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VARIETIES OF BACKLASH

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ABSTRACT

This essay reviews the various types of anti-globalization backlash that have arisen over the course of the last two centuries, and discusses ways in which governments can help the international trading system to withstand such shocks.

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Roughly two and a half millennia ago, in Greece, a man called Aesop who may or may not have existed is supposed to have told a story, that was subsequently written down, about an oak tree. This tree was a proud and principled plant. It believed in rules rather than discretion; rules that ought to be followed, no matter what the circumstances. The oak tree was dismissive of its neighbour, the reed, which it regarded as excessively flexible, addicted to discretion, and forever shifting in this direction or that, according to the prevailing winds. It was, as Mrs Thatcher might have said, just a little bit wet. And so things continued, until one night a great storm arose. The oak tree was uprooted, while the reed remained unscathed.

The moral of the story is that shock absorbers are a useful thing to have. They are useful for plants, for automobiles, and for the international trading system. When shocks arise, as they inevitably do, the system needs to be able to adjust. Otherwise it risks breaking down altogether.

Globalisation is neither new nor irreversible. Economic historians have known this for a long time. In periods when the international trading system is relatively open, this is because of domestic political equilibria favouring trade over protection, as well as a favourable geopolitical equilibrium.

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When globalisation goes into reverse, this is because of a shock or shocks which undermine these domestic political equilibria, or the geopolitical system as a whole, or both. In this brief paper I will consider three types of shocks.[1] Two are slow-moving: long run shifts in comparative advantage, and long shifts in the international distribution of economic and military power. The third is shorter run in nature, although it may reflect imbalances that have been gradually building up over time: financial and macroeconomic crises. I will begin with long run shifts in comparative advantage, and the distributional consequences that this can give rise to.

1. Distributional Shifts

In 1999, Jeff Williamson and I published a book on the ways in which late 19th-century globalisation brought Europe and the land-abundant frontier economies of the New World into much closer economic contact with each other.[2] This had profound distributional consequences. In Europe, free trade lowered the returns to owning land, and from the 1870s onwards landowners responded by demanding, and in many cases obtaining, protection. Thus came to an end a half-century of progressive trade liberalisation that had begun at the end of the Napoleonic Wars. In the New World, mass immigration lowered the relative incomes of workers and increased inequality, with the result that immigration restrictions were progressively tightened in many countries. Late 19th century globalization undermined itself, by inducing distributional shifts and political responses.

In the concluding section of the book, Williamson and I wrote that:

> Politicians, journalists, and market analysts have a tendency to extrapolate the immediate past into the indefinite future, and such thinking suggests that the world is irreversibly headed toward ever greater levels of economic integration. The historical record suggests the contrary… The record suggests that unless politicians worry about who gains and who loses, they may be forced by the electorate to stop efforts to strengthen global economy links, and perhaps even to dismantle them (O'Rourke and Williamson 1999: 286-287).

There is a reason that we framed our book in this fashion: the 1990s saw a heated debate among trade economists regarding whether the increasing inequality that was already apparent then, and had been ongoing since the 1970s, was due more to trade or to technology. If that sounds familiar, it

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1 See Irwin and O'Rourke (2014).

2 O'Rourke and Williamson (1999).

should. The political catastrophes of 2016 did not arise unexpectedly, like lightning in a blue sky: they were 40 years in the making. Ross Perot was a long time ago now! And academics have known since the early 2000s, at the latest, that opinions towards globalization in rich countries have varied by skill level exactly as Heckscher-Ohlin theory predicts, with less skilled workers being on average more hostile than the skilled (Scheve and Slaughter 2001; O'Rourke *et al.* 2001; Mayda and Rodrik 2005).

What the book did not discuss was what, if anything, policymakers can do to defuse protectionist pressures emerging as a result of such distributional shifts. A series of important articles and a book by Michael Huberman (e.g. Huberman 2012) discuss this issue in the context of the late 19th and early 20th centuries. He found that during this period several states began to develop a variety of social insurance programs that would later in the 20th century evolve into the modern welfare state. Strikingly, this development was most precocious in those countries that were most open to trade, mirroring Dani Rodrik's (1998) finding that more open economies have bigger governments. The point is that government interventions of various sorts, and maybe even the existence of a large government sector on its own, can help to protect workers against economic shocks, including those arising from international trade, and thus help preserve political support for openness. The social welfare state, and redistributive taxation, can limit increases in inequality. Government services can provide useful jobs for people across the skill distribution. In this perspective, George Osborne's austerity policies, which at the time might have been seen by some as market-friendly (because they were hostile to big government), in fact helped to cause the most market-unfriendly political development in Britain since the war, namely Brexit (Becker *et al.*, 2017).

