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THE GLOBAL 1970S AND THE ECHO OF THE GREAT DEPRESSION

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ABSTRACT

The Great Depression ushered in a long era of deglobalization that lasted for many decades. An old conventional wisdom (e.g. Polanyi) argues that the common aspect of this shock across all countries, a deep depression, can explain the large and persistent global shift away from orthodox liberal economic policies—including, for example, the collapse of free trade. Yet there is substantial unexplored variation, since not all countries experienced the same depth of shock in the 1930s. Hence, if the "policy path dependence" argument is correct, we should be able to detect it using this variation. Those countries with deeper slumps ought to have seen policy shifts that were larger and more persistent. A fuller economic history of the reglobalization of the postwar period should confront this question, and we present some preliminary evidence for the path dependence hypothesis.

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The decade of the 1970s sits on a delicate cusp: receding from conversations on the contemporary world, detaching from pressing policy debates, and sliding imperceptibly into the arena of historical scholarship. A tumultuous time in many respects, the era that began circa 1970 appears to offer the richest seams for students of social history, geopolitics, and culture; but in this paper I argue that in the sphere of economic history the 1970s may yet emerge as one of the most important turning points of the modern era.

Twenty years ago, when some of the contributors to this volume were beginning graduate school, new research on the economic history of the Great Depression, which is now indisputably a part of the standard syllabus, was at the cutting edge. The view that World War I demarcated the endpoint of history had been left behind. The new interwar scholarship has been a vital area of research ever since, and has helped us understand the first great economic turning point of the world economy in the twentieth century: the great deglobalization of the interwar period.

Time has now rolled on, and from where we stand that Great Reversal is surely long over, and it is the postwar process of reglobalization that now looms in the economic historian's rearview mirror. Understanding, documenting, and explaining that process is only just beginning—but as with the scholarship of the Great Depression a generation ago, the postwar period will form the new frontier for researchers. Where that exploration will take us remains to be seen, but I think we can already start to discern some important terrain.

In this paper I sketch how enduring questions about globalization, of both markets and society, can be seen to link the 1970s back in time to the Great Depression. Moreover, these very same concerns still resonate today in what many are starting to perceive as a moment when globalization, and the consensus behind it, is at risk of reversal yet again.

Economic historians discussing these topics are naturally drawn to an enduring account of the last Great Reversal, and still one of the most controversial and influential theses in the social sciences, Karl Polanyi's study *The Great Transformation*.[1] I do not discuss, much less endorse, many of the claims of that wide-ranging book—its much-disputed characterization of the premodern natural state of markets embedded in society, and its plainly incorrect expectation that developed economies operating as social democracies would henceforth be inimical to trade and financial openness. But as a description of the Great Reversal as it happened, the book has much to commend it.

After World War I, policymakers understood that the global economy had been damaged by the suspension of the gold standard, restrictions on trade, and exchange controls. Adverse policies were coincident with, and amplified by, the spillovers from the elevated levels of distrust and belligerence between nations. But everyone fully expected the situation to normalize, albeit after some effort, with a return to something like the largely laissez-faire pre-1914 global economy.

Following the Great Depression (and another war), the political-economy equilibrium shifted dramatically against this vision. Polanyi, if not the first to note this shock to economic structures and their supporting ideology, grasped its ramifications and deeper meaning. A global economy built along anything resembling the lines of the pre-1914 model was unlikely to return anytime soon (or ever, in Polanyi's view). The puzzle, then, is to understand what happened next, and how globalization was in many ways rebuilt after that time of massive retrenchment—what might be called a Polanyi Moment.

My first task is to present a set of facts: what actually happened in terms of globalization from the 1940s through the 1970s and up to today. As we shall see, the 1970s were notable for the persistence of controls on international capital flows, but at the same time saw a loosening of exchange rates, and growing world trade supported by major—but very uneven—steps toward trade liberalization.

This focuses my question. Why was reglobalization so slow and so uneven? We can discuss various forces that may have coalesced fortuitously in the 1970s to spark the engines of globalization into life, despite some other pressures that worked in the opposite direction. But to move from a descriptive narrative to an analytic one, we need some theory and a testable hypothesis.

As we now know, most countries, once stuck in the Great Reversal, eventually shifted policy gears and liberalized. Some trade-oriented countries liberalized very quickly in the 1970s or before; others oriented inward and clung to protectionist barriers up to the 1990s and beyond. But why were some so quick to liberalize and others much slower? That is the question.

