

Globalization and Nationalism: Retrospect and Prospect

Maurice Obstfeld

University of California, Berkeley; Peterson Institute; CEPR; and NBER

Italian Economic Association Annual Meeting, Palermo, Italy, October 24, 2019

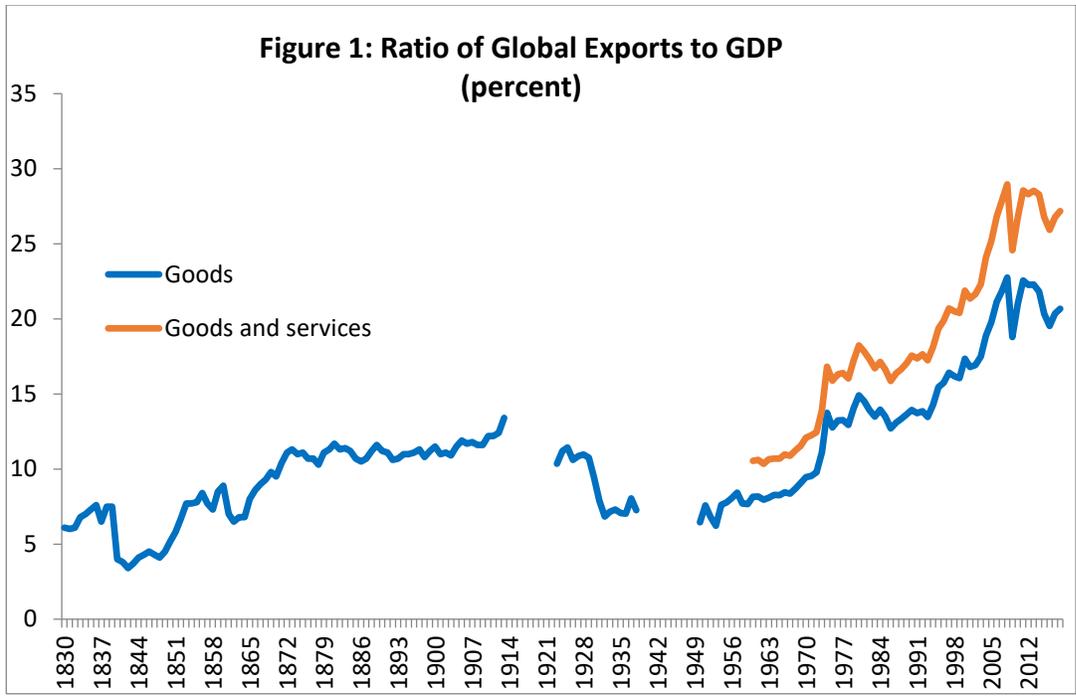
Nationalism is on the rise throughout the world – with peoples’ national attachments often driven by ethnic, racial, religious, or political identifications. The trend is evident in countries ranging from Myanmar, India, and China, to Italy, the United Kingdom, and the United States. Nationalism’s rise connects inseparably to globalization, if for no other reason than globalization’s capacity to confront a country’s residents with the outside world through trade, immigration, and media. The current *zeitgeist*, however, endangers a postwar structure of international economic linkages and institutions whose architects were convinced both that nationalistic policies helped bring on global depression and war and that global economic cooperation could promote prosperity and peace.

The bi-directional connections between nationalism and globalization – with globalization arguably spurring a nationalistic domestic politics and nationalism threatening policy shifts that compromise global economic integration – justify a focus on *economic nationalism* (de Bolle and Zettelmeyer 2019). In principle, economic policies aiming to further purely domestic objectives can be perfectly consistent with a high degree of global economic integration and cooperation. Thus, my key questions today will concern why this “divine coincidence” seems often difficult to achieve in practice, and why, when difficulties arise, global integration can be an early victim. While my goal is to get beyond quotidian observations about the “winners and losers from trade,” however essential these are as a starting point, you will see that my reflections add up to much less than a full and rigorous account. Still, it seems useful at least to put the current disruptions in their historical context – one objective being to illustrate the continuity with past developments and thereby offer hope that public action has some scope to address the current malaise.

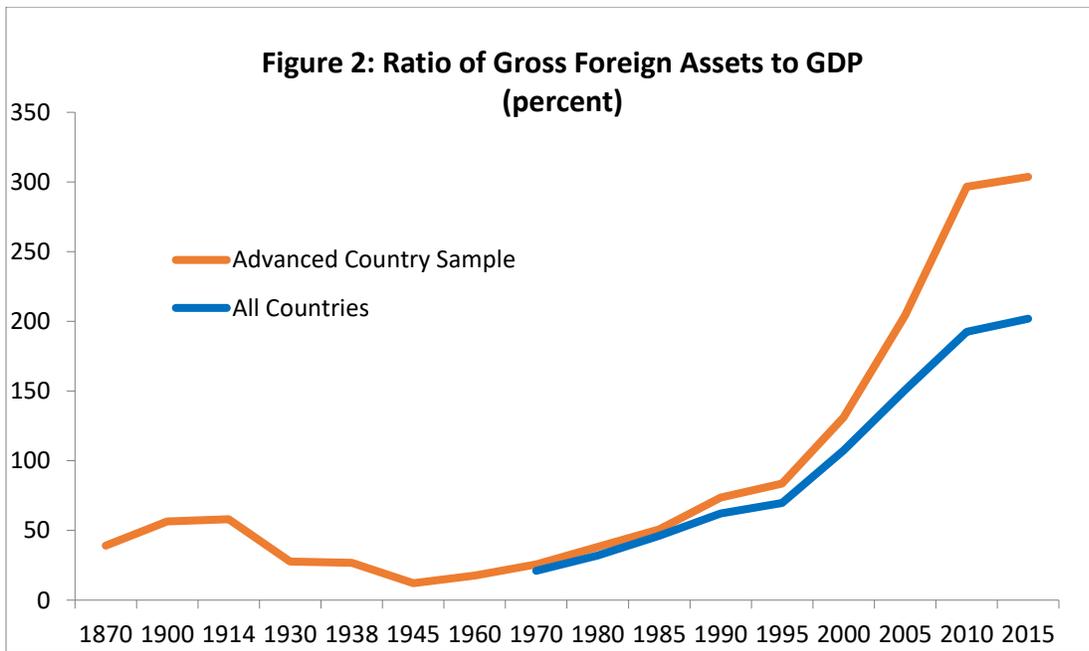
Tracking Globalization’s Rise, Fall, and Rise

Some data drawn from a recent survey by Luis Catão and myself (2019) illustrate the vicissitudes of globalization since the nineteenth century.

