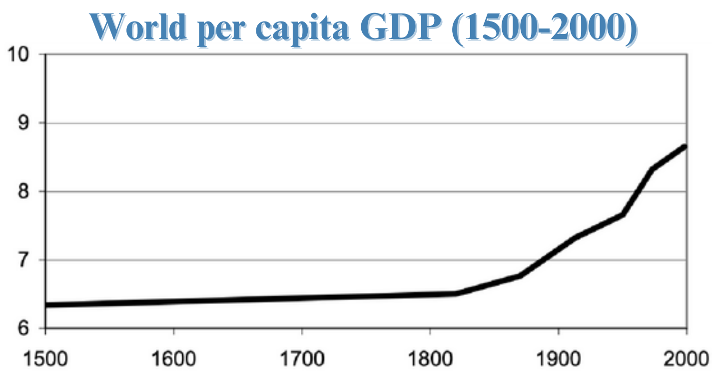
Economic foundations of early globalization, 1870–1914

A historical overview & subsequent discussion with Professor Duncan Wigan

The following essay examines the economic foundations of early globalization from 1870–1914. The essay is followed by an interview with Professor Duncan Wigan, which elaborates on selected aspects discussed in the text. Duncan is a professor of International Political Economy at the Copenhagen Business School's Department of Organization.

It is the hope of the IBP Communications Union that the discussion will inspire students to engage critically with patterns of economic history and policy. The essay has, by necessity, taken a Eurocentric and economic approach, largely omitting aspects such as colonial exploitation and gender disparities. The discussion is therefore centered on the principal economic structures rather than the wider social forces of the time.

If one is to think of a period in time marked by unprecedented economic growth, surges in cross-border investments and rapid technological change, the period from 1870–1914 is most likely not the first to come to mind. Yet, as the following essay will examine, this period is a fascinating tale of early globalization, economic growth and social change. The discussion explores some key metrics to quantify the period, examines the economic structure and technologies facilitating growth and briefly evaluates the period's social and institutional transformations. Throughout, this essay will refer to the period of 1870 to 1914 as the first wave of globalization.



Source: Jaume Ventura, "A Global View of Economic Growth," NBER Working Paper 11296 (2005)

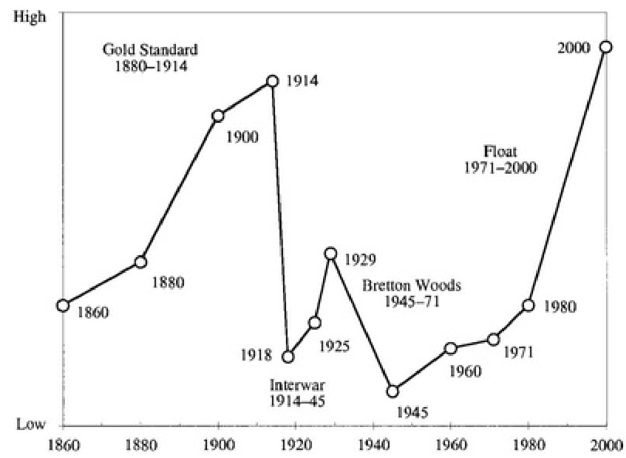
Measuring the first wave of globalization in a reliable manner on a global scale is easier said than done, in large parts due to the unavailability of reliable data. Yet by credible accounts, it is measurable that global per capita growth averaged 1.3% annually in the entire period, with global trade volume growing by a total of 400% and global financial assets increasing from 7.7 billion USD in 1870 to 38.7 billion USD in 1914. Conversely, global per capita GDP growth from 1820 to 1870 had come in at only 0.53% annually and financial assets had only grown from 0.9 to 7.7 billion USD in the same period. Considering that the entire period from 1500 to 1820 had only yielded cumulative per capita output growth of barely 18%, the period from 1870–1914 constituted the largest expansion of economic activity to its date.

To understand the key drivers facilitating change in this period, it is crucial to examine three main factors: The international gold standard, the liberal economic order and the growth of international trade.