Empirical variation naturally invites closer quantitative scrutiny. On the basis of preliminary evidence—and there is much more work to be done—I will argue that it was here that the Great Depression had its lasting effect, not (*pace* Polanyi) by preventing countries ever globalizing again, but by conditioning the speed at which they ultimately re-embraced globalization in the postwar period. The destination was the same, but the many routes taken diverged remarkably—and in some respects predictably. Especially among the developing countries—economies outside the advanced core, with a limited role in the General Agreement on Tariffs and Trade (GATT), and no role in the European

Union (EU) project—those that suffered more of a downturn in the 1930s were more "reactive" in policymaking afterwards, to use Carlos Díaz Alejandro's term, and they were more inclined to resist globalization the second time around.

If this argument withstands scrutiny it becomes an important link in our historical and institutional narrative, a bridge from the interwar calamity to more recent events, part of the making of the modern world economy. We could then argue that the global capitalist economy was not subject to a "hard reset" in 1946, starting from scratch under the new Bretton Woods order. Rather, there was a legacy from the 1930s, an institutional memory. Path dependence meant that the experience of the 1930s hung like a shadow over each country—its policymaking institutions, its interest groups, its politics and ideology. And it was a long shadow: policy persistence was shaped by this history for decades, carrying some countries forward into the vanguard of reglobalization, while holding others back.

Against this backdrop the lessons for the present are drawn into sharp focus in the conclusion to this paper. Policymakers have cautioned that the world stands on the brink of its worst financial crisis since the 1930s. For example, just before this conference, most of the policymaking elite attending the August 2008 Jackson Hole Symposium revealed that they had no clear idea how bad conditions were or might yet become. But history suggests that an exclusive focus on resolving the immediate credit crunch risks confusing the trees and the forest.

If a policymaker took a short-run view, one that could take globalization for granted, the response to the crisis might focus on how to contain periods of financial panic, fear, and distrust, which destabilize and disrupt financial markets in the manner explained by Hyman Minsky.[2] Such a Minsky Moment was certainly witnessed in the 1930s, and fear of a replay has haunted, and motivated, policymakers as a similar collapse in asset prices, credit, and liquidity erupted in 2008–09. But if we pause to take the longer view, then the example of the 1930s also shows that there can be more serious and longer-lasting downsides to any major crisis of capitalism. The worse the downturn, the greater the surge in anti-globalization and anti-market sentiments, reactions that can endure for decades once embedded in policy. On past form, a Minsky Moment may pass relatively quickly, but a Polanyi Moment will not.

Facts: What Do the Data Show?

Today "globalization" is everywhere; in the 1970s, it was mostly latent. As of August 2008 the word appeared in 3,840 book titles in the Library of Congress catalog; of those, 3,839 were published after 1987, the other one in 1983. Narrowing the focus simply to the scholarly literature in economics would also expose a profession forced to grapple more and more with problems in international economics from the 1980s onwards: trade and wages, currency crises, global imbalances, and so on, shifts that have mirrored the reality of rapidly changing economic environment.

Prior to the 1970s, with the exception of occasional cracks in the Bretton Woods fixed exchange rate regime, international economic relations were conducted under conditions of limited freedom for trade, and almost total prohibition for finance.

The evolution of trade policy from 1945 until the 1970s was constrained in terms of speed and scope. Unilateral liberalizations were few (but not unimportant for the countries in question), and with one notable exception (the European Economic Community) preferential free trade areas did not amount to much. That left GATT as the main locus for progress on trade liberalization. Yet the number of goods whose tariffs were cut was always very limited in this era, and the list of countries meaningfully participating in this bargaining process was very small—essentially just the developed countries. Until the GATT Tokyo Round (1973–79), developing countries played little effective role; they would not have a major say until the Uruguay Round (1986–93).

Trade liberalization may have been slow prior to 1970, but financial liberalization was virtually nonexistent. This was by design, of course, the goal of the Bretton Woods architecture being to make a world safe for international trade, not for international finance. After the 1930s, the latter was seen as destabilizing, and was clearly inimical to the new desire for macroeconomic policy autonomy in a world still wedded to fixed exchange rates. Thus by the 1960s only current account transactions were liberalized (though not rapidly) even as capital account transactions were still outlawed. But it did not take long for investors to find ways round these restrictions, and the porous controls led to larger financial drains, reserve leakage, and currency crises with increasing frequency as the system lurched, with all its contradictions, toward collapse.

After 1970 the reglobalization trend intensified, but this tendency was at first much stronger in the sphere of trade transactions than financial transactions.

Figure 1 shows the evolution of trade policy since 1970, using the longest-span dataset we have based on a trade-tax proxy for protectionism. (Note: it is only a proxy, and excludes many other important distortions such as quotas and exchange rate premia which might have been at least as large in their own right; but it is the only measure with adequate temporal and spatial coverage for our purpose.)