Figure 1 shows the data we have on the growth of world trade since the early nineteenth century. While the nominal trade data shown in the figure (as a percent of GDP) are not ideal, they do show how trade grew through the eve of World War I, consistent with historical accounts of the “first globalization.” Since the early 1970s trade has certainly grown beyond its earlier peak, especially with the strong growth in services trade more recently. The level of world trade follows a U-shape, however, declining sharply after the onset of the Great Depression in 1929, and remaining depressed before starting on a noticeable recovery in the late 1950s. The U-shape of global economic integration characterizes other indicators, as noted by myself and Alan Taylor (2004), and reflects the earlier retreat from economic internationalism in the aftermath of World War I.



Source: See Catão and Obstfeld (2019)



Source: See Catão and Obstfeld (2019)

Figure 2 shows an indicator of financial integration, the ratio of countries' gross foreign assets to GDP. The U pattern is again apparent, although since the late 1980s, increases in this de facto indicator of integration have led it to outstrip by far anything seen before World War I.

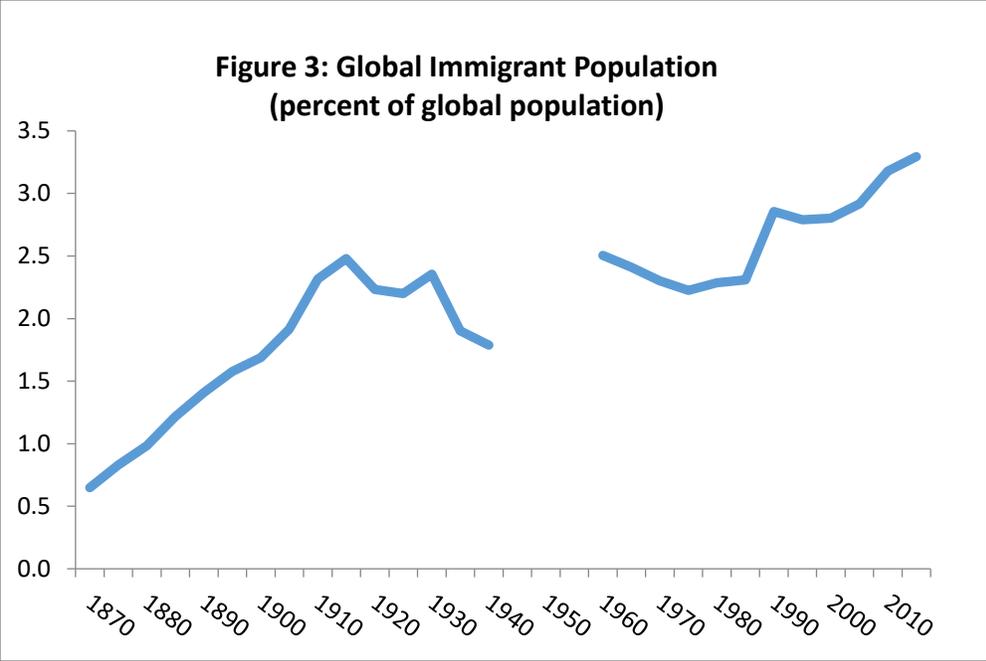
A third aspect of international economic integration is the international movement of labor. As shown in Figure 3, during the first globalization from 1870 to 1914, the global stock of labor resident in a foreign country rose fivefold, before receding in the face of war and immigration restriction by the United States (for example, the U.S. Emergency Quota Act of 1921) and other Anglo-Saxon countries of recent settlement. Resistance to immigration emerged even before World War I, in line with an emerging trade backlash in the period (O'Rourke and Williamson 1999; O'Rourke 2018). As Figure 4 shows, well before 1914, around the turn of the twentieth century, the White Australia policy was discouraging immigration there. Immigration recovered in the postwar period, however, with surges coming at different points in different advanced countries and a notable surge in global immigrant shares starting in the mid-1980s. The growth in advanced-economy immigrant presence in recent decades is, of course, an important driver of recent political developments.

The Great Depression and Keynes's Responses

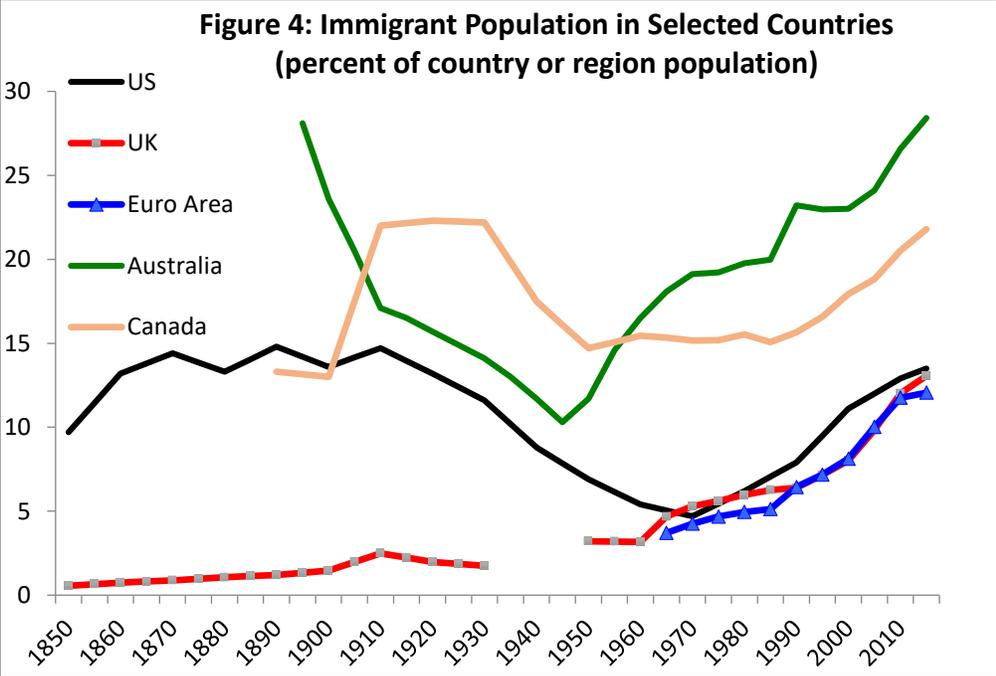
While tensions regarding trade and immigration, emerged well before the interwar period, the worldwide spread of the Great Depression resulted in a collapse of global trade and financial linkages, as chronicled by authors including Kindleberger (1973), James (2001), and Findlay and O'Rourke (2007). Against this backdrop, John Maynard Keynes (1936) published *The General Theory*, with its message that national governments have both the responsibility and the means to act in support of national employment and prosperity – something electorates had by then come to demand.

