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Book review

Globalization and History

Kevin H. O'Rourke and Jeffrey G. Williamson (eds.), MIT Press, July 1999, p. 343.

If the recent profusion of proclamations and discussion regarding 'globalization' and our evolution towards a new 'global economy' were to be taken at face value, one would conclude that we are now witnessing the beginnings of a historically unprecedented period of economic interdependence among nations with potentially momentous consequences. Depending upon one's view, these range from dark predictions of a substantial widening of income differences to a gradual undermining of our social institutions and the possibility of severe economic and social chaos to the more sanguine expectation of an unparalleled opportunity for markets to help in the individual and collective pursuit of wealth, freedom and happiness.

In *Globalization and History*, a splendid new book which colligates their research on this topic over the last decade, Professors Kevin O'Rourke and Jeffrey Williamson argue that such globalization as we are witnessing now is neither historically exceptional nor quantitatively unprecedented. They argue convincingly that in the period spanning the mid-nineteenth to the early twentieth century, increased international linkages led to substantial convergence in incomes amongst the now OECD economies (referred to by the authors as the Atlantic economy). Most interestingly, they also discuss and analyze the 'globalization backlash' that was stimulated by these changing circumstances – the imposition of barriers to migration and trade which many have argued to have brought on dire consequences. In understanding the nature of the current international economic environment and in estimating the consequences of any policies that we may be tempted to implement in response, we are thus reminded of George Santayana's cautionary maxim: 'Those that cannot remember the past are condemned to repeat it' (Of course, Santayana is also reputed to have said that 'History if a pack of lies about events that never happened told by people who weren't there', but that is another story!!)

After first documenting the pattern of convergence in real wages across the

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Atlantic economy (Chapter 2), O'Rourke and Williamson move on to a systematic investigation of the forces underlying this convergence. They start by observing (Chapter 3) that various technological innovations in transportation – more efficient steam ships, railroad development, refrigeration and so on – contributed to a reduction in transport costs (of roughly 1.5 percent per annum) which in turn through greater trade lead to substantial convergence in international goods prices. They then discuss the consequent pattern of factor price equalization and provide us with econometric results that suggest that factor prices were linked to commodity prices (implying, of course, that factor price convergence was driven in part by commodity price convergence). Government responses to these changes in the form of newly imposed tariff barriers are discussed in Chapter 6.

After this discussion, the book then proceeds to examine the physical flows of the factors themselves (Chapters 7, 8, 11 and 12). Labor and capital flows are both described in detail. The magnitudes are impressive. Labor migration out of some countries (and mostly into America) was as high as fifty persons per thousand per decade. Capital flows were high as well. For instance, greater than 50 percent of Britain's net investment was made abroad. The impact of the flows was substantial (Chapters 9 and 12). Migration of workers lowered inequality in incomes amongst countries. Migration of capital (which paradoxically was from capital poor to capital rich countries) raised it instead. The backlash was strong (Chapters 10): Immigration policy was gradually tightened in America. Labor flows dropped substantially as a consequence. Capital controls were imposed. This along with the abandonment of the gold standard (which indirectly affected capital flows by increasing exchange risk) led to a breakdown of capital markets in the inter-war period.

The authors attempt a decomposition of influences (summarized in Chapter 14). Their analysis suggests that mass migration of labor drove much of the convergence in incomes, that capital mobility (since flows of capital were more often from poorer countries to the resource rich new world) was on balance a force for divergence while the contribution of trade to convergence was uniformly small.

Globalization and History may be judged along several dimensions. In its central goals it succeeds admirably: It provides the reader with a comprehensive economic account of the times and is highly persuasive in making the case that the late nineteenth century was characterized by open economy interactions (measured by flows of labor and capital across borders) that likely surpassed the extent of cross border linkages today. The account provided here of the underlying political economy interactions behind the 'globalization backlash' is a fascinating one. As one may expect from authors with such distinguished records in the area, the study is very well informed historically. Starting students *and* specialists should both find much here that is new and of great interest.