The decline in trade taxes was dramatic, but occurred more rapidly in the developed countries. The developing countries, on average, liberalized trade later, with major moves occurring at the time of the Uruguay Round in the late 1980s and early 1990s. Nonetheless, some developing countries did liberalize much sooner: well-known examples include the more export-oriented economies of East Asia. Meanwhile, other countries maintained a more protectionist stance. It is this variety of trade liberalization experiences in the 1970s that deserves a closer look.

Why focus on trade policies in this discussion? Simply because financial liberalization in the 1970s was almost nonexistent. Most developed countries—even fast movers such as Britain in 1979 and Germany in 1981—delayed their financial liberalization until long after they had started to liberalize trade. They even waited until many years after the end of the Bretton Woods system had obviated the need for capital controls to protect fixed exchange rates in a world of nascent monetary activism. In the EU as a whole, financial liberalization was a slow process in the 1980s, with even some setbacks (as in France under Mitterand); and it would not be until the end of that decade, with the Maastricht Treaty looming, that capital market integration would be consolidated as part of the single market goal. Outside the advanced economies, progress was slower still. In the emerging markets and developing countries, financial liberalization was a rare event before the 1990s. [3]

Since the focus of this study is the 1970s as a turning point, and since the wave of financial liberalization came so much later, I turn my attention now exclusively to questions surrounding the advance of free trade policies. Why did it take so long for free trade policies to be reestablished? Why did some countries liberalize much more rapidly than others? How did this matter for economic outcomes in the longer run? And what lessons does this episode carry for today? These are large enough questions to more than occupy the remainder of this paper.

Puzzles: Why Was Reglobalization So Slow?

This paper treats the 1970s as a key turning point, when the first major postwar moves toward globalization emerged in the sphere of trade policy.

Why the 1970s? Despite the attempts after 1945 to forge a new international economic order around a consensus for prosperity through trade, the greater part of the trade liberalization that we now take for granted occurred was delayed at least twenty-five years. The period 1945–70 saw only modest progress, but the period 1970–95 witnessed much more rapid opening, albeit only in selected countries. Why did this rebuilding process take so long?

Certainly the structures of GATT did not prevent a slow pace, and may even have encouraged it. Admittedly GATT was off to a flying start when the first agreement in the Geneva Round of 1947 achieved big results, slashing 45,000 tariffs on $10 billion of trade among the 23 founding members. But subsequent rounds expanded the membership only slowly and achieved fewer cuts on ever-smaller tranches of an ever-expanding volume of world trade. The 2nd Round (Annecy, 1949) covered only 5,000 tariffs and admitted 10 more countries. The 3rd Round (Torquay, 1950–51) cut 8,700 tariffs and admitted 4 new countries. The 4th Round (Geneva II, 1956) covered just $2.5 billion of trade—one quarter the level of the first round a decade before. The Dillon Round (1960–61) achieved more (4,400 cuts on $5 billion of trade). Little in this record would have led one to predict an imminent acceleration in openness in the developed countries, or any expansion of these trends to the developing countries.[4]

The 1970s were also an inauspicious moment for globalization in other respects. An oil shock and global stagflation led many countries into recessions that were deeper than anything seen since the 1930s. Downturns have generally encouraged protectionist sentiments, and not just since the 1930s: Polanyi saw similar mechanisms at work, albeit with less destructive results, in the protectionist backlash during and after the recession of the 1870s, when the free trade treaties worked out in the 1860s by Cobden and others gave way to rising tariffs, especially in Continental Europe.

All that said, some opposing forces were present in the 1970s that could encourage, or at least sustain trade opening. Most notable of these was the absence of the "golden fetters"—fixed exchange rates such as the gold standard system that had amplified previous slumps. But the breakdown of the Bretton Woods system released monetary policy and exchange rates, giving countries other levers to control aggregate demand: as a tool to stimulate expenditure switching towards home goods, a devaluation could be as effective as a tariff, at least in the short run. And indeed, the larger trade flows are, the more powerful that tool becomes.

In addition, in the 1970s the success, actual or potential, of some pro–free trade projects was starting to become apparent. The EEC was attracting new applicants, and the growth accelerations of the East Asian newly industrializing countries (NICs) were just starting to register qualitative significance, if not yet statistical significance—although the latter would build over time. Meanwhile, the limitations of import-substituting industrialization in the more inward-looking countries were becoming clearer.

There had also been signs within trade negotiations of an increased desire for openness. Many more developing countries had joined GATT in the 1960s. The Kennedy Round (1964–67) was the biggest advance in 20 years, with 50 countries using across-the-board negotiations to achieve concessions on $40 billion of world trade. Even so these agreements still covered mostly manufacturing trade and the developed countries. But by the early seventies, 99 countries were present for GATT's Tokyo Round, and some success was achieved in reducing tariffs for tropical goods as well as manufactured goods, with agreements covering $300 billion in world trade. (These figures are not adjusted for inflation.)