I would argue that Keynes's approach itself marked a more nationalistic approach to economic policy than pre-Depression orthodoxy. But by the 1930s, it was obvious that the underlying political landscape had changed from that which had supported the pre-WWI internationalism so vividly described in Keynes's *Economic Consequences of the Peace* (1919) – the benefits of which were enjoyed most fully by the propertied class. The Great War itself had changed the game in two ways: First, workers demanded a greater political voice and a bigger slice of the economic pie after wartime sacrifices (the same happened after World War II). Second, the extensive control governments exercised during the war illustrated how far State action could go in affecting economic outcomes. With an eye to Russia and Germany, Keynes recognized that the continuing legitimacy of democratic government hinged on a forceful State response to depression, the response being primarily targeted toward national objectives in order to discourage national political upheaval.

Three years before *The General Theory*, Keynes gave a lecture in Dublin, in what was then the Irish Free State, which foreshadowed his call for radical government action to combat the Depression and set out his thinking about the changes in international economic relations then taking place. Coincidentally but appropriately, Keynes's lectured on April 19, 1933, the day before the United States under President Franklin Roosevelt abandoned the gold standard – itself a major blow against an institution that for many at the time “symbolized internationalism and the rule of international law” (Mundell 1968, 288). I would like to dwell on this speech because, while many have quoted some of its abundant memorable lines without adequate context, the speech as a whole can be read as a pragmatic response to the crisis of the times, with important lessons, I believe, for today's very different crisis.



Source: See Catão and Obstfeld (2019)



Source: See Catão and Obstfeld (2019)

It was no accident that Keynes's lecture on "National Self-Sufficiency" took place in Dublin. Not for the first or last time, events in Ireland carried a significance more universal, persistent, and consequential than one would guess from the country's small physical size. In a very interesting book, Mark Nolan (2013) has explored in detail the background of the invitation to Keynes, and his reasons for accepting it. (See also Skidelsky 1994, 476-490.) The story begins with the 1932 accession to power in the Irish Free State of the nationalist Fianna Fáil party led by Éamon de Valera, who soon renounced Irish land annuity payments owed to Britain as a result of the 1920s settlement. There followed a cycle of mutual trade policy aggression that would last until 1938 (O'Rourke 1991). For some in de Valera's circle, however, the trade war was not unwelcome: they hoped protection would spur diversification of Ireland's economy away from its then comparative advantage in dairy and agriculture, and toward greater self-sufficiency, including in manufacturing. Irish grandees skeptical of this program invited Keynes to give the first annual Finlay Lecture, believing he could warn credibly against the dangers of excesses.

He did – not by an appeal to a pre-Depression economic orthodoxy that he admitted had failed miserably – but with a plea for more gradual experimentation, rather than radical transformation toward a pre-destined endpoint determined by ideology rather than the practical goal of bettering people's lives. The shorter versions of the speech reprinted in the *Yale Review* and the *New Statesman* are most commonly cited, but as Nolan (2013) argues, the more complete version published soon after in the Irish journal *Studies* better captures Keynes's purpose and meaning. His message was that, in an unprecedented global crisis, no one had privileged knowledge of best practice – different nations might opt for different modes of experimentation, which might run more easily if some of the external turbulence of the times were temporarily shut out. National goals might also be easier to attain if some aspects of international integration were limited to give governments a freer hand – a point Dani Rodrik has made repeatedly since the late 1990s – and the Dublin lecture, consistently with *The General Theory*, does foreshadow an expanded role for the State, including in economic "planning" – the modern mixed economy. But Keynes also raised an alarm against the practice of destructive radicalism for its own sake.

Some relevant points from the lecture. First, a critique of pre-Depression capitalism:

- "[T]he age of economic internationalism was not particularly successful in avoiding war"
- "The decadent international but individualistic capitalism, in the hands of which we found ourselves after the war, was not a success."
- "There may be some financial calculation which shows it to be advantageous that my savings should be invested in whatever quarter of the habitable globe shows the greatest marginal efficiency of capital or the highest rate of interest. But experience is accumulating that remoteness between ownership and operation – which is historically symbolised for you in Ireland by absentee landlordism – is an evil in the relations between men"
- "[W]e have until recently conceived it a moral duty to ruin the tillers of the soil and destroy the age-old human traditions attendant on husbandry, if we could get a loaf of bread thereby a tenth of a penny cheaper."

Next, recognition of the case for experimentation, possibly better practiced under some restrictions on international transactions:

- “Each year it becomes more obvious that the world is embarking on a variety of politico-economic experiments, and that different types of experiment appeal to different national temperaments and historical environments.”
- “Advisable domestic policies might often be easier to compass, if the phenomenon known as ‘the flight of capital’ could be ruled out.”

Finally, caution about radicalism for its own sake:

- “[T]he policy of national self-sufficiency is to be considered, not as an ideal in itself, but as directed to the creation of an environment in which other ideals can be safely and conveniently pursued.”
- “The economic transition of a Society is a thing to be accomplished slowly. What I have been discussing is not a sudden revolution, but the direction of a secular trend.”
- “What a wound would have been inflicted on the fair face of Ireland if within two or three years her rich pastures were to be ploughed up and the result were to be a fiasco!”
- “No one has the right to gamble with the resources of a people by going blindly into technical changes imperfectly understood. Russia stands before us as an awful example”

While not putting it nearly in the same category as Stalinism, Keynes might, I suspect, say the same about Brexit.

