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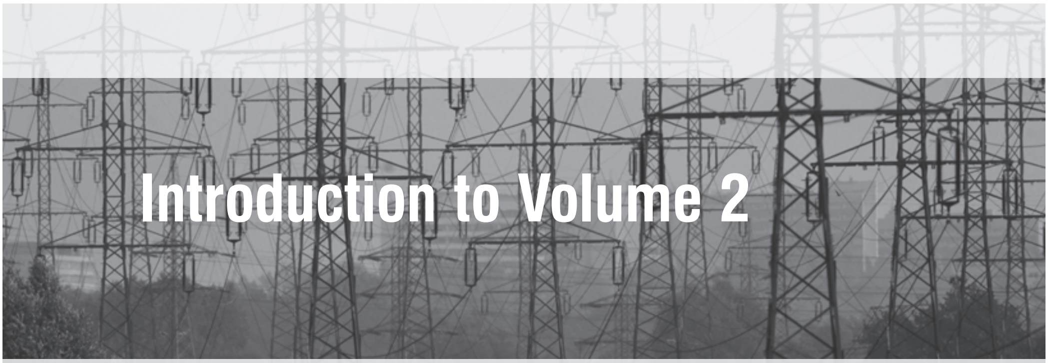

Introduction to Volume 2

Stephen Broadberry and Kevin H. O'Rourke

The economic history of Europe since 1870 can be divided into three phases. The first, which lasted until the First World War, was an age of globalization, and of European economic and political dominance worldwide. The Industrial Revolution, which was covered in Volume 1, led to the introduction of new steam-based technologies such as the steamship and railroad, which dramatically lowered transport costs, while the telegraph speeded the transmission of information. The Industrial Revolution also produced a dramatically asymmetric world, in which industrial output became increasingly concentrated in Europe and its overseas offshoots. Europe used the military power which flowed from this fact to dominate Asia and Africa politically, either through overt imperialism or in more indirect ways. The net result was a dramatic economic integration of Europe with itself and the rest of the world, despite trade policies which occasionally attempted to shield European farmers from overseas competition.

The promises which the Industrial Revolution had held out to ordinary workers were increasingly being realized across Europe during this period. According to the figures in Chapter 2, growth averaged a little over 2 percent per annum between 1870 and 1913. Real wages grew, and ordinary people lived longer, healthier and better-educated lives. While the period was certainly marked by business cycle fluctuations, governments on average found that the constraints imposed upon them by the gold standard were not excessively onerous.

The second era, which lasted from 1914 to 1945, was one of war, deglobalization, and depression: a "second thirty years war" during which Europe tore itself apart, and after which it would never regain its previous pre-eminence in world affairs. The period is a dismal confirmation of the cliché that "history matters": the roots of the interwar economic debacle, and therefore of the Second World War, can largely be traced back to the many national and international dislocations caused by the war of 1914–1918. The gold standard became unsustainable, although policy makers were slow to realize this, and the

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conflict created a host of protectionist pressures, as well as new borders along which these could be manifested. Meanwhile, the poisonous legacy of war debts and reparations would make international cooperation much more difficult, while the Russian Revolution of 1917 was an anti-globalization shock that continued to influence the world until the 1990s.

Economically, the period saw slow and extremely volatile growth, hyperinflation, and mass unemployment, despite continuing technological progress and structural change. The economic misery of the period, and in particular the Great Depression, was a man-made event, and a testament to the power of economic policies to influence people's lives for better or for worse. The two-way interaction between politics and economics is a constant feature of the period: not only did bad policies create the Great Depression, but the unemployment of the period was directly responsible for the election of Adolf Hitler. Those who escaped the period's conflicts saw improvements in life expectancy and education, but war and genocide destroyed millions of lives.

