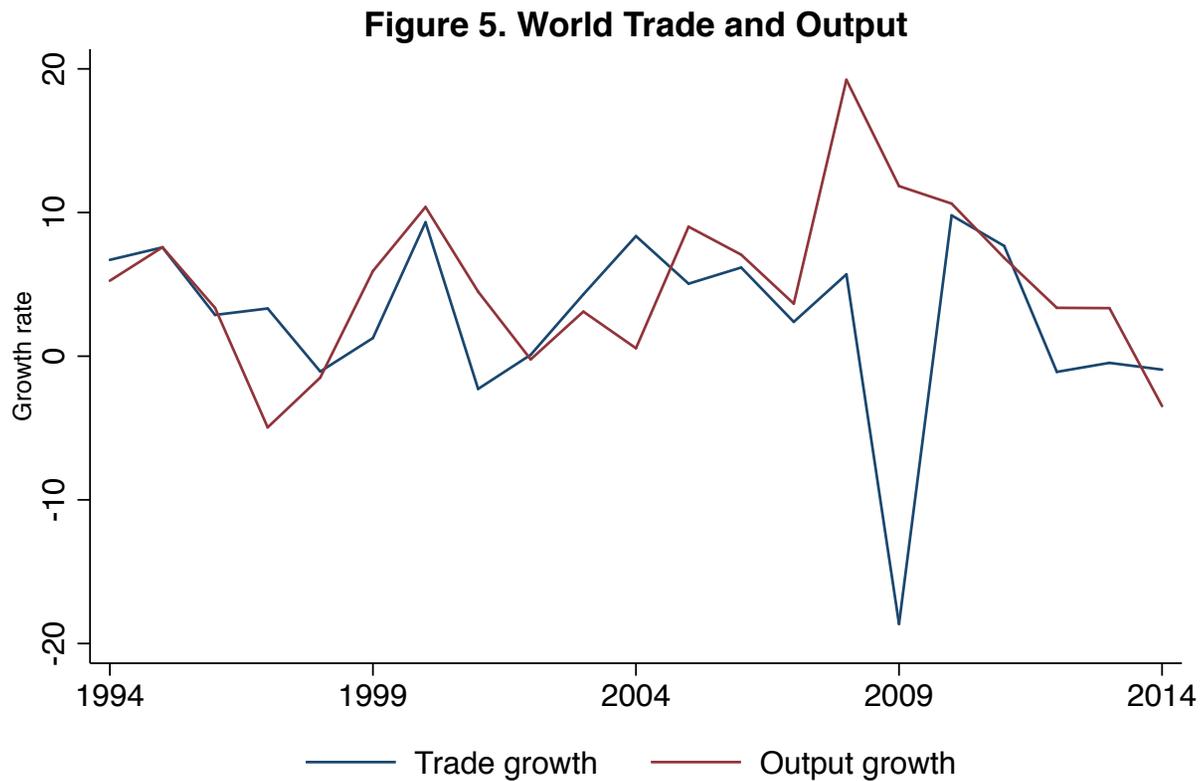
- It has been fifty years since the second era of globalization started
- Are similar forces at work?
- Are we on the brink of a massive deglobalization as occurred in the interwar?

# Since the Global Financial Crisis : Is the Second Era of Globalization Over?

## Trade

- The Global Financial Crisis of 2007-2008 led to a decline in world income not seen since the 1930s
- Trade declined by 10% much more than output and then snapped back (see Figure 3).
- Then the growth of trade relative to output declined from 2011 to 2015 by 50%
- Much of the decline reflected cyclical forces especially the collapse of investment

# Figure 3. World Trade and Output



Note: Trade is defined as the sum of exports and imports  
Source: Fouquin & Hugot (2016)

# Since the Global Financial Crisis : Is the Second Era of Globalization Over?

## Trade

- Secular forces were also important
- First was the collapse of global supply chains between the advanced countries and China and other Ems. It reflected diseconomies of scale
- Big multinationals are localizing
- Second was the slowdown in the growth of China from over 9% per year to 6.5% .
- China represents 15% of world output reflecting deep structural forces: the one child policy and the absorption of agricultural labor

# Since the Global Financial Crisis: Is the Second Era of Globalization Over?

## Trade

- Increased protection after the GFC was a less important factor
- This is very different from the 1930s when the rise of tariff protection was the key determinant of the collapse of global trade
- Thus globalization in trade has downshifted.
- Is this temporary or permanent?