As I have suggested, the Depression and war led to an upsurge in nationalism of a particular kind – not always inherently hostile to foreigners, but intent on purely domestic economic goals. In the decade remaining to him after *The General Theory*, Keynes eventually embraced the goal of reconciling his great book’s program for radical national action with the economic gains offered by vibrant international trade. A key element of this goal was to channel countries’ nationalistic pursuit of prosperity away from the collisions that beggar-thy-neighbor policies could cause, and thereby to promote *global* prosperity, including in the developing world.

Barry Eichengreen (1984) – who, as it happens, gave the last Finlay Lecture in 1996 before its endowment ran out of money – has argued that Keynes came to believe that international cooperation on balance of payments (as eventually codified in the International Monetary Fund) might go far to reconcile national full-employment policies with reasonably open trade, relegating tariffs to the status of second-best instruments. Eichengreen quotes Keynes defending the Bretton Woods treaty before the House of Lords in 1945:

Separate economic blocs, and all the friction and loss of friendship they bring with them, are expedients to which one may be driven in a hostile world where trade has ceased, over wide areas, to be cooperative and peaceful and where are forgotten the healthy rules of mutual advantage and equal treatment. But it is surely crazy to prefer that.

The IMF’s main tools to promote trade were balance of payments support, pegged but adjustable exchange rates, proscriptions against currency manipulation, and obligations to restore current-account convertibility -- but not free capital movements. Proposed rules for international trade – as eventually embodied in the GATT and WTO frameworks – were not included in the Bretton Woods architecture that Keynes helped negotiate, but in the later Havana Charter of March 1948.

Postwar U.S. Leadership, Evolving Market Pressures, and Europe's Path

Once the United States was shocked out of incipient isolationism by Soviet aggression – a development that led to the Marshall Plan and other policy innovations – the postwar architecture was quite successful in restoring global growth and trade. In particular, Europe returned to currency convertibility in 1959, having created a Common Market in the 1957 Treaty of Rome. A conscious part of US policy had also been to encourage the breakup of colonial empires while supporting economic growth in the newly independent developing countries, which would allow them better to resist Communist ideology and provide markets for US exports.

Over time, however, stresses in the Bretton Woods monetary system emerged, as greater de facto capital mobility enabled currency crises, the US balance of payments weakened, and US trade partners chafed under the asymmetric power of US monetary policy. A key geopolitical factor was US allies' uneasiness with the escalation of the war in Vietnam. Moreover, despite continuing progress within the GATT, domestic trade tensions emerged in the United States. Organized labor, which still supported the Kennedy Round of tariff reductions in 1962, moved to an anti-trade posture over the subsequent decade, in particular as unions recognized that firms' ability to move abroad and sell into the United States diminished labor's bargaining power (Alden 2017).

As inflationary pressures grew and growth slowed in the lead-up to the 1972 US election, the Nixon Administration unilaterally moved to shore-up the domestic economy at the expense of domestic institutions, markets, and trade partners. The approach ultimately hastened the breakdown of the Bretton Woods system. Nixon's nationalistic package featured:

- Severing the link between gold and dollars held by foreign monetary authorities.
- A 10% import surcharge of questionable legality, to be kept in place until trade partners agreed to revalue their currencies against the dollar.
- Domestic wage and price controls.
- Pressure on Federal Reserve chair Arthur Burns to loosen monetary policy despite inflationary pressures – an action that would also stoke unwelcome inflationary pressures abroad, given that other countries were pegging to the US dollar (Mallaby 2016, 140-144).

As Treasury Secretary John Connally memorably stated at a meeting of the Group of 10 around that time, "It's our currency, but it's your problem."

We should also admit that the adoption of floating exchange rates in early 1973 (at least among the advanced economies) was also a move in the direction of more nationalistic monetary policies – that is why economists advocating flexible rates in the 1950s and 1960s, such as Friedman, Meade, and Johnson, made reference to monetary autonomy or sovereignty. But it would be simplistic to view these economists as consciously promoting nationalism in economic policy. On the contrary, they believed that fixed exchange rates had forced countries to restrict trade in order to maintain them, and that conversely, flexible rates would encourage greater globalization of trade and payments. As Johnson (1969) put it:

The main argument for flexible exchange rates at the present time is that they would make [the] surrender of [monetary] sovereignty unnecessary, while at the same time making unnecessary

the progressive extension of interventions in international trade and payments that failure to resolve this issue necessarily entails.

Johnson and his school assumed that payments restrictions on capital (but not trade) account were either infeasible or an excessive price to regain monetary sovereignty with a fixed exchange rate. I suspect Keynes would not have agreed with this resolution of the monetary trilemma – nor would a growing school of economists today. Johnson et al. also underplayed the importance of the exchange rate as a potential target of monetary policy, not just as a residual outcome.

Why do many economists resist the idea that monetary independence with a flexible exchange rate is an inherently nationalistic innovation, in the sense that it permits the alignment of national policies with national goals? One reason is that pursuing the domestic goals of full employment and price stability can be seen as a Pareto-improving endeavor in principle, both with respect to the domestic electorate and foreign partners – it may simply be about putting underutilized resources to good use. In contrast, tariffs, for example, will clearly redistribute income domestically and immiserize foreigners. But despite a body of literature suggesting that the gains from international monetary coordination are small, and the protestations of advanced-economy central bankers that their monetary policies spill over positively to trade partners (e.g., Fischer 2016 and Bernanke 2017), monetary policies clearly can have unwelcome international repercussions, often small but sometimes significant, as well as domestic redistributive effects. This is the gravamen of Raghu Rajan's (2016) critique of advanced-economy unconventional monetary policies. It is also the point of President Trump's episodic railings against dollar strength.

Starting in 1973, Europe, of course, went a different route – with exchange flexibility against the dollar, but an increasing degree of internal exchange stability, viewed as necessary to support a single market, and which culminated in 1999 in the euro. This evolution inescapably coupled with complete surrender of monetary sovereignty (except to the extent of national voting power on the ECB Governing Council) and a surrender in fiscal autonomy that remains controversial. In many areas, regulatory sovereignty resides with the European Commission, whereas the division of financial stability policy between system-wide and national competencies remains a work in progress. The single market, coupled with labor mobility, has required at least some degree of convergence in approaches worker protections and benefits, even though the European welfare states remain diverse and indeed grew out of different traditions, with the United Kingdom at the liberal extreme (e.g., Esping-Andersen 1990). The tension between national sovereignty and system-wide efficiency (e.g., though expanded fiscal union) is central to the current debate over Europe's future.