The Europe which emerged from the ruins of the Second World War was overshadowed by the two main victors in that conflict, the United States and the Soviet Union, each with their own sphere of influence in the continent. The economic history of Europe from 1950 through the 1980s is one of a divided continent, characterized by two very different economic systems: communism in the east, and a mixed system combining markets and more or less activist states in the west. The post-war period saw a gradual rebuilding of international economic links between the non-communist industrial countries, and western Europe participated in this broader trend, while experiencing deeper regional integration of its own. This regional integration would come to include most of eastern Europe in the 1990s.

Both western and eastern Europe experienced rapid economic growth during the 1950s and 1960s: 1950–1973 was western Europe's golden age, and (as Chapter 12 puts it) eastern Europe's silver age. Both periods also experienced a subsequent slowdown, which in the case of eastern Europe was sufficiently destabilizing to lead to the collapse of the communist system at the end of the 1980s. The period after 1973 saw the oil shocks, stagflation, and the gradual emergence of a period of low volatility and steady growth which is now at an end (and which may, with the benefit of enough hindsight, eventually come to be regarded as one long, unsustainable boom).

The organization of Volume 2 reflects this globalization–deglobalization–reglobalization periodization, with one section devoted to each of these three epochs. So as to maintain comparability between periods, there are five chapters in each section. The first sets the scene, by discussing the globalization or deglobalization trends that characterized the era. There then follow chapters on economic growth, business cycles, sectoral developments, and population and living standards.

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PART I Before the First World War

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CHAPTER

1 Globalization, 1870–1914

Guillaume Daudin, Matthias Morys, and Kevin H. O'Rourke

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Documenting globalization

Introduction

The period from 1870 to 1914 represented the high-water mark of nineteenth-century globalization, which, as Chapter 4 in Volume 1 showed, had been developing since the end of the Napoleonic Wars. This chapter will explore several dimensions of this globalization, as well as its effects on the European economy. Since the topic is vast, our focus will be on the links between Europe and the rest of the world, rather than on the growing integration of the European economy itself, although that will be alluded to.

Nineteenth-century globalization involved increasing transfers of commodities, people, capital, and ideas between and within continents. The most straightforward measure of integration is simply the growing volume of these international flows, perhaps scaled by measures of economic activity more generally: for example, the ratio of commodity trade to GDP, or the number of migrants per head of population. Another measure is the cost of moving goods or factors of production across borders, and this cost will show up in international price gaps. Because it is less easy to measure integration in the international "markets" for ideas and technology, these flows are often not discussed in economists' accounts of globalization, but they are sufficiently important to be briefly considered here, problems of quantification notwithstanding.

Having documented the increasing integration of international markets in the late nineteenth century, we then discuss some of the effects of this unprecedented globalization. Finally, we turn to the question of how sustainable the relatively liberal nineteenth century world economy was: could globalization have continued unabated after 1914, had the First World War not intervened, or were there forces that would have undermined open markets even had that cataclysm not occurred?

Trade, 1870–1914

European international trade in current values grew at 4.1 percent a year between 1870 and 1913, as against 16.1 percent a year between 1830 and 1870.[1] In 1990 prices, European international trade grew at 6.8 percent a year (Maddison 2001, p. 362), with growth being particularly high in Belgium, Germany, Switzerland, and Finland (Table 1.1). The European trade to GDP

[1] Bairoch 1976, p. 77; Prados de la Escosura 2000 and personal communication with the author.

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Table 1.1 European real trade 1870–1913

	1870 (million 1990 $)	Growth 1870–1913
Austria	467	+333%
Belgium	1237	+492%
Denmark	314	+376%
Finland	310	+415%
France	3512	+222%
Germany	6761	+465%
Italy	1788	+158%
Netherlands	1727	+151%
Norway	223	+283%
Spain	850	+335%
Sweden	713	+274%
Switzerland	1107	+418%
UK	12237	+222%
Weighted average		+294%
Weighted average, rest of the world		+379%

Source: Maddison 2001. Includes intra-European trade.

ratio, including intra-European trade, increased from 29.9 percent to 36.9 percent, while excluding intra-European trade it increased from 9.2 percent to 13.5 percent (Table 1.2), slightly more than the United States figure (12 percent in 1913).