The gold standard emerged in Britain in 1821 following the Napoleonic Wars and gradually expanded to include all major economies by the 1870s. Under this system, each national currency was defined as a fixed weight of gold, such as one pound sterling equating to

113 grains of fine gold or one US dollar to 23 grains. National treasuries and central banks guaranteed convertibility by buying and selling gold at the official rate, which effectively anchored the value of paper money to the quantity of available gold reserves. As all national currencies were tied to the same commodity, exchange rates under the gold standard were effectively fixed at set rates, in principle, creating a global environment of monetary stability. At the centre of this monetary system stood London, with the pound sterling becoming the global reserve currency and many peripheral economies pegging their currencies to the sterling rather than holding national gold reserves.

A stylized view of capital mobility in modern history



Source: Maurice Obstfeld and Alan M. Taylor, Globalization in Historical Perspective (University of Chicago Press, 2003)

Complementing the international monetary system of the gold standard was an economic order rooted in the principles of classical liberalism. This economic theory, developed by thinkers such as Smith and Ricardo, believed that markets were inherently self-adjusting and would converge towards a state of natural equilibrium if left untouched. The role of the state was therefore to secure property rights and the rule of law for free markets to run their course. The resulting policy environment of this theory was characterized by comparatively low levels of business regulation in the form of tax favourable jurisdictions, lack of labour laws and a near absence of antitrust laws. For instance, few major economies had any regulation on corporate mergers until the late 19th century, resulting in the formation of large industrial conglomerates. Additionally, taxes as a share of GDP were below 10% in most economies, compared to 20-30% today. Crucially, as governments placed virtually no limits on capital flows, the exchange rate stability of the gold standard ensured that capital mobility reached levels not replicated until the 1980s. This capital mobility led to a great surge in cross-border investments, as banks and corporate conglomerates, supported by the predictability of fixed exchange rates, chased profitable returns through overseas investments. Such investments were especially prevalent in large-scale transport and telegraph infrastructure.

The importance of these infrastructure projects can hardly be overstated. Although most states still insulated their economies through various protectionist trade measures, the technological innovations in transportation led to a great surge in global trade volume during the entire period. By the 1870s, most international shipping had shifted from sail to steam, and it is estimated that global freight rates roughly halved between 1870 and 1910. Moreover, the continued expansion of railroad infrastructure, both across industrialized states and in colonial regions, transformed land-based transport by connecting rural areas with cities and major ports. For instance, between 1870 and 1913, global railway length grew from roughly 200,000 to over one million kilometres, drastically reducing inland freight costs and integrating previously disconnected markets. Likewise, the invention of the telegraph and the establishment of a global telegraph network from 1866 onwards proved crucial in accelerating the flow of information across vast distances, further reinforcing the growth in global trade and finance.

While the structural effects of the gold standard system, classical liberal orthodoxy and rapid technological innovations facilitated the period’s economic growth to a great extent, critics have argued that these came at great social costs. For one, for states to maintain currency convertibility under the gold standard, their economies underwent cyclical periods of deflation and recession through a process Hume formulated as the 'Price-Specie Mechanism'. Simultaneously, the classical liberal framework did not constrain the exploitation of labour through long working hours, low wages, and arduous working conditions. Child labour was widespread in most economies until the turn of the century and the great influx of rural workers to urban industrial centres, led to overcrowding and deteriorating living conditions. With minimal taxation and near lack of redistributive mechanisms, gains from economic growth were also disproportionally concentrated within a small industrialist class, and relative economic inequality grew significantly during the entire period.

Other scholars, however, have emphasized that the period's rapid growth was accompanied by measurable social and economic improvements. Despite growing inequality and harsh working conditions, living standards and real wages rose steadily from the turn of the century onwards, and life expectancy increased across most industrial economies. The introduction of early social legislation, such as Bismarck's welfare reforms in the 1880s, together with the growing influence of trade unions, began to strengthen workers' bargaining power and alleviate some of the most severe conditions of industrial labour. Alongside these economic developments, the period also saw the rise of social movements and institutional modernization. Here, the suffragette movement expanded women's participation in politics and public life, while the founding of new schools and universities raised literacy rates and supported a more skilled industrial workforce.

