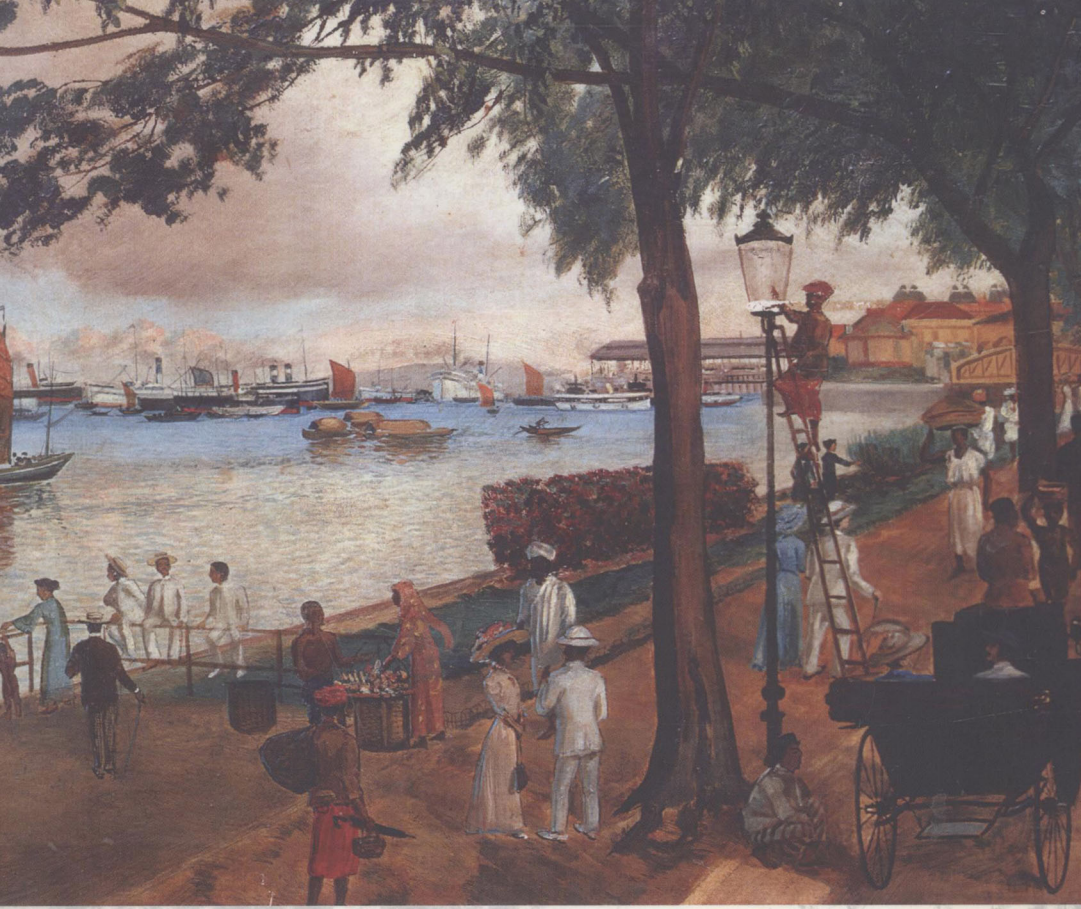

Trade and Poverty

When the Third World Fell Behind

Jeffrey G. Williamson

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To our amazing, talented, and wonderful grand children
Maya, Nell, Erin, AJ, and Sarah

Acknowledgments

When I was a graduate student at Stanford in the late 1950s, I wanted to write a book like *Trade and Poverty: When the Third World Fell Behind.* But my mentors at that time—Irma Adelman, Ken Arrow, Hollis Chenery, Bob Mundell, and especially Moe Abramovitz—wisely advised against it. After all, the third world had yet to establish a long enough postindependence track record to assess the questions raised in this book, questions about the connection between globalization and what is now called the great divergence. "Why not use economic history to start exploring the connection," they asked? Why not indeed!

And so this book has been brewing for about half a century. An early (and very incomplete) assessment was given in Stockholm as the Ohlin Lectures in October 2004, subsequently published as *Globalization and the Poor Periphery before 1950* (MIT Press, 2006). *Trade and Poverty* deepens the argument, extends the evidence for the century before W. Arthur Lewis's starting point of 1870 (an important extension since, as we will see, that's where the action was), combines time series with case studies, and is written in a way that I hope speaks to a much wider audience. Were my still very active mentors at Stanford to read this, and had Moe Abramovitz lived long enough to read it as well, they might best decide whether the half century was worth the wait.