Price evidence also shows impressive international integration during this period. Between 1870 and 1913, the wheat price gap between Liverpool and Chicago fell from 57.6 percent to 15.6 percent, and the London–Cincinnati bacon price gap fell from 92.5 percent to 17.9 percent. The period also saw US–British price gaps for industrial goods such as cotton textiles, iron bars, pig iron and copper falling from 13.7 percent to −3.6 percent, 75 percent to 20.6 percent, 85.2 percent to 19.3 percent, and 32.7 percent to −0.1 percent, respectively (O'Rourke and Williamson 1994). Prices also converged between Europe and Asia, with the London–Rangoon rice price gap falling from 93 percent to 26 percent, and the Liverpool–Bombay cotton price gap falling from 57 percent to 20 percent (Findlay and O'Rourke 2007, pp. 404–5). However, both Federico and Persson (2007) and Jacks (2005) point out that grain price convergence was if anything more impressive between 1830 or 1840 and 1870 than between 1870 and 1913.

International trade grew for many reasons. International freight rates declined steadily as a result of constant technical improvements and the growth in the use of faster and more regular steamships, especially after the opening in 1869 of the Suez Canal (which could only be used by steamships). However, as overland transport was much more expensive than water transport, the reduction

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Table 1.2 Exports plus imports as share of GDP

	1870	1880	1890	1900	1913
Austria	29.0%	25.5%	25.2%	26.8%	24.1%
Belgium	35.6%	53.2%	55.6%	65.4%	101.4%
Denmark	35.7%	45.8%	48.0%	52.8%	61.5%
Finland	31.7%	50.8%	39.3%	47.6%	56.2%
France	23.6%	33.5%	28.2%	26.8%	30.8%
Germany	36.8%	32.1%	30.1%	30.5%	37.2%
Greece	45.6%	42.3%	39.4%	42.3%	29.4%
Hungary	19.4%	23.7%	22.1%	22.3%	20.8%
Italy	18.3%	18.3%	15.9%	19.0%	23.9%
Netherlands	115.4%	100.5%	112.3%	124.1%	179.6%
Norway	33.9%	36.1%	43.6%	43.4%	50.9%
Portugal	33.7%	43.8%	45.3%	48.9%	57.4%
Russia		14.4%	15.0%	11.4%	13.8%
Spain	12.1%	14.8%	18.8%	22.6%	22.3%
Sweden	29.4%	37.3%	44.9%	39.4%	34.7%
Switzerland		78.2%	81.9%	67.2%	64.5%
UK	43.6%	46.0%	46.6%	42.4%	51.2%
Best guess, European trade to GDP ratio	29.9%	33.4%	32.5%	31.9%	36.9%
Idem, net of intra-European trade	9.2%	10.7%	10.8%	11.1%	13.4%

Note: Ottoman Empire, Bulgaria, Romania, and Serbia not included.
Source: Bairoch 1976, and data kindly provided by Leandro Prados de la Escosura.

of internal transport costs through the development of railroads was crucial (Figure 1.1). As a percentage of the Chicago wheat price, the cost of shipping wheat to New York declined from 17.2 percent to 5.5 percent, while the cost of shipping it from New York to Liverpool fell from 11.6 percent to 4.7 percent (Findlay and O'Rourke 2007, p. 382). Railroads were particularly important in large countries such as Russia (Metzer 1974).

In addition, peace between the main powers between 1871 and 1914 promoted trade (Jacks 2006). The development of European formal and informal empires increased extra-European trade through the reduction of trade barriers, the inclusion of colonies in currency unions, and the better protection of (European) property rights (Mitchener and Weidenmier 2007). Meanwhile, the gradual spread of the gold standard dampened exchange rate fluctuations and reduced uncertainty in trade. Whether international currency arrangements such as the Latin Monetary Union (LMU) and Scandinavian Monetary Union (SMU) had an additional positive effect on trade is a matter of controversy (Estevadeordal, Frantz, and Persson 2003; López-Córdova and Meissner 2003; Flandreau and Maurel 2005).