2. Financial Crises

The most celebrated recent example of deglobalization is surely the wave of protectionism that arose in the wake of the Great Depression. The classic analysis of the Depression emphasizes the role of the gold standard, which generalized negative monetary shocks, and made it impossible for countries to respond adequately (i.e. to loosen monetary policy, and less logically, but de facto, even to loosen fiscal policy) when they fell into recession (Temin 1989; Eichengreen 1992). Since the Great Recession, however, Anglo-Saxon economists have been emphasizing something that was perhaps always obvious to their German counterparts, namely the role of international capital flows (in particular to Central Europe) and sudden stops in making the Depression truly Great, in 1931 (Accominotti and

Eichengreen 2015). To the extent that this interpretation is valid, we have yet another case of globalization undermining itself. The sudden stop view of the Depression also suggests an obvious analogy between it and the Eurozone crisis, while the procyclical austerity pursued by European governments since 2011 is reminiscent of the flawed macroeconomic policies of the 1930s (although European monetary policy has obviously been extremely accommodating this time around).[3]

Eichengreen and Irwin (2010) demonstrate that there was a striking positive correlation between the length of time during which governments persisted in remaining on gold during the 1930s, and the extent to which they raised barriers to trade. The lesson seems clear: macroeconomic shocks imply the need for macroeconomic shock absorbers. Absent those, the demand for protection can become irresistible. (A second lesson may be that we should be wary of international capital flows, which helped provoke crises even during the classical gold standard period when the system supposedly worked well.)[4] The good news is that globally, the policy response in 2008 was far superior to the interwar one (Eichengreen and O'Rourke 2009; Almunia *et al.* 2010). On the other hand, there seems little doubt but that the lurch towards procyclical austerity in Europe post-2011 helped fuel populist sentiment in various crisis-stricken countries around the European periphery. It is striking, however, that in 2016 it was the UK and US that succumbed to populism, even though those countries' macroeconomic policies were surely better than the Eurozone's after 2008. Perhaps this is related to the fact that it was in these two countries that the shift away from the state, and towards the market, has been greatest since 1979.

3. Geopolitical Shifts

Even though, as noted above, distributional shifts were already undermining late 19th century globalization prior to 1914, there is no doubt that the First World War brought the episode to an abrupt end, and ushered in a period of geopolitical instability that led first to the Second World War, and then to a Cold War. It thus had profound, negative implications for international economic integration that persisted until the 1990s.

At one level, the First and Second World Wars can be thought of as a failure of the international system to accommodate the rise of new pow-

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3 On the other hand, it took a while to get there.

4 See for example Bordo *et al.* (2010).

ers, notably Germany and Japan. Strikingly, the world was still extremely globalized in 1914, but this did not suffice to prevent the outbreak of war, despite the often-expressed view that trade makes war much less likely. Indeed, there is an argument to be made that dependence on imports, in a context where these were potentially subject to blockade by the UK or US, was one motivating factor behind German and Japanese decisions to go to war. As Azar Gat has put it, "the quest for self-sufficiency in strategic war materials became a cause as well as an effect of the drive for empire, most notably in the German and Japanese cases towards and during the Second World War" (Gat 2006: 556). This seems especially obvious in the Japanese decisions to invade Manchuria, China, and Southeast Asia, but the dream of strategic self-sufficiency was also a constant obsession of Hitler's, while as Avner Offer has convincingly argued these factors were also important in driving Anglo-German naval rivalry in the years preceding World War 1 (Barnhart 1987; Tooze 2006; Offer 1989; Bonfatti and O'Rourke 2017).

If there is an analogy today, it is with the rise of China, and with that country's dependence on imported raw materials and energy, especially oil coming through the Straits of Malacca. This makes China vulnerable, while Chinese naval expansion, which could be seen as a logical response to this vulnerability, inevitably worries its neighbours and rivals further afield, leading to the potential for further escalations of tension.

The rise of new powers 100 years ago had catastrophic consequences, and it is vital that the world do a better job this time around. If ever there was a time to reassure all countries that they will be able to trust the market to provide them with the food and raw materials that they need to survive, this is it. Providing that certainty is in my view the most important function of the rules-based international trading system that we have today. That is why the 2016 votes in the UK and US are potentially so dangerous, and why ensuring that states retain the shock absorbers necessary to maintain a generally open international system is so important.

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