Trade and Poverty relies heavily on past collaborations that resulted in: "The Impact of the Terms of Trade on Economic Development in the Periphery, 1870–1939: Volatility and Secular Change," *Journal of Development Economics* 82 (January 2007), with Christopher Blattman and Jason Hwang; "Measuring Ancient Inequality," NBER Working Paper 13550, National Bureau of Economic Research, Cambridge, Massachusetts (October 2007), with Peter H. Lindert and Branko Milanovic; "Mughal Decline, Climate Shocks and British Industrial Ascent," *Explorations in Economic History* 45 (July 2008), with David Clingingsmith; "Mexican

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Contents

1 When the Third World Fell Behind

1.1 The World Economic Order in 1960

Before the Gang of Four (Hong Kong, Singapore, South Korea, Taiwan) had completed their postwar growth miracle, before China, India and the rest of Asia began to play with double-digit growth rates, and just as Africa gained independence from their European colonial masters, there was a *world economic order* in place that had been two hundred years in the making. Income per capita in Asia and Africa was less than 14 percent of western Europe in 1960, Latin America was a little more than 41 percent, and the three combined were about 16 percent (table 1.1). Thus one characteristic of the *world economic order* in 1960 was the wide gap in per capita income and living standards between what this book will call the rich industrial core and the poor pre-industrial periphery. The second characteristic of the *world economic order* was that the poor periphery exported primary products or what we call today commodities, while the rich core exported manufactures: indeed 85 percent of the poor periphery's exports were either agricultural or mineral products (for sub-Saharan Africa it was 94 percent), while the figure for western Europe was only 30 percent. Trade, specialization in commodities, and poverty were closely correlated.

Thus today's wide economic gap between the post-industrial OECD and the third world is hardly new. It was there more than a half century ago before the aid and cheap loan largess of the World Bank, before the International Monetary Fund bailouts, before the health and education delivery systems of the United Nations, before activist nongovernmental organizations, before the global trade boom, and before the exploration of pro-development policies in much of the recently autonomous third world. If the *world economic order* was with us in 1960, then we need to look at least at the two centuries between 1760 and 1960 to understand its origin,

Table 1.1
World economic order in 1960

Region	GDP per capita 1990 GK$	GDP per capita relative to western Europe	Share of exports in manufactures (%)
Western Europe	7,582	100	70
Latin America	3,136	41.4	11
Africa	1,055	13.9	6
Asia	1,025	13.5	na
Africa and Asia	1,030	13.6	na
Africa, Asia, and Latin America	1,239	16.3	15

Sources: GDP per capita calculated from Maddison (March 2009), http://www.ggdc.net/maddison. Manufactures export shares for 1960 Africa and 1960 Africa + Asia + Latin American are taken from Martin (2003: fig. 3, 194), while Latin America and western Europe are 1965 from World Development Indicators online.

perhaps even before. Indeed the new institutional growth economics led by Douglas North (1990, 2005), and Daron Acemoglu, Simon Johnson, and James Robinson (2001, 2002, 2005) suggests that we must go back at least five centuries to find the sources of today's wide divergence between the OECD and the third world. Others have argued that we need to go back more than a millennium and even into pre-history to get the right answers (Diamond 1997; Olsson and Hibbins 2005; Comin et al. 2008).

1.2 When Did the Great Divergence Take Place?

Let's start by identifying exactly when the great divergence between the west European leaders—a economic group often augmented by the United States—and the poor periphery emerged. Table 1.2 shows that there was already a big income per capita gap in 1820 when the industrial revolution was just warming up in Europe: the poor periphery had only half the GDP per capita that the west European leaders had. So whatever explanation one hopes to find for the appearance of the gap, the search for it must be before the industrial revolution. And we see it over the long century 1700 to 1820, where although pre-modern per capita income growth was almost glacial the world around, it was still four times as fast in western Europe than in the periphery (0.16 versus 0.04 percent per annum). Still the gap was already large in 1700, with the periphery only 56 percent of the core.

Table 1.2
World per capita GDP growth performance, 1700 to 1820

	GDP per capita in 1990 GK$		Per annum growth (%)	GDP per capita relative to western Europe	
Regional group	1700	1820	1700–1820	1700	1820
Western Europe	1,032	1,243	0.16	100.0	100.0
European periphery	653	737	0.10	63.3	59.3
Latin America	540	712	0.23	52.3	57.3
Middle East	564	571	0.01	54.7	45.9
South Asia	550	530	–0.05	53.3	42.6
Southeast Asia	580	601	0.03	56.2	48.4
East Asia	595	605	0.01	57.7	48.7
Periphery unweighted average	580	626	0.04	56.2	50.4

Source: Maddison (March 2009), http://www.ggdc.net/maddison
Regional definitions: Western Europe: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Netherlands, Norway, Sweden, Switzerland, United Kingdom. European periphery: Albania, Bulgaria, Czechoslovakia, Hungary, Poland, Romania, Yugoslavia, Russia; Ireland, Greece, Portugal, Spain. Latin America: Brazil, Mexico. South Asia: India. Southeast Asia: Indonesia. East Asia: China, Japan.

