

The 1914 effect

## The globalisation counter-reaction

*Globalisation is a highly disruptive force. It provoked a reaction in the early 20th century. Are we seeing a repeat?*



WHEN the Archduke Franz Ferdinand (pictured right) was assassinated in 1914, there were few initial indications that world war would follow. In retrospect, many people have argued that the killing was a freak event that should not have resulted in the folly of war.

But was the subsequent war really an exogenous event? Or was it the near-inevitable consequence of the tensions resulting from the first great era of globalisation? If Franz Ferdinand had survived, maybe something else would have triggered the conflict. If the latter possibility is right, that may be a warning sign for the current era.

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From 1870 to 1914, the first great era of globalisation saw rapid economic growth, trade that grew faster than GDP, mass migration from Europe to the New World and convergence of real wages between the old and new worlds. In Europe, GDP per capita grew more than 70%; in the new world, (Argentina, Australia, Brazil, Canada and the United States) it doubled. Trade grew from 5.9% of global GDP to 8.2%. In

many European countries growth was much higher; nearly 15% in the UK and 18% in Belgium. This occurred despite the restoration of tariffs in many countries in the 1880s onwards. Transport costs were falling fast thanks to the railway and the steamship which meant that prices for goods like wheat, iron and copper converged across the western world.

Migration rates were remarkable. In the decade 1901-10, 5% of those from Austria-Hungary left the country, more than 6% of Britons, 7% of the Irish, 8% of Norwegians, and nearly 11% of Italians. Argentina added another 30% to its population, in immigrants alone, in that decade. Europe had lots of workers; the new world not so many. So as the workers moved, real wages nearly doubled in Europe during the period compared with a 50% rise in America.

That globalisation had brought greater prosperity was recognised at the time. Keynes famously said that in 1914

*“The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep; he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages.”*

Capital flowed freely. Britain financed the railways of Latin America; France the economic expansion of Russia. In his 1909 book, *The Great Illusion*, Norman Angell, argued that war between the great powers was futile because of the economic damage it would cause.

And yet in 1914, the great powers “sleepwalked” into war, as one author put it. Globalisation then went into reverse. It wasn’t until the 1960s or 1970s that trade recaptured its share of global GDP or countries like America started to re-open their borders to immigrants in a substantial way. Capital flows weren’t freed until the 1980s. The intervening period saw two world wars and a great Depression.

Globalisation was one of the forces that helped created the First World War because it has profoundly destabilising effects, effects we are also seeing today. In large part globalisation is about the more efficient allocation of resources—labour, capital, even land—and that creates losers. People don’t like change, especially when they lose from it. Clearly, the mid-19<sup>th</sup> century was a period of enormous change that were not just economic. In America, the industrial north defeated the agricultural south; Germany and Italy became nation states, and the multi-national Austro-Hungarian and Ottoman empires sunk into terminal decline.

Germany and America were able to catch up and, in the latter’s case, surpass the British economy. The pax Britannica in which Britain supported global trade through its powerful navy and financial system was weakened; the Bank of England needed loans from other central banks when Barings collapsed in 1890.

Industrialisation meant that new sources of power emerged to challenge the old aristocratic elites—industrialists and factory workers. Workers were able to use their muscle to demand more rights and, increasingly, the vote. Elites turned to nationalism as a way of distracting voters from economic issues and shoring up their support. This nationalism led to clashes with the other great powers where their interests diverged; between Britain and Russia in Asia; Russia and Austria in the Balkans; Germany and France in north Africa.

As the powers sought to head off these challenges, they split into the triple entente of Britain, Russia and France and the triple alliance of Germany, Austria-Hungary and Italy. Britain worried about the growing economic power of Germany and entered a naval race; Germany worried about the growing power of Russia and wanted a war sooner rather than later. Confrontation looked more attractive than collaboration.

Globalisation also meant that events in other part of the world become more important; if anything ought to have been an event in a “far way country of which we know nothing”, it was the assassination of an archduke in Sarajevo. But it dragged Britain into a war that ultimately sabotaged its status as a great power.

At the same time, the great powers had to deal with much unrest at home. What George Dangerfield called "The Strange Death of Liberal England" saw a potential civil war in Ireland, mass strikes and suffragette protests. The Russian regime nearly fell in 1905. France was convulsed by the Dreyfus affair, which divided society as clearly as Brexit or the Trump presidency. And then there were assassinations: Tsar Alexander II, the Italian king, the Spanish prime minister, the Empress of Austria and the American president William McKinley. In some cases, the murderers were immigrants; the clichéd picture of the anarchist with a bomb in hand dates from this era.

To sum up, globalisation disrupted both international power structures and domestic ones. This rapid change caused a reaction that was often violent. World War One was not inevitable but it was unsurprising.

So let us move to the current era of globalisation, during which the export share of global GDP has more than doubled since the 1960s. New economic powers have emerged to challenge American dominance; first, Japan, and now China and potentially India. Imperial overstretch threatens America as it did Edwardian Britain. The ability and, more recently, willingness of America to act as global policeman has been eroded. Indeed, unlike Britain in 1914, America is a net debtor not a creditor. Can it hold China's ambitions in check in the Pacific, counterbalance Iran and the terrorists of Islamic State in the middle east and deal with a nationalist Russian regime? It seems clear that other powers think it can't. They are pushing to see whether America will react.

Migration has increased again, not quite to pre-1914 levels but in another direction: from the developing world to the developed. This has led to cultural and economic resentment among voters and imported the quarrels of other countries. We see terrorists on the streets of London, Manchester, Paris and Boston; all inspired by events thousands of miles away. Economic integration means that financial crises can quickly spread; just as American subprime mortgages hit the world in 2008, Chinese bad debt may do so in future.

Within the economy two big changes have occurred. Manufacturing capacity has moved from the developed world to Asia. Technology has rewarded skilled workers and widened pay gaps. Voters have rebelled by turning to parties that reject globalisation. This didn't happen in France but generally it has made life more difficult for centre-left parties and turned centre-right parties more nativist.

America's Republicans used to be enthusiasts for free trade. Now they have elected Donald Trump.

Just as in the first era, globalisation has disrupted international and domestic power structures. Thankfully this does not mean that another world war is inevitable. But it is easy to imagine regional conflicts: Iran against Saudi Arabia, or an American attack on North Korea that provokes a Chinese reaction.

But we will see more resistance to globalisation from governments, as they calculate that voters will reward nativism. Foreign takeovers will be blocked. Domestic companies will be subsidised or favoured in government programmes. Tit-for-tat trade embargoes and tariffs will be imposed; the WTO could come under threat. Immigration will be discouraged, even of high-skilled workers. Populism can emerge from the left (higher taxes and nationalisation) as much as from the right; see Britain.

The real danger is that this a zero-sum game. Governments will appear to grab a larger share of global trade for their own countries. In doing so, they will cause trade to shrink. That might make voters even angrier. From the early 1980s to 2008, most companies could count on a business-friendly political environment in the developed world. But it looks as if that era has ended with the financial crisis. Globalisation has caused another counter-reaction.

The best hope is that technology can deliver the economic growth and rising prosperity voters want. If that happens, these threats will not disappear but they will be much reduced. But for all the hype about new technology, productivity has been sluggish. The omens are not great.