Still at some level, these explanations lack a deeper explanatory power, and in some cases they suffer from a serious simultaneity problem. Macroeconomic policies may have been reconfigured after the 1970s, and GATT may have been reinvigorated—all encouraging events for trade liberalization—but are these events causes or symptoms? And why did steps toward liberalization occur at different times in different countries?

We need to look back and explore the causal connections that bridge the gap from the historical crisis of globalization circa 1930 and the reconstruction that began in earnest circa 1970.

Hypotheses: A Legacy of the Great Depression?

A familiar yet unquantified narrative bridge is often used to link the policy shocks of the 1930s, the reaction against laissez-faire orthodoxy, with the endurance of these policies into the postwar era. It is central to Polanyi's thesis, although he saw the shock as more permanent. It is present in the narratives of economic history and the history of economic thought. For example: Carlos Díaz Alejandro explaining the "reactive" trade isolationism of South America; Deepak Lal exploring the rise of "dirigiste" economic thinking more broadly; or Peter Temin describing the legacy of the Great Depression as "socialism in many countries." In these and other accounts the crisis of the 1930s demanded a response; but it was not to be temporary, and after wartime autarky there were strong political economy constraints that ensured the long-run persistence of the new policies, as political inertia and the rise of new interests set policy on a path-dependent course.[5] While this narrative is true at a general level, it was obviously by no means a uniform trend in all countries. Thus we can potentially learn much more by looking closely at the variation among them. Some countries experienced deep economic pain in the Great Depression; and by the same logic, if this deep pain were translated into policy responses, we ought to have seen more "reactive" policies imprinted in countries that had the deepest slumps. Conversely, in countries where the slump was mild, or almost nonexistent, the political dynamic ought to have been very different, with less of a reaction against economic orthodoxy.

To sum up, where the standard narrative focuses on a representative experience common to many countries—Great Depression then policy reaction—I think we can make further progress by thinking about the extent to which there was a heterogeneous shock in the 1930s. We can then use that variation in the data and subsequent policy responses, to understand why the Great Depression echoed so loudly in some countries that were clinging to inward-looking policies in the 1970s, and reglobalizing slowly, while in other cases reactive policies were more temporary and policy reform pushed ahead more rapidly.

The key problem is to explain *policy persistence*. If this idea has empirical content, then we can make advances on other fronts. We can cease thinking of the policy choices of the postwar period as purely exogenous random variations, or as simply problematic endogenous responses to economic growth. Instead we can confront and put to further analytical use their origins as historically contingent, or as path-dependent outcomes possessing some regularity.[6]

Empirics: Evidence of the Echo?

Given the space available, I will show some preliminary evidence that the depth of the Great Depression did carry over, through the subsequent decades, into policymaking responses in the latter part of the twentieth century. I will also show that this path dependence was more strongly evident in direct measures of policy reform than in measures of participation in the liberalization process under GATT.

More than any other institution GATT was supposed to be the venue for countries to work together and repair the damage to international trade wrought by the interwar crisis. Thus, one might think, one useful measure of policy persistence, of attitudes towards a return to free trade, might be gleaned from the point in time when countries actually signed up to GATT. For example, as I noted earlier, few developing countries were involved in the early GATT rounds, but by the time of the Tokyo and, especially, Uruguay rounds, dozens had signed up.

Can we detect any impact of Great Depression experiences in this process? Did the countries that were hurt most by the Great Depression spend a longer period of time on the sidelines outside of GATT, thus manifesting their greater reaction against orthodoxy and resistance to open trade? The answer is no, but this is by no means damaging to my hypothesis.

As Table 1, column 1, shows there is absolutely no correlation between the date of entry into GATT and the depth of the Great Depression, where the latter is measured by the standardized cumulative GDP losses in the years 1930 to 1934 relative to the 1929 level in each country. In fact the correlation is slightly negative but not statistically significant. (Data for Former Soviet Union and Eastern bloc countries are excluded.)[7]

But this is not damning evidence for the policy persistence hypothesis. After all, being a member of GATT has never been the same thing as being an active and effective participant in GATT. Many developing countries joined GATT and yet participated little at first, and offered few tariff concession until the later rounds. Therefore, GATT membership date tells us nothing about the point at which they seriously moved to lower trade barriers and promote trade.

This finding is therefore consistent with recent influential research by Andrew Rose which shows that there is no correlation between joining GATT (or the World Trade Organization) and an increase in trade. Actions speak louder than words: GATT membership is neither necessary nor sufficient to ensure liberalization at any given moment.