From Market Ascendancy to Renewed Crisis

In the 1990s, major center-left political parties, notably in the US and UK, embraced more of a laissez-faire attitude toward regulation and the market; moreover, market-based approaches also were followed by a good number of emerging market economies, with especially impressive aggregate growth results in two of the largest, China and India. Export orientation was a major component of emerging-market success, though in many cases, particularly in East Asia, some form of subsidization, including through exchange-rate policy, clearly helped.

One key development behind this shift was the 1989-1991 demise of the Soviet bloc, which largely discredited its centralized economic model. But apart from the impact on economic policy practice, the geopolitical implications were massive. The U.S. had finally won the struggle with the USSR that began in

the latter 1940s. The way was open for NATO expansion and for the expansion of the European Union eastward.

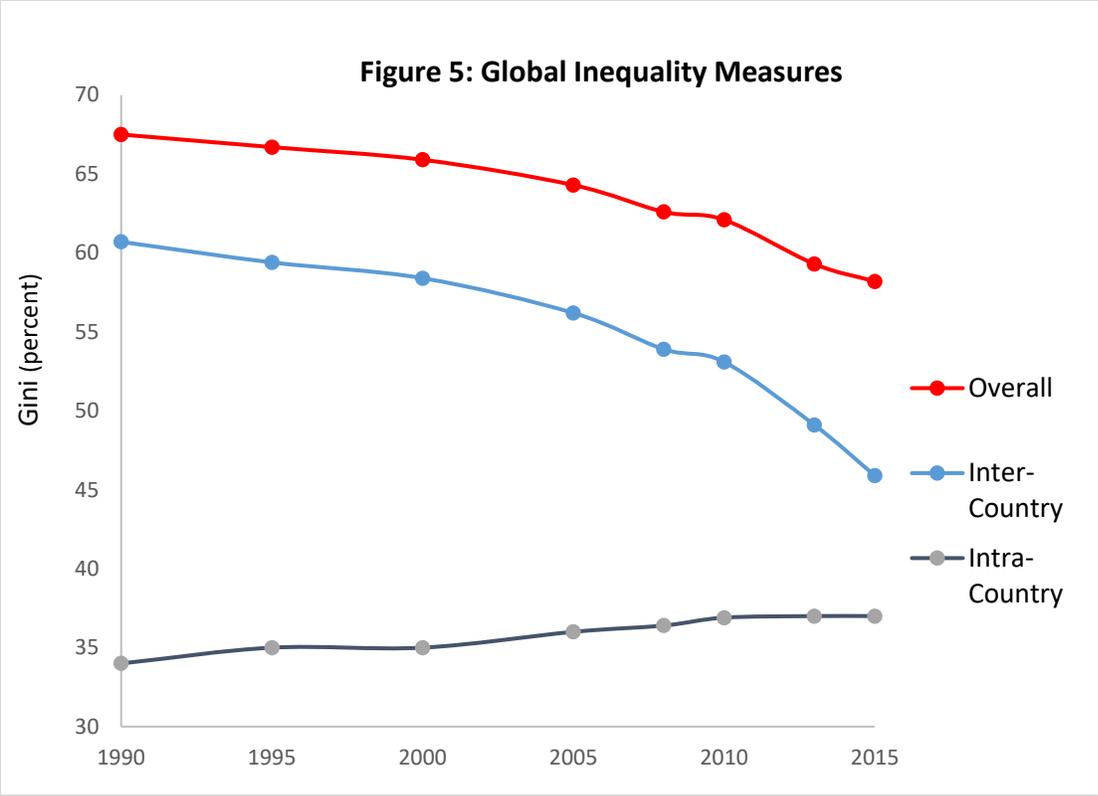
An important indicator of success for the related postwar project of elevating the poorer countries was a notable decline in *inter-country* inequality in the world economy, as indicated in Figure 5. This has been more than simply a China-India story, although there remains a sizable fraction of poor countries failing to converge to developed-economy per capita income levels (International Monetary Fund 2017, Box 1.3). At the same time, however, Figure 5 also shows that *intra-country* inequality rose over this period. This rise in inequality was pronounced in some richer countries, notably the United States, while it was somewhat more muted in Europe (at least with respect to after-tax incomes) due to welfare-state structures.

And we now know that in the United States especially, the 2000s saw considerable industrial restructuring due to trade and technology trends, entailing disruption of local communities. David Autor and co-authors (2016) have famously documented U.S. effects of Chinese import penetration. Even before then, labor-market polarization had been building as the skill premium widened. However, overall advanced-economy growth was generally healthy in the 1990s and 2000s up to 2008, muting the resulting political pressures. Growth in the 2000s depended on unsustainable financial froth, however, and when it collapsed in the 2008 crisis, a number of political tensions ultimately came home to roost.

Arguably, we are at a new crisis stage – most notably in the advanced economies, but also elsewhere – as evidenced by the rise of populism and nationalism, as well as nationalistic trade policies. Its causes are familiar: stagnant median wage growth coupled with growing inequalities, including between workers at different skill or education levels and between thriving urban regions and smaller towns; de-industrialization and an attendant loss of higher-paying middle-skill jobs; in many cases, corruption; and sharper cultural divides, sometimes linked to immigration, but not really separable from disorienting economic shifts and dislocation. (Wolf 2019 describes causes and symptoms and draws parallels with earlier crisis periods.) Among voters embracing nationalist politicians, a sense of national decline and even expropriation often prevails, with “the nation” typically defined in fairly narrow terms that may evoke nostalgia for a mythical past.

In the context of a European Union undergoing enlargement and deeper integration in the mid-1990s, the late historian Tony Judt (1996) accurately captured the danger of some citizens feeling left behind in an increasingly globalized world:

If “Europe” stands for the winners, who shall speak for the losers—the “south,” the poor, the linguistically, educationally, or culturally disadvantaged, underprivileged, or despised Europeans who don’t live in golden triangles along vanished frontiers? The risk is that what remains of these Europeans is “the nation,” or, more precisely, nationalism; not the national separatism of Catalans or the regional self-advancement of Lombards but the preservation of the nineteenth-century state as a bulwark against change.... [W]e should recognize the reality of nations and states, and note the risk that, when neglected, they become an electoral resource of nationalists.