On the quantitative side, the analyses undertaken by the authors are ambitious ones: estimating, say, the impact of migration on factor rewards to full satisfaction would be a challenging exercise to undertake even in a much narrower partial equilibrium context. Some general equilibrium theorists and econometricians with a preference for structural modeling may therefore worry about the validity and robustness of the exercises undertaken here. It would be fair to say that some of the regression analysis conducted by the authors is subject to (at least) the same type of endogeneity and measurement error problems that are typical in exercises of this nature and that the authors do not make a great effort or use any of the state of the art techniques to deal with these issues. In fully general equilibrium contexts like the ones being considered here, it is not always clear what the appropriate reduced form econometric specification should be and where elaboration would have been preferred, O'Rourke and Williamson sometimes provide only a very sketchy discussion to motivate their specification and inferences. Consider, for instance, their tests of factor price convergence (Chapter 4). In strict form, in the standard 'textbook' cases, trade theory predicts that with free goods trade, factor prices ratios should be independent of domestic factor supplies (at least for small open economies) and related *only* to commodity price ratios. In contrast, the single equation OLS estimates (with factor price ratios on the left hand side with relative factor supplies and relative commodity price ratios as explanatory variables) obtained by the authors imply that factor prices are indeed dependent on domestic relative factor supplies. This, at one level, may be interpreted as evidence *against* the idea that openness to trade leads to (full) factor price equalization (i.e., that it makes factor price ratios independent of domestic factor supplies). Focusing instead on their finding of a significant correlation between factor price ratios and commodity price ratios, the authors report and discuss this as evidence of factor price equalization through goods trade. In a general equilibrium context, numerous questions on the validity of such illations and of the single equation estimates may be raised. While these are the type of criticisms that purists would level at perhaps the majority of statistical exercises being conducted today and while the paucity of data (particularly severe in this historical context I would imagine) undoubtedly constrained the authors from estimation of more fully specified systems, I feel that the book's substantial merits would have been further enhanced if greater attention had been paid to some of these issues.

Some important bits of analysis conducted by the authors (and reported in their published papers) such as the decomposition of wage-rental ratio trends which show how much can be explained by trends in exogenous variables are referred to and cited but not included here. This would be of central interest to economists and the omission is somewhat surprising. Some greater detail on the CGE modeling techniques used by the authors (again – referred to but not included here) would have been useful as well. The text reads occasionally unevenly and could have benefited from some greater editorial effort at organization. The details of the experiences of various countries, while always interesting, can be sometimes overwhelming and readers may have preferred a systematic tabulation or summary of results at the end of the each chapter.

These are minor blemishes however. For readers interested in absorbing the primary conclusions arrived at by this study, Chapter 14 provides an excellent closing summary. The authors also attempt to draw some lessons from history. Of central interest to economists today is the question of how much trade (and relocation of production to low wage capital-poor countries) contributes to the rising income inequality observed recently in the OECD countries. Given their finding that the explanation for (within country) income distribution changes in the earlier period was that the bulk of the work was done by labor migration and *not* trade, the authors note that this may offer 'some solace to those worried about trade and inequality in the North today'. They note also, that 'what is true for one era is not necessarily true for the other'. This is, of course, important to note and true. The majority opinion today (as I understand it) is that the rise in inequality observed in the OECD economies in the last decades is mostly explained by skill and/or sector biased technological change – factors that O'Rourke and Williamson do not consider explicitly as centrally relevant in the earlier era.

How much can we learn from the political implications of the earlier globalization then? Is a backlash comparable to the one before likely now? At one level, since the reasons for rising income inequality within countries today are most likely different from those before, we may be tempted to conclude that a backlash in the form of migration and trade controls is unlikely. Still, as O'Rourke and Williamson note, there is nothing inevitable about the world heading monotonically towards greater levels of economic integration. Indeed, an important conclusion of their study is that the historical record indicates otherwise. Whether or not history repeats itself in this manner, and whether or not this history proves to be directly relevant for the debates of today, we would do well to understand the arguments and evidence put forward in this delightful, learned and timely book.

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