Thus we should look more carefully to find more accurate measures of changes in trade policy. But this task is not so simple, given the broad span of time I wish to investigate. Hence the next natural candidate I examine is the widely used index of openness created by Jeffrey D. Sachs and Andrew Warner, updated by Romain Wacziarg and Karen Horn Welch.[8] This is a binary (0–1) indicator, where 1 is openness as judged by multiple criteria, including tariff levels, quotas, exchange rate distortions, and market structures (socialist planning and export monopolies). In contrast to the GATT entry date, the Sachs-Warner openness variable, as a policy proxy, is a measure better suited to gauging when liberalization actually happened.

As column 2 of the table shows, using this indicator, we find that there is a positive correlation of dates of opening with the intensity of the Great Depression. Economies damaged more by the Great Depression waited longer to liberalize in the postwar period, as my working hypothesis would suggest. Nevertheless, the statistical significance of this relationship is weak (though it is higher if the sample restricted to developing countries).

Can we do better? And to address the question posed earlier, can we focus specifically on that critical period of the 1970s, when some countries took the lead in opening their economies for the first time since the 1930s, whilst others lagged behind? In search of a more precise measure of trade policy alone I finally turn to direct estimates of trade taxes as a fraction of total trade (exports plus imports), based on the Economic Freedom in the World database.[9] These narrowly defined and continuous data might be preferred by some to the Sachs-Warner dummy indicator as a measure of trade reform, since the latter includes some components that are not connected to trade policy per se (such as exchange rate distortions and export marketing boards). I consider the percentage change in the level of the trade tax ratio in the 1970s. Note that this variable is used only as a proxy for trade barriers; many other policies (such as quotas) are not captured by this measure.

As column 3 demonstrates, in the 1970s there appears to have been a very clear echo of the Great Depression. The near-zero intercept shows that there was barely any trend toward policy liberalization on average in these data, which is not that surprising in the context of a decade of global slowdown and the first deep recessions in many countries since the 1930s. Still, heterogeneous outcomes stand out when we look across countries. The countries that suffered relatively mild downturns in the 1930s were still more likely to lower trade barriers in the 1970s. Countries that suffered the worst of slumps in the 1930s were much more standoffish when the prospect of reglobalization appeared on the horizon, and their trade taxes tended to stay high or even rise. A country with a 1 standard deviation lower level of output loss in the early 1930s was likely to cut trade taxes by an additional factor of 17% in the 1970s. Moreover, these results are statistically significant, despite the small sample.

In column 4 I consider the problem that some early liberalizers (most EEC and OECD countries and some open developing countries such as South Korea) had already lowered their trade barriers before 1970. These countries might bias the results toward a null finding or a low correlation, since they would have little to gain from further trade liberalization and would have completed their own reversal.

I therefore exclude from the sample the countries that already had below median trade taxes in 1970. I find that in the sample that is left, the “more protected” group (mostly developing countries, as one might guess), the echo of the Great Depression is even more pronounced, as might also be expected. Here, a country with a 1 standard deviation (s.d.) lower level of output loss in the early 1930s was likely to cut trade taxes by an additional factor of 26% in the 1970s.

To put it another way, if we take the seriously argument of an "echo effect" from the Great Depression, these results say that during the 1970s, an initially unliberalized Country A carrying the institutional memory of a relatively painful Great Depression output loss of 1 s.d. more than average would have retreated into proetctionism, raising trade barriers by about 25%. But an initially unliberalized Country B carrying the institutional memory of a relatively mild Great Depression output loss of 1 s.d. less than average would have been more inclined to continue liberalization, lowering trade barriers by about 25%.

The net result would be a significant divergence in policy stances by the end of the decade for initially identical countries: Country A would end up with trade barriers nearly twice as large as Country B's, owing to the more severe policy persistence. If these mechanisms can be further substantiated, they will attest to a very heavy hand of history weighing on the postwar reconstruction of the global economy in the 1970s.

Previously all of this might have been intuited from the broad patterns: for example, we knew that East Asia, somewhat decoupled from the financial and output collapses in Europe and North America, suffered only a mild recession in the 1930s and liberalized more rapidly; in contrast, Latin American commodity exporters were badly hit by the West's 1930s economic disaster, and subsequently kept their trade barriers up longer.[10] To give some specific country examples from the data, there is a marked regional contrast in the measure of output loss in the Great Depression as we compare, say, the large losses of Mexico (loss of +0.43 standard deviations above the mean), Uruguay (+0.43 s.d.), Argentina (+0.50 s.d) or Chile (+1.52 s.d.) with the milder downturns in Japan (–0.60 s.d.), Taiwan (–0.83 s.d.), the Philippines (–0.99 s.d.), or

Korea (–1.37 s.d.), where the deviations are cumulative lost output from a large sample of N = 51 countries. In the former group of countries, the adverse shocks were closely identified with the global economy, as in the writing of Raúl Prebisch and others, and a new reactive economic ideology replaced the old orthodoxy in the early postwar period. In the latter countries, the shocks were mild to nonexistent, and comparatively little change in economic thinking ensued. The economic future envisaged by Polanyi came to pass, but it emerged in some places more strongly than in others.