True, some parts of the periphery had done better than others: the European periphery to the south and east of the leaders was at the top of the list, about 63 percent, while South Asia and Latin America were at the bottom, about 52 or 53 percent. But what distinguished living standards the world around in 1700 was that western Europe was already ahead while the rest of the world was tightly clustered together behind: that is, the divergence between regions in 1700 was almost entirely the divergence between western Europe and the rest.

Thus we have to search even earlier in pre-industrial times to find the explanation for the great divergence, and the recent historical literature on the pre-1800 economic divergence is lively and contentious. Robert Allen (2001) led the way in documenting a great divergence within Europe starting with the early modern era, when living standards in the northwest pulled ahead of countries to the east and south. Kenneth Pomeranz's book *The Great Divergence: China, Europe, and the Making of the Modern World* gave us the phrase and focused the debate on when the China–Europe gap first appeared. Since then, pre-industrial evidence on the great divergence has

deepened and widened (Parthasarathi 1998; Bengston et al. 2004; Allen 2005; Allen et al. 2009). Thus it is clear that divergence has been with us for 500 years or more, but while it took western Europe many centuries to achieve incomes per capita double those of the periphery in 1820, it took only one century to drive that figure up to 3.5 times in 1913 (the gap was 29 percent: table 1.3). Note, however, that the gap was no higher in 1940, and perhaps even a little lower (34.7 percent: table 1.4). Thus the 19th century looks like a period of exceptionally rapid divergence between core and periphery, and that divergence was most dramatic over the half century 1820 to 1870.

1.3 A Trade and Divergence Connection?

The correlation between the world trade boom and accelerating divergence during the first global century up to 1913 is a seductive fact.

As the next chapter will make clear, the world became global at a spectacular rate from the early 19th century to World War I. While the world trade boom was accompanied by mass migrations and the development of an international capital market, that boom had never happened before and it would not happen again until after World War II, closer to our time. The European economies went open, removing long-standing mercantilist policies and lowering tariffs. Their colonies did the same, and European and American gunboats forced many others to follow suit. Much of the world integrated their currencies by going on the gold standard and other currency unions, lowering exchange risk. Led by new steam engine technologies, the world also underwent a pro-trade transport revolution. As the cost of trade fell dramatically, the ancient barriers of distance began to evaporate. The telegraph, another pro-trade technology, lowered uncertainty about prices in distant markets, stimulating trade still more. Most important, the industrial revolution in Europe raised GDP growth rates many times faster than what had been common over the previous two millennia, and the demand for everything soared, especially traded goods. To give the world trade boom yet another nudge, *pax Britannica* brought peace.

There is that seductive correlation, the first world trade boom occurring at the same time as the acceleration in the great divergence. Correlations like this invite causal interpretations: Did globalization contribute to the great divergence? This question was debated during the first global century, and it is debated now in the midst of the second global century.

Table 1.3
World per capita GDP growth performance, 1820 to 1913

	GDP per capita in 1990 GK$			GDP per capita relative to western Europe			Growth rates per annum		
Regional group	1820	1870	1913	1820	1870	1913	1820–1870	1870–1913	1820–1913
Western Europe	1,243	2,087	3,688	100.0	100.0	100.0	1.04	1.15	1.18
English-speaking offshoots	1,202	2,419	5,233	96.7	115.9	141.9	1.41	1.81	1.59
European periphery	737	992	1,607	59.3	47.5	43.6	0.60	1.13	0.84
Latin America	712	742	1,618	57.3	35.6	43.9	0.08	1.83	0.89
Middle East	571	707	978	45.9	33.9	26.5	0.43	0.76	0.58
South Asia	530	533	679	42.6	25.5	18.4	0.01	0.56	0.27
Less India	462	544	765	37.2	26.1	20.7	0.33	0.80	0.54
Southeast Asia	601	604	890	48.4	28.9	24.1	0.00	0.91	0.42
East Asia	605	555	646	48.7	26.6	17.5	–0.17	0.35	0.08
Less China	648	748	1,270	52.1	35.8	34.4	0.29	1.23	0.73
Periphery unweighted average	626	689	1,070	50.4	33.0	29.0	0.19	0.92	0.51
Periphery unweighted average, no China, India	622	723	1,188	50.0	34.6	32.2	0.29	0.96	0.67

Source: Maddison (March 2009), http://www.ggdc.net/maddison.