Source: Methodology of Bourguignon (2015), as kindly updated by the author

Globalization does not bear the sole blame for this sense of loss. To the extent that technology and trade are separable at a global level, the former has been immensely important. But whether we like it or not as economists, the new crisis is causing political changes that may lead, and are already leading in some countries, to a questioning of economic orthodoxy analogous to the 1930s when Keynes spoke in Dublin. One hopes that today's process will be less dramatic and destructive, but national policies will likely shift, accompanied by some alterations to the global economic architecture established over the postwar decades. Just as in the 1930s, it is hard to discern which approaches will be more successful in terms of combining favorable economic and political outcomes, or if those successful modes of adjustment will come to prevail globally.

Political Dynamics and the Future of Globalization

A first question is how the political landscape has changed, and the role of economic factors.

Political polarization is hollowing out the political middle. We also see attacks on established international trading relationships by the president of the United States and elements of the UK political class who only a few years ago looked to be on the fringe. As Tolstoy might say, "every country is unhappy in its own way," and the underlying drivers of a rejection of more global-minded "elites" range from de-industrialization to immigration to corruption. But economists and political scientists (sometimes using individual-level data) have begun to uncover some illuminating empirical evidence linking recent economic to political developments, notably in advanced economies.

At a very general level, Funke, Schularick, and Trebesch (2016) look at data from 20 advanced economies since the late nineteenth century and find that financial crises tend to be followed by political polarization, marked by a heightened influence of right-wing sentiment demonizing minorities and foreigners. De Bromhead, Eichengreen, and O'Rourke (2013) take a closer look at the economic roots of right-wing extremism in the interwar period and find that a failure of governments to tackle depressed conditions – which, as we have seen, Keynes worried about – was a big factor.

Consequences of the crisis in many advanced economies included higher government deficit and debt levels, which in turn led some governments to embark on fiscal austerity. Fetzer (2019) finds that British voters' support for the UKIP party (as well as other measures of political unhappiness) resulted from exposure to austerity in 2010. Furthermore, Fetzer documents a degradation in the UK welfare state's ability to redistribute income from 2010 on, when David Cameron became Prime Minister and George Osborne became Chancellor. Becker and Fetzer (2017) demonstrate a link between inward migration to the UK from EU accession countries and anti-EU sentiment, as well as a congestion effect on government services and housing.

Regional economic decline has reinforced voters' migration toward populist-nationalist parties. Becker, Fetzer, and Novy (2017) find votes for Brexit in June 2016, as well as for Marine Le Pen in the French presidential election the year after, were driven by past de-industrialization, high unemployment, lower incomes, and lower education levels. Broz, Frieden, and Weymouth (2019) document the geographic link between populist support and relative economic decline in the United States and Europe, and argue that uneven impacts and recoveries from the financial crisis deepened the divide between metropolitan and more sparsely populated areas, heightening voter resentment in the latter.

Looking more closely at import-driven deindustrialization, Colantone and Stanig (2018a) show that a “China shock” instrument helps explain UK support for Brexit, while Colantone and Stanig (2018b) find that in 15 European countries over 1988-2007, Chinese import penetration moved voters toward right-wing nationalist parties. Autor, Dorn, Hanson, and Majlesi (2017), who study a number of U.S. Congressional and Presidential elections between 2002 and 2016, find that their Chinese import penetration instrument predicts greater political polarization toward anti-trade and nativist politicians. Margalit (2011) finds particular US voter sensitivity to trade-related job loss, especially from offshoring.

Even if import penetration has had impacts on political polarization in Europe as well as the United States, it seems clear that the backlash against international trade *per se* has been much more of a factor in the United States. There, President Trump has implemented a program of tariff aggression toward trade partners – with the aim of making bilateral “deals” to enhance U.S. net exports -- and a general retreat from multilateral cooperation, on issues ranging from exchange rates to trade to climate. His avowed aims are to enhance US growth and restore US manufacturing closer to its earlier postwar glory. The US retreat from its traditional championship of a non-discriminatory and rule-based trading order is especially significant, in view of the key global convening and coordination role that the US has played up to now, and which it now seems prepared to abandon. But as Europe reacts to US actions, to its own internal dynamics, and to other external events such as China’s drive to expand its global influence, it, too, will play a big role in the future of globalization.

These reflections lead to a second question, upon which the future of globalization depends. Given a changed political landscape, where are these two key players, the United States and Europe, headed?

Figure 6 (from Catão and Obstfeld 2019) offers (an admittedly simplistic) schematic for organizing thinking about the politics of trade policy. One can think of at least four different political equilibriums that could emerge from democratic processes, with only two of them favorable to globalization, and the second of those possibly politically unstable (as some would argue the recent US experience shows):

Upper left. Voters embrace egalitarian policies (high progressive taxation financing an extensive social safety net), which can then facilitate trade and financial openness, and even some immigration (for example, classic European social democracy).

Upper right. Voters do *not* want policies to address inequality directly (through higher progressive taxes and extensive social transfers), but economic openness is still the chosen policy regime – e.g., Reaganism or Thatcherism.

Lower right. Voters do not demand government policies to address inequality directly, and government successfully deflects blame toward other countries, rolling back globalization and trying to extract rents from foreigners through higher import tariffs, the discouragement of offshoring, and tighter immigration rules, both to raise domestic employment as well as wages and possibly to appease xenophobic sentiment (the pattern under right-wing populism). Trade restrictions rather than explicit redistributive policies of the State are the tool of choice to support the political base.

Lower left. Voters do want policies that directly address inequality, and the government chooses to redirect resources both through more progressive taxation and taxes on foreign trade as well as business (the case of left-wing populism).