It is desirable, and I argue feasible, to move beyond those broad brushstrokes and examine the links between these key transitions in economic history more closely. Clearly more analysis remains to be done to expand the sample, examine other indicators and mechanisms, and ascertain the robustness of the correlations. Nonetheless, there is suggestive evidence here that the institutional memory of the 1930s crisis was a factor that influenced policy for a long time to come, including the speed at which countries embraced the opportunities of reglobalization in the 1970s.

Lessons for Today

The Great Transformation was not an "end of history" moment, and the subsequent fifty years witnessed something of a reglobalization along classical liberal lines that Polanyi could not envisage. The new globalization differed from its laissez-faire predecessor, and its foundations were built on international and domestic institutions that supported an "embedded liberalism" with more social protection. Nonetheless, by the 1990s it could be argued that the acceleration of globalization had eroded or disembedded much of that protection.[11]

As a generality, the idea that the Great Depression was a watershed moment that echoed throughout the rest of the twentieth century is an ingrained element of conventional wisdom. It is most often viewed in this light as a story of what happened *within* countries, to explain the timing of reactions against laissez faire and in favor of more state intervention. In many scholarly as well as popular accounts, these great long swings in economic ideology and policy outcomes and their similarities around the globe tend to take center stage.

These grand narratives implicitly emphasize the "common shock" of the Great Depression and the policy response worldwide. In this paper I have sought to argue that this view is incomplete, and that we can better understand the legacy of this defining moment by using the approaches of *new comparative economic history* to see how the differences in experiences across countries led to a variety of path-dependent outcomes evolving over time. Certainly, using the depth of the slump in the 1930s is a crude indicator, and one-dimensional at that. It is a first step only, and further, deeper research will be needed to validate the argument and flesh out the linkages; but the payoffs to this scholarship could deliver important lessons for research and policymaking.

Both research and teaching in international economic history tend to treat the history of the modern world in separate phases. Major breaking points are rarely bridged by narrative, and have received much less quantitative analysis. The Great Depression is a case in point. When we discuss the origins of the postwar economic order, we tend to view Bretton Woods as a clean slate. But around the globe, countries emerged from World War II with very different experiences, ideologies, interest groups, and agendas. Outside the Communist bloc they may have signed up in some general way to a new economic order including the goal of freer trade under GATT. But how policies and economic development played out in each case over subsequent decades would reflect the countries' very different initial conditions, including the impact of the crisis of the 1930s on domestic policymaking. A more complete global economic history of the 20th century is needed to bridge that transition with more than narrative so that we can better understand how those heterogeneous developments came about.

Research in economic growth will also benefit. Despite some skeptical resistance, one of the most widely held views in the research on postwar economic growth is that open economies have grown faster than closed economies. The divergence of economic fortunes became most apparent after 1970, when countries like the Asian NICs began their export-oriented growth, while at the other end of the spectrum, more autarkic regimes such as the import-substituters of Latin America, waited much longer to liberalize. That correlation is robust, but is it causal? One way to think about the legacy of the Great Depression is that it generates some plausible exogenous variation in subsequent trade policy, and in that respect (as an instrumental variable, in econometric language) it may help us better estimate the impact of differential speeds of policy reform on growth acceleration. In a recent paper Antoni Estevadeordal and I put this idea to work, showing that even as late as the 1990s, trade reforms still carried an echo of the Great Depression, and the faster reformers saw more rapid growth acceleration than the slow reformers.[12] There is some irony here: the countries that were worst hit by the Great Depression adopted reactive policies that may have helped somewhat in the 1930s, but they fell behind economically in the long run. If that logic holds up, then one question worth investigating is whether the Great Depression was a major contributing factor to the Great Divergence, thanks to the wide range of policy responses it unleashed.