Falling transport costs implied increasing potential market integration, but politicians always had the option of muting or even reversing this via protectionist

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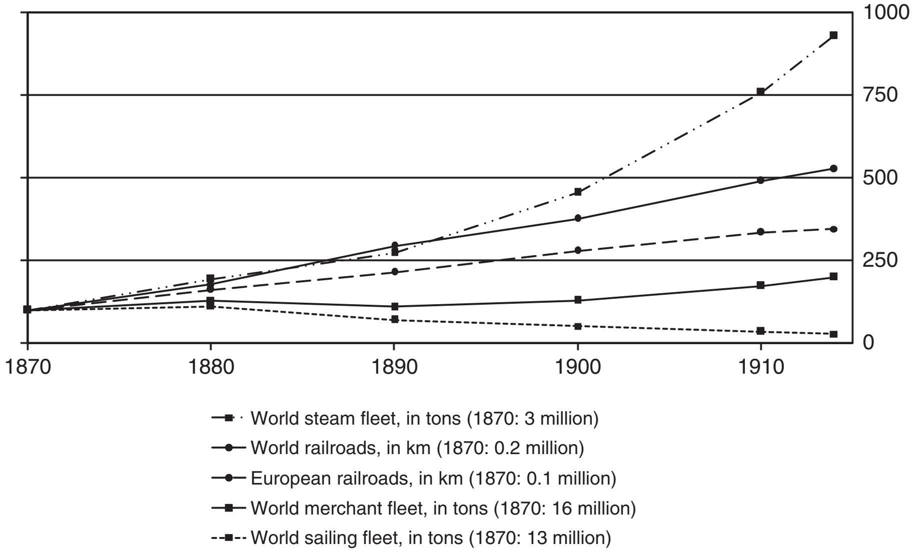

Figure 1.1 Transport infrastructure, 1870–1913 (index numbers, 1870 = 100).
Source: Bairoch 1976, pp. 32, 34

policies. Beginning in the 1870s Continental European countries raised barriers to trade in grain and other commodities (Bairoch 1989). Thus, Federico and Persson (2007) show that while grain prices converged among free trade countries during our period, this was more than counterbalanced by a substantial increase in price dispersion between free trade and protectionist countries.

As regards the pattern of trade, Europe as a whole was a net exporter of manufactures and a net importer of primary products, although this masks important differences among regions. At one extreme lay the United Kingdom, massively dependent on imported food and raw materials paid for with exports of manufactures and services. The rest of northwest Europe had a similar but less extreme specialization. Eastern and southern Europe, however, despite growing industrialization, still exported primary products and imported manufactures, net. The overall European deficit in commodity trade was partly balanced by net exports of services. To give an idea of their magnitude, the United Kingdom surplus in business services trade averaged over $800 million during 1911–13, as compared with a figure for total European exports of $11 billion in 1913 (Imlah 1952).

Capital flows, 1870–1914

International capital market integration was extremely impressive during this period. Europe was the world's banker (Feis 1930), and those regions with good access to European capital and abundant resources such as the USA, Canada,

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Table 1.3 Foreign investment by England, France, and Germany, 1870–1913

	England			France	Germany
	Saving / GDP	Foreign investment / GDP	Foreign investment as % of saving	Foreign investment as % of saving	Foreign investment as % of saving
1870–79	12.3%	4.0%	32.5%	23.9%	10.2%
1880–89	12.2%	4.7%	38.5%	5.1%	18.8%
1890–99	11.0%	3.4%	30.9%	16.5%	12.1%
1900–4	12.6%	3.7%	29.4%	19.1%	8.3%
1905–14	13.1%	6.5%	49.6%	17.3%	7.5%
Net national wealth held overseas in 1914	32.1%				
Share of global foreign investment	41.8%			19.8%	12.8%

Sources: Feis 1930; Edelstein 1982, 2004; Maddison 1995, 2003; Lévy-Leboyer and Bourguignon 1990; Jones and Obstfeld 2001.

