
Buttonwood's notebook
Financial markets

Economics and politics **Globalisation backlash 2.0**

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ASKED about the biggest risks facing the financial markets, more than half of fund managers polled by Bank of America Merrill Lynch this month cited geopolitics and protectionism. And that seems hardly surprising, given the Brexit vote, the failed Turkish coup and the nomination of Donald Trump as the Republican presidential candidate.



Those who operate in the financial markets instinctively favour the free flow of goods, people and, of course, capital. And things have gone their way since the Thatcher/Reagan policy revolution of the early 1980s and the opening up of China, India and eastern Europe to global markets.

The first great era of globalisation in the 19th century saw the share of trade in global GDP rise eightfold between 1820 and 1913. The emergence of the railway and steamship allowed bulky products to be sent speedily across borders. British freight rates fell by 70% between 1840 and 1890. No longer did international trade have to focus on high value goods like silks and spices. Capital also flowed across borders with British savers helping to finance railway construction in Latin America and elsewhere. Mass migration was another phenomenon of the late 19th and early 20th centuries; Europeans emigrated at a rate of 300,000 a year in the first three decades after 1846, and over 1m a year between 1900 and 1914. On the eve of the First World War, foreign born people comprised 15% of the populations of America and Canada; by 1965, just 6%.

The war brought an abrupt end to the trend. But there were signs of a backlash even before the guns started firing in August 1914. Britain was wracked with a period of civil and industrial strife

dubbed “the strange death of Liberal England”; strikes on the railways and in the mines; and an effective mutiny in northern Ireland. Both Germany and Russia saw the war as a way of enhancing patriotism and countering the rising power of socialism. Terrorism emerged with prominent examples being the attack on the Barcelona opera house in 1893, a Parisian cafe bombing in 1894, the assassination of Tsar Alexander II of Russia in 1881 and President McKinley (pictured) in 1901. Of course, the First World War itself began with the assassination of the Austrian heir, Franz Ferdinand.

Were the events linked? Globalisation means that prices for commodities tend to be driven by international, rather than local, forces. The opening up of the American markets for wheat and meat led, in Britain, to the "great agricultural depression" of 1873-96. The use of the gold standard protected creditors from inflation but led to short, sharp recessions in which unemployment rose sharply, at a time when welfare states were non-existent. Nationalism had emerged as a powerful motivational force (the equivalent of religion today) with Italy and Germany uniting in the 1860s and 1870s and new eastern European states emerging from the Ottoman empire. Industrialisation, by concentrating workers in factories and towns, had given the working classes the chance to exercise their muscles, at a time when many were denied the vote.

In short, globalisation can mean rapid change in industries and across economies; change that many people find it difficult to adjust to. While economists talk of retraining and mobility, many people would rather stick to what they know and where they live. So they resist that change or look for someone (foreigners, minorities) to blame (Karl Lueger, an antisemite, was elected mayor of Vienna three times before the First World War).

The war hastened the arrival of democracy; if the workers had to fight for their country, why couldn't they vote? Attempts to resuscitate the pre-war trading system proved short-lived; the gold standard broke down quickly. International co-operation was harder with America (the dominant post-1918 economy) unwilling to play the role assumed by Britain before 1914. Reparations poisoned Franco-German relations. When the economy faltered in the early 1930s, governments opted for protectionism and competitive devaluation; the example of Soviet Russia made them very keen to keep their workers happy. Migration also slowed with America imposing a literacy test in 1917 and restrictions on Asian immigration in the 1920s.

Perhaps globalisation can only go so far before it provokes a political reaction. In his book "The Globalisation Paradox", Dani Rodrik suggested that

we cannot simultaneously pursue democracy, national determination and economic globalisation. If we want to push globalisation further, we have to give up either the

nation state or democratic politics

In theory, we could combine globalisation with international democracy (giving up the nation state) but as your blogger has [pointed out before](http://www.economist.com/blogs/buttonwood/2016/02/economics-and-democracy) (<http://www.economist.com/blogs/buttonwood/2016/02/economics-and-democracy>) , politicians are stuck between voter demands for local control and the international forces that shape economies. When they try to cooperate—on trade deals, for example—they are accused of selling out to corporate interests or other states. The Brexit vote in the UK was a rebellion against international co-operation, with the loss of local sovereignty that implies.

Luckily, the reaction against globalisation needn't lead to world war this time (although political violence seems to be increasing). Still, the prospects are worrying. That is because a feedback process can set in; terrorism can lead to repression, which inspires more recruits to terrorism (think Northern Ireland in the 1970s). And it is also because economic nationalism leads to the kind of "eye for an eye" process that makes everyone worse off. Already world trade growth is in the doldrums; [according to the CPB](http://www.cpb.nl/en/figure/cpb-world-trade-monitor-may-2016) (<http://www.cpb.nl/en/figure/cpb-world-trade-monitor-may-2016>) , it has fallen in each of the last three months. Immigration is Europe's best hope of dampening the effect of a shrinking workforce (see [last week's column](http://www.economist.com/news/finance-and-economics/21702477-can-debt-fuelled-model-growth-cope-ageing-populations-vanishing) (<http://www.economist.com/news/finance-and-economics/21702477-can-debt-fuelled-model-growth-cope-ageing-populations-vanishing>)) but that door may be closing. Things may get worse. As Russell Jones of Llewellyn Consulting writes of Donald Trump's trade policies

Trump's trade stance would risk deepening already burgeoning global protectionist pressures, while at the same time resulting in higher prices, lower quality, and less choice for domestic consumers. It could also conceivably usher in a full-blown trade war akin to that of the 1930s.

Indeed, he adds of the whole Trump policy package that

Reviewing this inventory of policy proposals, what is striking is its naiveté and incoherence. It is a litany of simplistic ideas, with no guiding principle, little clear direction, and no over-arching notion of how these various initiatives might fit together to deliver short-term macroeconomic stability, or improved long-term growth potential and flexibility. Trumponomics is hyperactive, myopic, inward-looking, and never escapes the traps of equating a country with a business, or more generally of partial equilibrium analysis. It also runs against the grain of much that the US has stood for since 1945, and which has been the keystone of the post-WWII global institutional architecture.

So the feedback is that angry voters back nationalist politicians, whose policies further impoverish those voters, who become even angrier and so on. Now of course one can retort that pro-globalisation politicians have failed to ensure that workers have enjoyed the fruits of trade growth. But they will enjoy a trade slump even less.