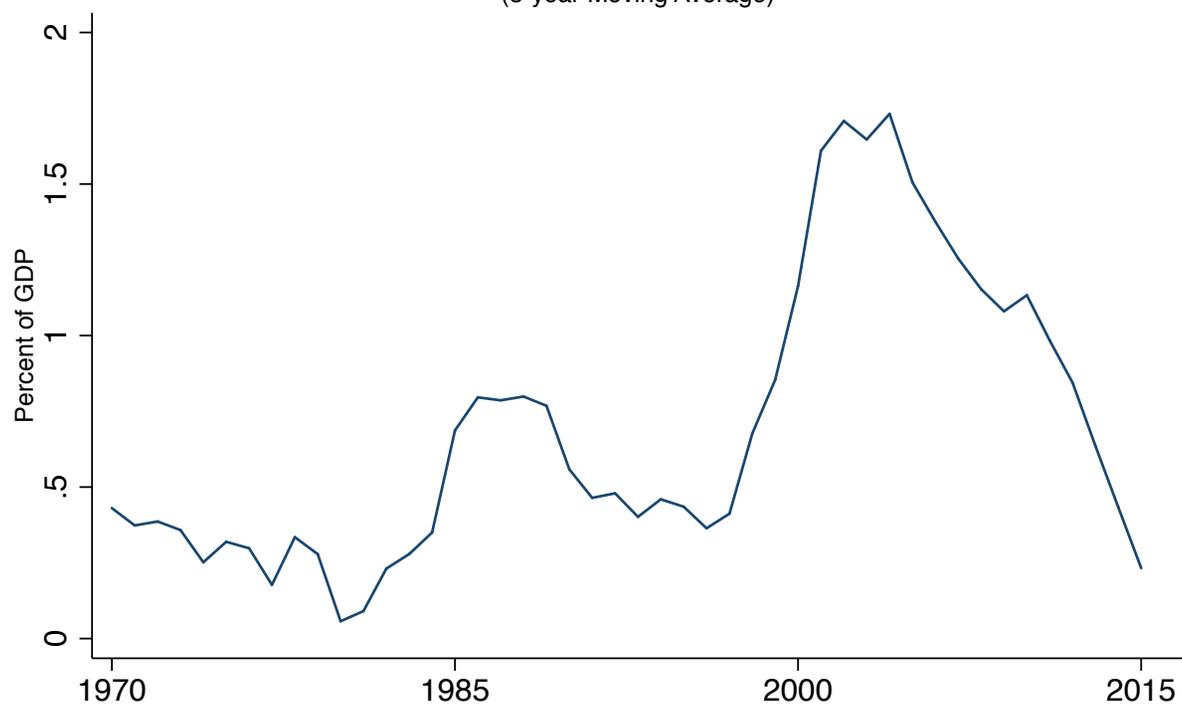
# Since the Global Financial Crisis: Is the Second Era of Globalization Over?

## Capital Flows

- Capital Flows also collapsed since the GFC and have not returned to their previous trend (see Figure 4).
- It reflects : the slowdown in the real economy; risk aversion and increased regulation of banks and the financial sector ( Basel III)
- As in the 1930s banks were blamed for the GFC
- More dramatic collapse in cross border lending (see Figure 5)
- Reflects microprudential policies which targeted cross border loans more than domestic loans (Forbes et al. (2016))