Figure 6: Political Orientations and Trade

	LEFT	RIGHT
FREER TRADE	Moderate Social Democracies	Laissez-Faire Conservatism
TRADE INTERVENTIONISM	Left-Wing Populism	Right-Wing Populism

Source: See Catão and Obstfeld (2019)

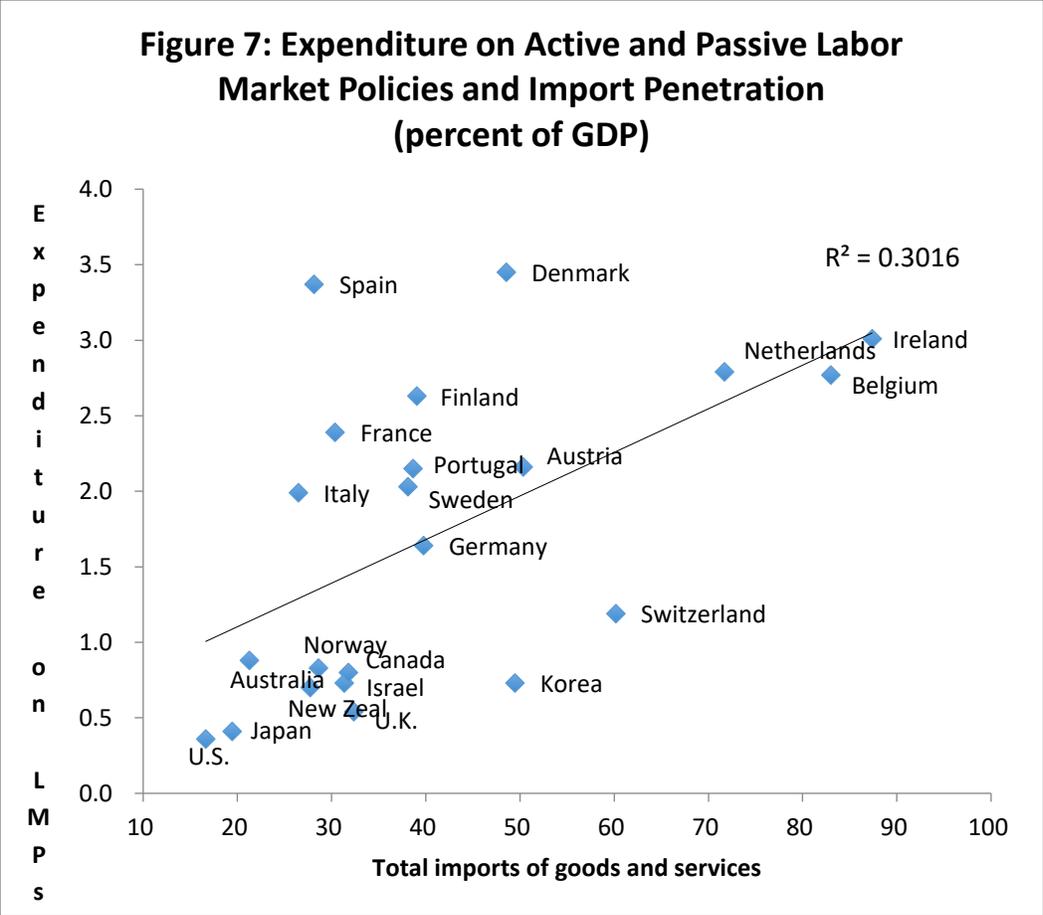
In their classic study, O'Rourke and Williamson (1999) hypothesized that trade globalization, through its very success in reallocating resources more efficiently, could set up political pressures that eventually undermine open trade. Likewise, the recent US experience suggests that the Upper Right entry may be unstable, especially as the pressures from structural change in the global economy reinforce pressures from technological change to disadvantage key segments of the population, with inadequate social safety nets to soften the blow. Consistent with this view, as noted above, the attenuation of UK social safety nets due to austerity, and under perceived pressure from EU immigration, may also have promoted voting for Leave in the United Kingdom. On the other hand, trade backlash has been much more muted (so far) in continental Europe, where social safety nets have remained more robust, as represented by the Upper Left combination.

Rodrik (1998), among others, has observed and documented the tendency for more open economies to have larger governments. Another illustration, covering advanced economies, is in Figure 7. According to Rodrik's logic, economies that are more open are subject to bigger external shocks, and therefore require more extensive government resources for social protection. At the same time, a more extensive welfare state may bolster support for global integration. Thus, it is plausible that the size and efficiency of the welfare state is intimately linked to support for trade. And this insight is key to answer our question about the future role the United States and Europe will play in the global economy.

In pursuit of that answer, it is helpful to ask two sub-questions: First, does the US open-trade regime that prevailed until recently devolve into a Lower Left or Lower Right skepticism over trade in Figure 6 – and does it matter? And second, are there shocks that could destabilize the Upper Left combination in a way that markedly reduces support for trade? The answers may hinge on the evolution of government social support policies.

First, on the United States. It is hard to overstate the change in trade attitudes that has occurred in the Congressional Republican party (if not in the sizable component of its grass-roots base that Trump has mobilized). When Democrats lost control of the Senate in November 2014, President Obama saw an opportunity to work with Republicans on passing the Trans-Pacific Partnership (TPP). As a member of the Council of Economic Advisers, I witnessed the close coordination between the White House and the Republican chairman of the House Ways and Means Committee, Paul Ryan, to pass the (fast-track) Trade Promotion Authority (or TPA) critical for TPP's eventual passage. On the whole, Congressional Democrats were strongly opposed to their own president's initiative. In the June 2015 votes on TPA (the same month Trump announced his candidacy), only 13 Democratic senators (all from coastal or farm states) and 28 Democratic representatives supported trade. (Even Democratic Rep. Adam Smith of Washington state voted against trade – so sad!) A large majority of Republicans, however, did vote for TPA. In sharp contrast, no Republican objected openly when Trump, then President, withdrew from TPP within a few days of taking office only a year and a half later.

With both major US political parties now basically in the trade-skeptic camp, the prospects for robust US support of the global trading system seem bleak. On the Republican side, some are attempting to spell out a new ideological framework to underpin a political philosophy combining skepticism of a big central



Source: See Catão and Obstfeld (2019)

government with industrial protection and immigration restriction. In a notable effort, Republic Sen. Josh Hawley of Missouri (Hawley 2019), elected in November 2018, attacked a “cosmopolitan elite” that allegedly favors globalization over “things like place and national feeling and religious faith,” as well as consumption over (the presumably more virtuous activity of) production. Clearly, part of the program requires restrictions on immigration, trade, and capital flows – the last of which have so far, perhaps due to the finance industry’s political influence, escaped relatively unscathed from the US turn against globalization. The speech does not mention the bill Hawley and Sen. Tammy Baldwin, a Wisconsin Democrat, have introduced, which would tax US capital inflows so as to limit the trade deficit to no more than ½ percent of GDP -- a policy that, in my view, would accomplish none of Hawley’s goals, but instead cause a sharp recession.¹ However, one must assume that the bill is consistent with Hawley’s program. The speech also refers to investments in workers and in “heartland” communities. However, it is short on details, does not spell out how new programs would be consistent with a presumed small-government philosophy, and diverges conspicuously from policies the Trump administration has actually pursued. Hawley places a strong emphasis on support for family and religion, with religious communities “protecting the vulnerable, defending the weak.” This does not sound like a recipe for expanding the US welfare state.

