The Beginning of the End: Backlash to the First Wave of Globalization

Lecture 7

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Backlash to the First Wave of Globalization

- The first wave of globalization led to significant increases in trade, foreign investment, and migration.
- Lower trade and transportation costs boosted global integration across these dimensions.
- Economists often argue that integration enhances welfare and economic efficiency.
- However, the benefits were not distributed equally across all sectors and groups.
- Uncompetitive industries faced disruption, leading to job losses and economic dislocation.
- Such distributional effects altered the political landscape and generated public discontent.
- Globalization, while overall beneficial, imposed real adjustment costs on certain groups.

Backlash to the First Wave of Globalization

- Capital flows increased financial instability, occasionally causing economic crises.
- Immigration intensified labor market competition, sparking social resistance.
- These side effects contributed to a growing political backlash against globalization.
- The uneven distribution of gains and losses fueled protectionist demands.
- Sectors and interest groups that experienced losses sought political support for barriers.
- This chapter explores such distributional issues, highlighting winners and losers.
- Ultimately, these tensions contributed to significant disruptions in the interwar period.

Convergence or Divergence in Economic Outcomes

- According to the Heckscher–Ohlin model, globalization should lead to income convergence.
- However, the model also predicts differing gains across factors: in land-abundant countries, returns to land rise faster than wages.
- In labor-abundant economies, wages rise relative to land rents due to specialization in labor-intensive goods.
- Thus, trade may increase overall welfare, but its benefits are unevenly distributed.
- Some groups, such as landowners or laborers, may benefit more than others depending on the factor endowments of each country.
- These differences fuel economic inequality within and across countries.

Convergence or Divergence in Economic Outcomes

- During the first wave of globalization, global income inequality between nations increased.
- Western Europe and the U.S. experienced sustained economic growth.
- In contrast, regions in Asia and Africa stagnated or fell behind.
- This divergence challenges the assumption that trade alone ensures convergence.
- Geography, institutions, and history also shaped global income patterns.

Figure 7.1: Global Income Inequality

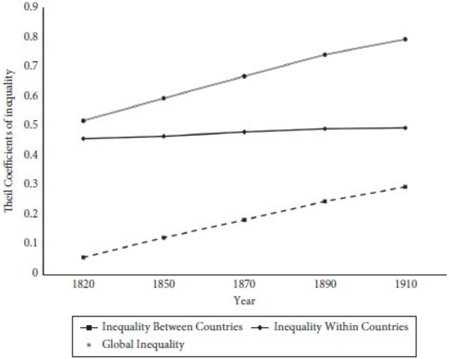

Figure 7.1 Global Income Inequality, 1820–1910
Source: Author's calculations based on data in Bourguignon and Morrisson (2002)

- The figure shows increasing divergence in income levels across regions during the first globalization wave.
- Industrialized economies outpaced non-industrialized ones, deepening the global gap.

Colonial Origins of Divergence

- Colonialism also contributed to economic divergence.
- Settler colonies like Canada and New Zealand developed strong institutions and property rights.
- Extractive colonies like British India or West Africa lacked these institutions.
- Disease environments in tropical regions discouraged European settlement.
- As a result, weak institutions and autocratic governance emerged in these areas.

Institutional Persistence and Path Dependence

- Acemoglu, Johnson, and Robinson (2001) argue that institutions persist over time.
- Weak institutions established during colonialism still affect income levels today.
- A strong correlation exists between historical settler mortality and current income levels.
- Countries with high settler mortality developed weak institutions that persisted.
- Institutional path dependence explains why some countries remain poor despite globalization.

Backlash: Taking Shelter from the Global Economic Storm

- Engagement with the global economy has not always been a "positive sum" game.
- Policymakers historically recognized the downsides of exposure to global competition.
- Thinkers like Colbert, List, and Hamilton argued for high tariffs to shield "infant" industries.
- The idea was to allow domestic industries time to grow, learn, and become globally competitive.
- Protection through tariffs gave local producers incentives to build capacity while limiting foreign supply.
- Ideally, such protection would be temporary and removed once industries matured.