However one deems to evaluate the economic, social, or institutional changes experienced in the first period of globalization, the structural forces discussed here were evidently instrumental in facilitating such change. Yet, with the outbreak of the First World War in 1914, the economic order built on monetary stability, financial exchange and global trade abruptly unravelled. Ultimately, it would take several decades, and a radically altered international order, before a new system sought to rebuild on the lessons and failures of this first era of globalization.

To elaborate on these issues, IBP Communications has been fortunate to speak to Duncan Wigan, himself lecturer of International Political Economy in the International Business and Politics program.
We want to thank the professor for his time and academic insight into the discussion.
This interview has been edited and condensed for clarity.

You are a professor of political economy, and we are talking about the history from 1870-1914. Could you give us an overview of the state of the political economy in this period?

The period of 1870 to 1914 marked a transition period between the industrial Revolution and increasing rivalry between nation states leading up to the first world war. It's a period of great expansion in output and trade, as well as a financial globalization. At the same time, we should recognize that the start of this period, until 1896, depending on how you measure it, was marked by a global recession of profitability. This recession is a key feature of the period, and the move away from this recession involved the emergence of strong rival powers to the United Kingdom and a formal annexation and appropriation of overseas territories. It ended, of course, in the rivalry between old powers such as the UK and the emerging powers of the US, Germany and to a lesser extent Japan. So overall, it's a period of huge social, political, and economic transformation, but also a period of economic tumult, as the initial 20 years were a recession.

Adam Smith wrote 'The Wealth of Nations' just a couple of decades before this period. What role do these ideas play in this period?

This period is much more associated with an ideology of empire and of British hegemony than liberalism as a realistic depiction of capitalist organization. Classical liberalism, in its purest form, would denote independent entities maximizing their own interests in an open market without any form of socialization. Yet, in this period, we see a large degree of socialization as these market processes become contained within nation states and centre around large combinations, we call firms. As Karl Polanyi described, capitalism in this period was unable to manage the contradictions it produced itself, especially as economic expansion required great degrees of planning within corporations and states, which in itself is antithetical to the basic tenets of classical liberalism. I would say that the previous 100 years much better resemble a high point of classical liberalism.

Economists like Milton Friedman argued that this period was the purest form of capitalism to date. Does this mean that we have wrong understanding of this period?

I think it is an insensitive assessment, as this was a transitional period to the more organized capitalism of the 20th century, a form of organization antithetical to classical liberalism. It is understandable that this evaluation might be prevalent given the ideology of empire and British hegemony, especially as the UK was able to police a free trade system and maintain the gold standard through London's role in the international economy. But, as someone once said, 'we were never modern'. I would add that we were never liberal. Say, you were an investment banker in London in 1905, then from your limited viewpoint, you might have perceived the world to be liberal in that moment. Yet, how can the world be liberal when over 60% of the world is violently occupied? That does not in any way resemble the tenets of classical liberalism. At the same time, we see the emergence of all sorts of combinations: Combinations in capital, but also in labour, as well as the emergence of socialist and union movements from the mid 19th century onwards.

In this period, we observe that the international monetary system was characterised by the gold standard. What was this system and what were its implications for trade, finance and economic growth?

The period of 1870 to 1914 marked the universalization of the gold standard and an international dependence on the pound sterling. What the gold standard implies is that a country's supply of money must exactly match the physical amount of gold it holds, which means that a countries gold reserves are a direct reflection of its position in international trade and its ability to gain from trade. It also implies that, if all countries commit to maintaining a fixed exchange rate in gold, then any outflow of gold would result in deflation and a reduction of the quantity of money in the economy. This means that the burden of adjustment falls on labour, who see their wages fall or face unemployment as investment declines. Even though labour in this period is gaining a stronger political and institutionalized voice, they bear the burden of the socially regressive adjustment mechanisms, especially during the crisis of profitability from 1870 to 1896.