That is not the approach of the US left, which clearly shares some of Hawley’s concerns about middle-class decline but sees a definite role for expanded government action. Sen. Elizabeth Warren’s plan (Warren 2019) for “economic patriotism” hits many of the same notes as Hawley’s speech, but with much greater policy specificity. There are certainly parts of her program that would be problematic from the point of view of US relations with trade partners – subsidizing exports and seeking a weak dollar. But the program itself is not inherently protectionist, anti-immigration, or anti-globalist, and the expanded social safety net Sen. Warren has proposed, if constructed, could ultimately raise US voters’ support for trade. Republicans at the Niskanen Center, who have largely broken away from Trump, have explicitly advocated enhanced domestic risk sharing sponsored by government as a way to promote trade (Lindsey et al. 2018).

Addressing Our Crisis: Obstacles and Promise

For addressing the current crisis, advice that Tommaso Padoa-Schioppa (2010) applied to the Global Financial Crisis a decade ago certainly fits:

The exit from the configuration that led to [the crisis] should be a government which, of course, respects economic freedom, but at the same time exerts its role forcefully and is not prostrate before the twin idols of the market and the nation-state.

However, voters have to choose such a government, an outcome endogenous to the political system and dependent on a range of initial conditions. And this likelihood faces obstacles.

Important research by Alesina and Glaeser (2004) suggests that an important barrier to a more extensive welfare state in the United States is racial heterogeneity. Unfortunately, attitudes toward race and ethnicity also look likely to be key to the 2020 US elections. A year ahead, it remains very unclear if

¹ URL: <https://www.baldwin.senate.gov/imo/media/doc/FINAL%20ONE-PAGER%20The%20Competitive%20Dollar%20for%20Jobs%20and%20Prosperity%20Act.pdf>

US voters will swing in a direction more friendly to institutional innovations that might eventually generate more support for international trade.

And what about Europe? Not all is well there, either. In light of the current tensions over immigration there, we cannot discount the possibility that those same tensions eat away at the European welfare state, with consequences for attitudes toward trade. As Alesina and Glaeser wrote 15 years ago:

One natural implication of our conclusion that fractionalization reduces redistribution is that if Europe becomes more heterogeneous due to immigration, ethnic divisions will be used to challenge the generous welfare state.

Basing his assessment on more recent data, Lindert (2019) surveys the interplay between immigration policy and the welfare state and concludes that in Germany and Sweden, opposition to immigration could translate into a dilution of social entitlements. Supporting this concern, Alesina, Miano, and Stantcheva (2019) survey natives in the United States, United Kingdom, and four continental European countries. They find that respondents generally overestimate the number of immigrants in their countries, underestimate their education and skills, and become more negative about redistribution after hearing questions about immigrants. Thus, claims that nationalist sentiment in Europe stems largely from immigration rather than trade ignores the potential for immigration strains to spill over onto trade attitudes down the road.

Of course, demographic trends also endanger the welfare state.

Even in a benign scenario where countries experiment in the hope of reducing domestic inequities while maintaining economic openness – at least with respect to cross-border transactions – there remains Keynes’s question of the degree to which openness itself can frustrate policy goals. Rodrik (2000) suggested a trilemma whereby at most two of the following three can be simultaneously compatible: “international economic integration, the nation-state, and mass politics.” For example, an extensive welfare state can insure citizens against the bigger economic shocks that exposure to world markets brings, while redistributing resources domestically to compensate the losers from trade. But if capital is entirely footloose and can flee abroad to avoid taxation, countries may well enter a competitive race to the bottom in capital taxation, leaving labor to bear the entire burden of the welfare state. This disproportionate burden, in turn, could be politically destabilizing.

One solution, which would have drawn Keynes’s sympathy, is control over capital flows. This approach entails a compromise of economic openness. But another avenue is multilateral cooperation over capital taxation. This entails a partial delegation of fiscal sovereignty. OECD countries have embarked on some degree of coordination to discourage profit shifting by multinational enterprises, but much more needs doing, including on digitalization, agreed minimum corporate taxes, and concerted action against offshore havens and money laundering.

Such initiatives, explained well to the public, could themselves bolster support for multilateral economic governance reform in other essential areas, notably security, trade, corruption, labor standards, climate, and aid (Thier and Alexander 2019). All of these could help stem the flows of migrants out of poorer countries in response to natural and manufactured disasters – currently a central political stressor. In addition, while multilateralism does entail a delegation of sovereignty, it can furnish a commitment technology that avoids lose-lose equilibria. Furthermore, for smaller countries, multilateralism can actually enhance sovereignty, by acting as a bulwark against bullying by larger countries – a real danger, as we have seen in the Trump era (Zedillo 2019). Making this program work will also require investment in education and a free media – to open minds. All in all, this is a program Keynes certainly would have supported as well.

An integrated world economy, in which international trade and capital movements facilitated disruptions to the balance of power as well as imperialist rivalries, incubated World War I (Tooze and Fertik 2014; Wolf 2019). World War II grew instead out of a world of economic nationalism. By the time of the Bretton Woods conference in 1944, had Keynes's opinion of 1933 – that deep economic interdependence not only might fail to promote peace, but conceivably could undermine it – changed? I suspect he would have argued pragmatically that the benefits of economic integration can be considerable, including for geopolitics, but in light of political realities, they extend only up to a point. The evolution of the current China-US trade conflict seems consistent with this view. The challenge for countries today is to find a comfortable and safe position on the tradeoff between economic sovereignty and integration.

Eighty-six years after Keynes lectured in Dublin, Ireland is a test case for the proposition that economic integration can foster peace. Probably the most striking supportive example in today's world has been the Good Friday agreement of 1998, a settlement that required Irish and UK membership in the EU single market (O'Rourke 2019). As Brexit looms, with its threat of an economic border through the Irish island or through the Irish sea, violence has already started to return.

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