The Politics of Protectionism

- Politicians often supported protectionism to secure political support or due to genuine belief in its benefits.
- Interest groups actively lobbied governments to raise tariffs, especially as trade costs declined post-1860s.
- In several countries, coalitions of domestic producers and politicians made protectionism politically viable.
- This led to widespread tariff increases, particularly after 1870.
- The backlash reflected a desire to shelter vulnerable sectors from intensifying international competition.

Figure 7.4: Tariff Increases in the Late 19th Century

Figure 7.4 Average Tariff Rate, Twenty-Seven Countries, 1865–1913
Source: Author's calculations based on data underlying Clemens and Williamson (2004a)

- The figure illustrates rising tariff levels after 1870 in many countries.
- This protectionist shift was a key component of the backlash to globalization.

Agricultural Protection: European Grain Farmers

- European grain farmers struggled to compete with cheap, high-quality wheat from the U.S., Canada, and Argentina.
- Italian pasta makers, for example, preferred Canadian durum wheat over domestic varieties.
- As global wheat markets expanded, local farmers faced shrinking market shares.
- This spurred political pressure to impose tariffs and protect domestic agriculture.
- The case shows how specific sectors mobilized politically against the forces of globalization.

Industrial Protection: U.S. Steel Rails

- British steel rail producers initially dominated the U.S. market in the 1860s.
- From the 1870s onward, U.S. producers benefitted from tariffs over 40
- Over time, the U.S. rail industry became more efficient, aided by cheap domestic inputs like iron ore and coal.
- Evidence suggests the tariff was not essential to industrial success.
- Two key lessons: tariffs may redistribute welfare (from consumers to producers), and other structural factors matter more for long-term growth.

Tariffs and U.S. Economic Growth

- High tariffs in the U.S. on capital goods from Europe likely reduced investment and lowered long-run growth.
- Estimates suggest income per capita was 10–12% lower than under free trade.
- However, between 1865 and 1913, U.S. economic growth remained robust and stable.
- The U.S. economy thrived due to its large internal market, rich natural resources, and healthy domestic competition.
- Growth occurred despite protectionist trade policies—not because of them.
- This suggests other domestic factors offset the negative effects of tariffs.

European Response: Tariff Backlash in the 1880s

- Several European countries raised tariffs in the 1880s as part of a backlash against globalization.
- This contributed to a noticeable slowdown in international trade growth.
- In Germany, cheap wheat imports from the Americas and Eastern Europe prompted a "grain invasion."
- Agricultural interests lobbied for protection, and Chancellor Bismarck responded with higher tariffs.
- Tariff increases extended beyond agriculture to industrial products as well.
- These actions reflect how political coalitions shaped trade policy in reaction to global market pressures.

Tariffs and Economic Growth: A Complex Relationship

- Some studies find that GDP per capita rose following increases in manufacturing tariffs (O'Rourke, Clemens Williamson, Lehmann O'Rourke).
- However, this association may only reflect short-run effects and selective timing.
- Countries may have adopted tariffs only when economic conditions were already favorable.
- Growth could have been driven by other structural forces rather than protectionism itself.
- Tariffs may have diverted demand toward domestic production at the cost of efficiency.
- Overall, the positive association does not confirm causation.

Figure 7.5: Tariffs and Growth (1875–1910)

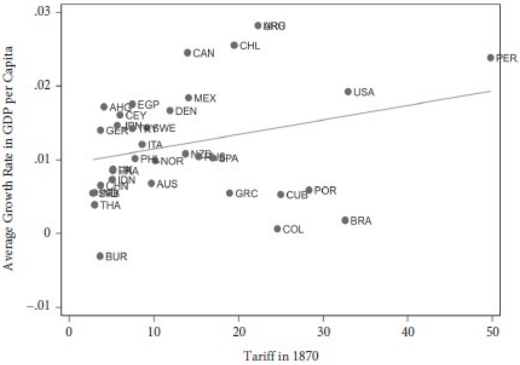

Figure 7.5 Economic Growth and Tariffs, 1870–1910

Source: Author's calculations based on data underlying Clemens and Williamson (2004a)

- The figure suggests a long-run positive relationship between tariff levels (1870) and GDP per capita growth (1875–1910).
- However, interpretation must be cautious due to potential endogeneity and omitted variables.