How does sterling as the reserve currency benefit the UK in this period?

Well, this is similar to the role of the dollar in the later Bretton Woods and post Bretton Woods system. As long as people believed in the stability of the sterling, and its relationship to gold, then the UK had more room to manoeuvre in the adjustment mechanisms of the gold standard. Also, it is important to remember that the UK controls more than 60% of all maritime transport, it directly controls more than 30% of the world's territory and it is at the centre of the emerging global economy. An emerging economy of specialization, where developing countries are providing primary products and industrial countries are exporting industrial goods. So, countries such as Chile are producing copper and countries such as Congo, under the horrific King Leopold, are producing rubber. Depending on your perspective, you can call this surplus extraction from the global south or a globalized division of labour. Everyone should read the book "King Leopold's Ghost" by Adam Hochschild if they want to learn about the racial violence of imperialism in this period.

In your lectures, you have pointed out that levels of capital mobility were extremely high in this period. One could assume that this led to a corresponding increase in global inequality?

Well, going back to our previous point, we noted that the gold standard relied upon workers as the mechanisms of adjustment. But, as workers didn't have any franchise, and really only property owners had any electoral franchise, we see that the massive expansion of profitability in the Belle Epoque after 1896 was not being redistributed. Now, we must be careful about the type of inequality we talk about, since even though we see overall growth in wealth, the gap between rich and poor became much, much bigger. Which, of course, parallels the last 50 years or so.

How did this growing inequality between labour and capital lead to social changes or even revolutions in this period?

As I've said, this period is the transition to the world of the 20th century, in which workers have the right to vote and organize, especially through the growing trade unions, which came into existence in the UK by the mid 1860s. Yet, you see different sorts of social mechanisms, which might explain how inequality was actually contained. One of these is race, and another is, of course, gender. Now, how do you keep a group of downtrodden white Englishmen happy with their lot in life? By creating another group of people they can feel superior to. So, as long as the workers in the industrialized world can have some sort of identity coherence vis-a-vis a group of black people, then there my be a sense of psychosocial stability in society. Talking about gender, we see a movement towards gender norms of the 20th century, albeit limited to upper class women of the time, where women gain some sense of independence from the marital institution. Of course, I'm not arguing at any point, until today, that we've fully conquered gender inequality. Also, of course, the expansion of industry, the spreading of industrial capacity amongst the industrial countries, and the surplus that's being taken out of the developing and occupied world does lead to increases in consumption standards. By 1914, workers are living almost indescribably better in terms of their ability to consume, than they were in 1850. Even the recession until 1896 marks a real growth in workers' wages, as the price deflation includes the prices of the goods that workers are consuming. So, these things work together. We have growing representation of workers, we are seeing the beginnings of greater gender equality, we have huge technological innovation, a huge expansion in the number of goods that are being produced for the market, and an expansion in the number of people who can access those goods. Meaning that much of the stability of social relations in this period must come from this actual lived experience of white workers in the industrialized world.

Would you say that the consumption economy that originated in this period is something that carries on until today?

Yes, there is a wonderful film called "The Century of the Self", about the creation of the consuming individual throughout the 20th century, which is one of the key characteristics of the last century and a half. Even in my half century plus lifetime, when I was 18 and I spent six months wandering around India, only a very tiny percentage of the massive population was able to consume in anything like the way that I had experienced as a child in the US and the UK. But what we are seeing today in countries such as India and China is the emergence of a huge middle class, a middle class that, in the case of China, is larger than the whole of Europe. And yes, certainly this consumption economy has its origins in the crucial period from 1870 to 1914.

In that sense, the wave of economic growth that was constrained to the industrialized world from 1870 to 1914 has now spread to the countries previously left out?

Yes, I guess you could say so. I mean, if we think about the recent trade disputes between Donald Trump and Xi Jinping, who would have thought, even 15 years ago, that China would win in these negotiations, hands down? That's a monumental change and it has involved lifting nearly a billion people out of poverty.

Thank you for your time.