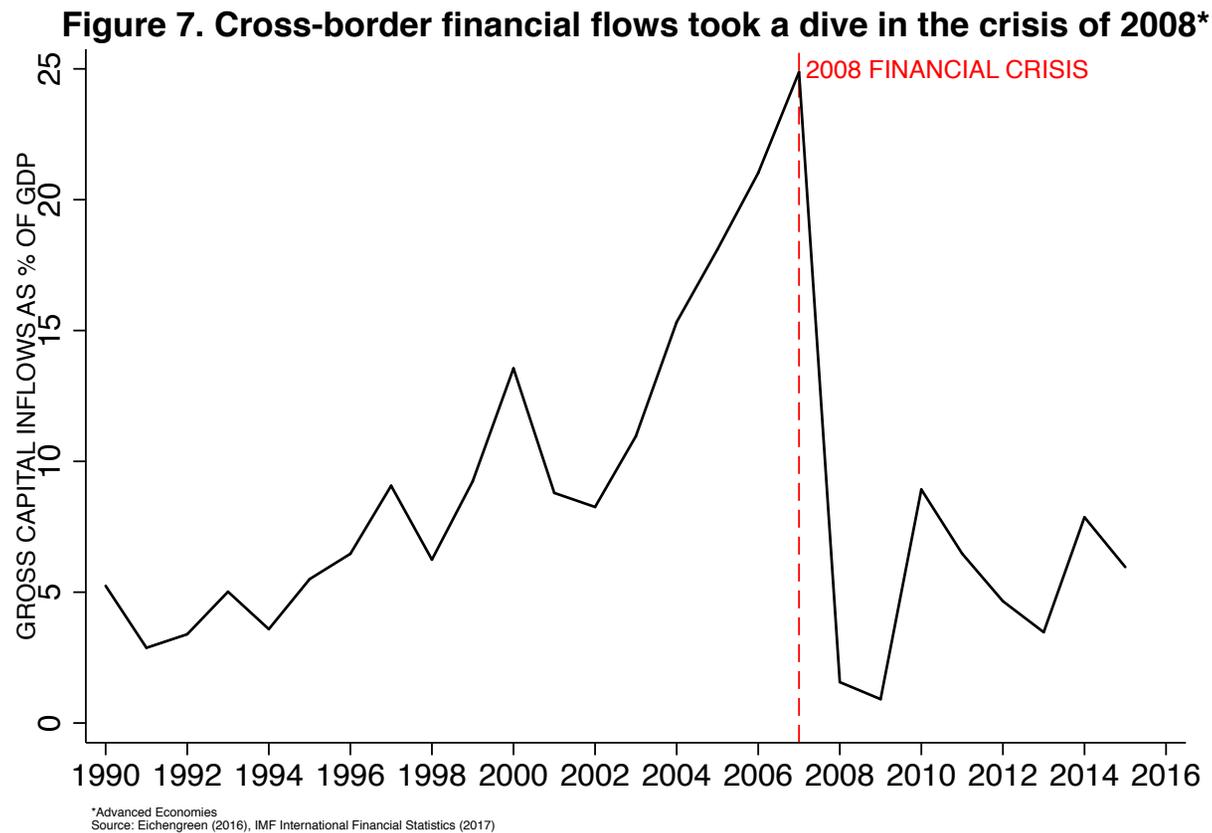
# Figure 4. Net Capital Inflows for Selected Countries\* (5-year Moving Average)

**Figure 6. Net Capital Inflows for Selected Countries\***  
(5-year Moving Average)



\*Argentina, Australia, Canada, Denmark, France, Germany Italy, Japan, Norway, Sweden, UK and USA  
Notes: 10-year data from 1970 until 1990; 5-year data from 1990 until 1997; annual data from 1997 on.  
Sources: IMF International Financial Statistics (2017)

# Figure 5. Cross-border financial flows took a dive in the crisis of 2008\*



# Summary

- The GFC was a huge shock which stalled the pace of globalization and may be the beginning of a reset
- There has been a populist backlash against globalization and technological change seen in recent elections
- As in the first era of globalization the losers have turned to political action
- In addition to the shock, evidence by Autor et al. (2016) shows that, since joining WTO, Chinese imports have displaced large numbers of workers in the US and Europe
- The losers from globalization and technological change have been opponents of globalization

# Summary

- Will the current slowdown and possible reset of globalization mark the end of the second era of globalization?
- It seems unlikely:
  - 1) The growth of trade is more widespread than than pre 1914 and so the groups harmed are outweighed by those that benefit (e.g. Walmart)
  - 2) There are more escape valves in trade legislation
  - 3) Trade disputes can be resolved by the WTO unlike pre 1914
  - 4) Many countries adopted compensation packages and retraining schemes to help the losers

# Summary

- 5) Most countries have learned to follow stable macroeconomic policies in sharp contrast to the 1930s
  - The Fed learned the lesson of 1931 during the GFC
- 6) The global proliferation of large MNEs is different than pre 1914
  - The cost of unraveling this seamless web of interconnections with tariffs and other restrictions would be disastrous

# Conclusion

- The prediction for the future of globalization depends on the direction of the political forces at play in the world
- Negative shocks like Trump and Brexit may reduce the growth of trade
- Positive shocks like the French elections may reverse these forces
- Increased financial regulation throws sand in the wheels of financial globalization

# Conclusion

- The real question is whether these long –run forces will change the dynamics of international capitalism
- Millions have been lifted from poverty in the second era of globalization
- Millions of others have improved their living standards
- The losers from globalization are a vocal minority but still a minority
- The bottom line is that the second era of globalization is not ending
- It is going through a reset following the GFC and the inevitable political reaction to it