Interpreting Tariffs and Long-Run Growth

- While some countries experienced growth after raising tariffs, causality remains unclear.
- Tariffs may have supported certain industries but distorted broader economic efficiency.
- Other institutional, geographic, or technological factors may explain observed growth.
- Protectionism might yield short-term boosts but hinder long-term resource allocation.
- Historical patterns remind us that trade policy must be evaluated in context—not isolation.
- The debate on tariffs and growth continues in both historical and modern economic analysis.

Long-Run Growth and Market Openness

- Most empirical studies agree that long-run economic growth is negatively affected by protectionism.
- Limiting market access and reducing engagement with international markets tends to hinder overall welfare.
- Sheltering domestic markets from foreign competition reduces efficiency and innovation.
- In the long term, open economies generally outperform closed economies in terms of income growth.
- Trade openness creates opportunities for specialization, scale economies, and knowledge spillovers.
- The consensus is that global integration supports sustainable growth and prosperity.

Market Potential and Economic Performance

- Studies from the late 19th century show a strong positive link between GDP per capita and market access.
- “Market potential” reflects the effective external demand for a country’s goods and services.
- It is influenced by the income levels of trade partners and adjusted for trade costs.
- Higher-income partners and lower trade costs increase market potential.
- Both regional and sub-national openness to trade were linked to better economic outcomes.
- These findings reinforce the importance of global and regional integration for development.

The Impact of Immigration

- The first wave of globalization led to real wage convergence across countries.
- Falling barriers to migration and international trade played a central role.
- As with commodity price gaps, labor market integration equalized wages.
- Immigration increased the labor supply in receiving countries, putting downward pressure on wages.
- Organized labor opposed immigration, fearing job competition and wage declines.
- These dynamics are consistent with standard labor supply and demand theory.

The Impact of Immigration

- Immigration made land and capital more productive by increasing labor input.
- Countries like Brazil, Argentina, and Canada subsidized European immigration to reduce labor costs.
- U.S. capitalists favored immigration, anticipating higher returns on capital.
- If immigrants are perfect substitutes, native wages fall significantly.
- But if immigrants and natives are complements, immigration may raise productivity and even domestic wages.
- Historical evidence suggests both substitution and complementarity effects played a role.

The Impact of Immigration

- Despite few formal barriers before 1914, anti-immigrant sentiment was growing.
- The Chinese Exclusion Act of 1882 was the first major U.S. immigration restriction.
- It suspended new immigration from China and restricted reentry of existing Chinese residents.
- Organized labor lobbied for broader immigration controls in the 1890s.
- The Immigration Act of 1891 added health and character restrictions.
- Proposed literacy tests in 1897–1898 nearly passed, aiming to reduce immigration from Southern and Eastern Europe.

Summary of the First Wave of Globalization (1820–1914)

- Between 1820 and 1914, the world experienced rapid integration through trade, migration, and capital flows.
- Trade led to wage and income convergence across Western Europe and the Americas.
- However, many non-European regions, particularly in Asia and Africa, faced deindustrialization and slower growth.
- Colonization patterns—especially extractive colonialism—negatively influenced long-run institutional and economic development.
- The politics of globalization varied: some countries embraced free trade, others saw rising protectionist sentiment.
- Financial integration brought both investment opportunities and exposure to financial crises.

Summary of the First Wave of Globalization (1820–1914)

- Some countries used capital flows to build infrastructure; others over-borrowed and faced crisis when shocks hit.
- The gold standard created monetary discipline but also limited policy flexibility during downturns.
- Globalization produced both winners and losers—some managed integration smoothly, others experienced instability or political backlash.
- Countries differed in their responses: Britain, Japan, and Denmark upheld free trade; France, Germany, and the U.S. raised tariffs.
- A growing debate emerged over the risks of foreign capital and the political uses of investment.
- While globalization brought undeniable gains, it also came with discomfort, disruption, and long-term challenges.