At a broader level, understanding the very-long-run persistence of policy shocks emanating from the 1930s carries lessons for policymaking. Policies are never irreversible, but they can take on a life of their own and endure for decades. Theorists have shown in various ways how policy persistence mechanisms can make this happen. Evidence isn't plentiful, but if any past episode can prove this hypothesis, it would be policy responses to the greatest slump in history, the 1930s crisis. Should the thesis be more strongly confirmed, the lesson for current times of economic turmoil would be very clear. Avoid a Great Depression, or else face a risk that policymaking could veer into a radically autarkic stance for a many decades. From a historical standpoint, there is good reason to put extra weight on safeguarding the world economy against a deep slump, if such a meltdown would shift the political economy equilibrium past some threshold, and unleash even stronger isolationist pressures than already exist.

To sum up, in terms of global economic history, the 1970s can be seen as a bookend decade matched with the decade of the 1930s. The 1930s marked an end of globalization, which, although some expected it to be a permanent shift, kept trade flows in abeyance for only a few decades. The 1970s saw a widening embrace of trade liberalization that set the world on course for reglobalization. It is a process that still continues for now, but if we want to understand better the possible risks of another reversal, we might profitably invest more attention in the historical dynamics of the last one.

Figure 1
Trade Liberalization 1970–2000

To present a proxy for trade liberalization across many countries and years, this figure shows average levels of trade taxes as a percentage of exports plus imports for the full sample of countries in the Economic Freedom in the World 2005 dataset. Also shown are average levels for advanced and developing countries.

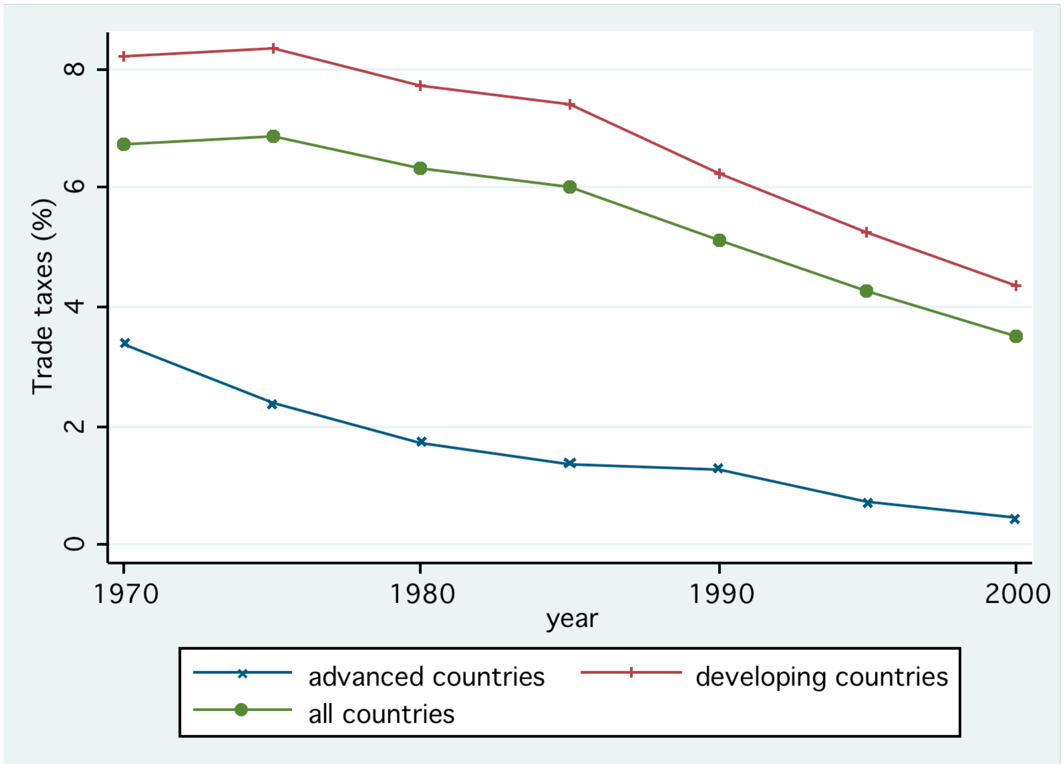

Table 1
Postwar Liberalization and the Great Depression

The table shows cross-country OLS regressions of various measures of postwar trade openness on the depth of the Great Depression, measured by cumulative real GDP loss in Maddison's data in the years 1930–1934 relative to the 1929 level (standardized to a mean of 0 and an s.d. of 1). Angus Maddison, *The World Economy: Historical Statistics* (Paris, 2001). Column 1 uses as a dependent variable the year when a country joined GATT according to Andrew K. Rose, "Do We Really Know That the WTO Increases Trade?" *American Economic Review* 94, no. 1 (March 2004): 98–114. Column 2 uses as a dependent variable the year when a country became open using the Sachs-Warner criteria according to Romain Wacziarg and Karen Horn Welch, "Trade Liberalization and Growth: New Evidence," *World Bank Economic Review* 22, no. 2 (June 2008): 187–231. Column 3 uses the proportional change in the 1970s in the ratio of trade taxes to total trade, taken from the Economic Freedom in the World 2005 dataset. Column 4 is the same as (3) but restricted to countries that initially had high (above-median) trade taxes in 1970, mostly the developing countries. The Great Depression output loss measure is statistically significant in columns (3) and (4) at the 5 percent and 1 percent levels respectively. Standard errors are shown in parentheses. Asterisks denote statistical significance at the 5 percent (*) and 1 percent (**) levels.