Argentina, and Australia prospered most between 1870 and 1913. There was also a smaller, but still important, transfer of capital from the western European core to the more peripheral economies of south, central, and eastern Europe.

For the UK, Edelstein (2004, p. 193) estimates that 32 percent of net national wealth was held overseas in 1913. This reflects four decades in which foreign investment as a percentage of (domestic) savings averaged roughly one third (Table 1.3). The UK committed, on average, some 4 percent of its GDP to capital formation abroad over a period of more than 40 years, an unprecedented phenomenon. Europe as a whole dominated foreign investment. In 1914, England (42 percent), France (20 percent) and Germany (13 percent), Belgium, the Netherlands, and Switzerland combined accounted for 87 percent of total foreign investment (Maddison 1995, p. 65).

Capital market integration has traced out a U-shape over the past 150 years (Obstfeld and Taylor 2004), with late nineteenth-century integration being followed by interwar disintegration and a slow move towards reintegration in the late twentieth century. According to Obstfeld and Taylor (2004, p. 55), foreign assets accounted for 7 percent of world GDP in 1870, but for nearly 20 percent from 1900 to 1914. The figure was only 8 percent in 1930, 5 percent in 1945, and still only 6 percent in 1960. However, it then shot up to 25 percent in 1980, 49 percent in 1990, and 92 percent in 2000. On this measure it was not until some time in the 1970s that the pre-1914 level of integration was

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recouped. Another measure of integration was suggested by Feldstein and Horioka (1980). International capital mobility breaks the link between domestic savings and domestic investment, as domestic savings can be invested abroad and domestic investment can be financed externally. Consequently, the weaker the relationship between domestic savings and domestic investment, the higher is international capital mobility. The U-shaped pattern emerges yet again from the data. A third measure looks at bond spreads. Bond spreads between peripheral economies, whether in Europe or elsewhere, and England, France, and Germany fell, on average, from some 5 percent in 1870 to only 1 percent in 1914 (Flandreau and Zumer 2004). Mauro, Sussman, and Yafeh (2002) have shown that emerging market bond spreads then were, on average, less than half of what they were in the 1990s, which demonstrates just how safe investors perceived foreign investment to be at the time.

Capital market integration was not a continuous process. As is true today, there were reversals which subjected capital-receiving countries to "sudden stops" (Calvo 1998). A first wave of financial integration came to an end with the Baring crisis of 1891. Capital receded dramatically for roughly a decade before massive foreign lending resumed again around the turn of the century.

What explains late nineteenth-century capital market integration? The absence of military conflict among the main lending countries between the Franco-Prussian War and the First World War certainly helped create and stabilize an atmosphere conducive to foreign lending. Another political explanation, by contrast, has been highly controversial. Marxists have long argued that late nineteenth-century capital exports and imperialism are only two sides of the same coin: excessive saving at home, generated by a highly unequal distribution of income, required outlets in underdeveloped countries, as domestic investment would have been subject to Marx's law of the falling rate of profit. This idea (associated with J. A. Hobson) prompted Lenin to declare imperialism to be the highest stage of capitalism. The contention of a connection between empire and capital exports was subsequently discredited, to be resuscitated recently by revisionist historians arguing for a more benign interpretation of imperialism. For example, Ferguson and Schularick (2006) argue that countries in the British Empire benefited from their colonial status through substantially reduced interest rates, presumably as a result of more secure property rights. But Table 1.4 raises doubts as to whether colonial affiliation mattered for the size and the direction of capital flows. All English colonies combined (excluding Canada, Australia, and New Zealand) received a paltry 16.9 percent of English capital exports, which is less than what the USA alone received (20.5 percent). The French and German experiences suggest the same, with colonies receiving only 8.9 percent and 2.6 percent, respectively, of the overall capital exports of their respective mother countries.

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