	(1)	(2)	(3)	(4)
Dependent variable	Year country joined GATT	Year country went open	Average change in trade taxes in the 1970s	Average change in trade taxes in the 1970s
Sample	All	All	All	Above median trade taxes in 1970
1930–34 output loss (standardized)	–3.843	1.334	0.171*	0.264**
	(2.89)	(2.86)	(0.084)	(0.090)
Constant	1961**	1974**	–0.0362	0.0661
	(2.60)	(2.49)	(0.075)	(0.080)
Observations	41	35	41	21
R-squared	0.04	0.01	0.10	0.31

NOTES

[1] Karl Polanyi, *The Great Transformation* (New York: Farrar and Rinehart, 1944).

[2] Hyman P. Minsky, "The Financial Instability Hypothesis," The Jerome Levy Economics Institute Working Paper No. 74, May 1992.

[3] On trends in financial globalization, see Maurice Obstfeld and Alan M. Taylor, *Global Capital Markets: Integration, Crisis, and Growth* (New York: Cambridge University Press, 2004). On the evolution of international financial policies see Rawi Abdelal, *Capital Rules: The Construction of Global Finance* (Cambridge, Mass.: Harvard University Press, 2007).

[4] On various interpretations of the limited role of developing countries in GATT prior to the Uruguay Round, see Rorden Wilkinson and James Scott, "Developing Country Participation in the GATT: A Reassessment," *World Trade Review* 7(3), 473–510 (June 2008).

[5] Carlos Diaz Alejandro, "Latin America in the 1930s," in Rosemary Thorp, ed., *Latin America in the 1930s: The Role of the Periphery in World Crisis* (London: Macmillan 1984). Deepak Lal, *The Poverty of 'Development Economics* (Cambridge, Mass.: Harvard University Press, 1986). Peter Temin, *Lessons from the Great Depression* (Cambridge, Mass.: MIT Press, 1989).

[6] Theoretical treatments of policy persistence include, inter alia, Gordon Tullock, "The Transitional Gains Trap," *Bell Journal of Economics*, vol. 6(2), 671-678 (Autumn 1975). Raquel Fernandez and Dani Rodrik, "Resistance to Reform: Status Quo Bias in the Presence of Individual-Specific Uncertainty," *American Economic Review* 81(5), 1146-55 (December 1991); Alberto Alesina and Allan Drazen, "Why Are Stabilizations Delayed?" *American Economic Review* 81(5), 1170-88 (December 1991); and Stephen Coate and Stephen Morris, "Policy Persistence," *American Economic Review* 89(5), 1327–36 (December 1999). A recent empirical work which uses this idea to explain growth outcomes is Antoni Estevadeordal and Alan M. Taylor, "Is the Washington Consensus Dead? Growth, Openness, and the Great Liberalization, 1970s–2000s," NBER Working Papers 14264 (August 2008). A recent theoretical paper argues that openness spread slowly after 1950 because policymakers were subject to learning and policy frictions; see Francisco J. Buera, Alexander Monge-Naranjo, and Giorgio E. Primiceri, "Learning the Wealth of Nations" (unpublished paper, UCLA, May 2008).

[7] Computations of GDP loss are based on data from Angus Maddison, *The World Economy: Historical Statistics* (Paris: OECD, 2001).

[8] Jeffrey D. Sachs and Andrew Warner, "Economic Reform and the Process of Global Integration," *Brookings Papers on Economic Activity* 26(1), 1–118 (1995); Romain Wacziarg and Karen Horn Welch," Trade Liberalization and Growth: New Evidence," *World Bank Economic Review* 22(2), 187–231 (June 2008).

[9] Data from the Economic Freedom in the World Annual Report, 2005 and previous issues. http://www.freetheworld.com/ .

[10] Angus Maddison, *Two Crises: Latin America and Asia 1920–1938 and 1973–1983* (Paris: OECD, 1985).

[11] John Gerard Ruggie "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," *International Organization* 36(2): 379–415 (Spring 1982); Dani Rodrik, "How Far Will International Economic Integration Go?" *Journal of Economic Perspectives* 14(1), 177–186 (Winter 2000).

[12] See note 6.