Regional definitions: Western Europe: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Netherlands, Norway, Sweden, Switzerland, United Kingdom. English-Speaking Offshoots: Australia, Canada, New Zealand, United States. European Periphery: Albania, Bulgaria, Czechoslovakia, Hungary, Poland, Romania, Yugoslavia; Russia; Ireland, Greece, Portugal, Spain. Latin America: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay, Venezuela. Middle East: Western Asia plus Egypt, Morocco, Tunisia. South Asia: Burma, Ceylon, India, Nepal. Southeast Asia: Hong Kong, Indonesia, Malaysia, Philippines, Siam, Singapore. East Asia: China, Japan, Korea, Taiwan.

Table 1.4
World per capita GDP growth performance, 1913 to 1940

	GDP per capita in 1990 GK$		Per annum growth (%)	GDP per capita relative to western Europe	
Regional group	1913	1940	1913–1940	1913	1940
Western Europe	3,688	4,984	1.12	100.0	100.0
European periphery	1,607	2,087	0.97	43.6	41.9
Latin America	1,618	2,122	1.01	43.9	42.6
Middle East	1,213	1,675	1.20	32.9	33.6
South Asia	681	695	0.08	18.5	13.9
Southeast Asia	892	1,231	1.20	24.2	24.7
East Asia	1,270	2,567	2.64	34.4	51.5
Periphery unweighted average	1,214	1,730	1.32	32.9	34.7

Source: Maddison (March 2009), http://www.ggdc.net/maddison.
Regional definitions: Western Europe: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Netherlands, Norway, Sweden, Switzerland, United Kingdom. European Periphery: Albania, Bulgaria, Czechoslovakia, Hungary, Poland, Romania, Yugoslavia; Russia; Ireland, Greece, Portugal, Spain. Latin America: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay, Venezuela. Middle East: Turkey. South Asia: Ceylon, India. Southeast Asia: Indonesia, Malaysia, Philippines. East Asia: Japan, Korea, Taiwan.

Before we move much farther along in this book, some issues must be laid to rest. Most important, look again at the evidence in table 1.3, and note two big facts reported there. First, the periphery did *not* suffer a fall in GDP per capita during the first global century. Indeed GDP per capita growth there was just short of 1 percent per annum between 1870 and 1913. More to the point, percent per annum GDP per capita growth rose from 0.04 between1700 and 1820 up to 0.19 between 1820 and 1870, then up to 0.92 between 1870 and 1913. The periphery growth rate was, of course, less than the core, which rose from 0.16, to 1.04, to 1.15 percent, per annum. Second, no economist since Adam Smith has ever found the evidence or the argument to reject the gains from trade theorem: all participants gain from trade. By exploiting specialization and comparative advantage, trade raises GDP. Some residents, classes, and regions may gain more than others, but average incomes will rise in all trading countries as a consequence of trade. Then again, in the long run will some countries

gain more from trade than others? Indeed, did the rich core gain more than poor periphery?

The last question motivates this book: Did the global trade boom between 1820 (or even 1750) and 1913 serve to augment the great divergence? Trade certainly creates gains from specialization, but it can also be growth-enhancing. It can, after all, be a conduit for knowledge, technological transfer, and political liberalism. Trade can also be growth-enhancing if it fosters agglomeration and scale economies, and if it fosters capital flows and accumulation in capital deficient countries. In modern terminology, this would be called trade-driven endogenous growth (Krugman 1981, 1991a, 1991b; Romer 1986, 1990; Helpman 2004; Lucas 2009). Fair enough, but couldn't these growth-enhancing forces be weaker, absent, or even negative in some circumstances? For example, could trade have growth-diminishing effects in poor countries exporting primary products? What about de-industrialization there? What about the price volatility associated with their primary products? What about the contribution of global-induced inequality to anti-growth rent-seeking by the increasingly powerful rich in the periphery? Did trade augment growth rates in the rich core by much more than the poor periphery, contributing to the great divergence?

1.4 What Do We Mean by "Open" Economies?

Some otherwise very clever economists get a little confused when talking about countries being "open" to trade. Typically, in exploring the correlation between "openness" and growth, the former is measured by trade ratios, that is, exports plus imports all divided by GDP. But trade shares may be high simply because income is high, and trade shares may rise simply because income rises. Instead, a country's openness should be measured by the height of trade barriers around it—including tariffs, nontariff barriers, distance from foreign markets, cost of transportation to and from foreign markets, and anything else that adds to the barriers. But even if we agree on how to measure the trade barriers, it is the *change* in the trading environment that will induce *changes* in the domestic economy, and the *changes* in the trading environment that matter are *changes* in relative prices in the home market. How might relative prices change? Two ways: by a decline in trade barriers from any source, and/or by a change in world market conditions. Both of these will induce a change in the (net barter) terms of trade (the price of exports over the price of imports) facing the country in question, as well as the prices of these tradables relative to

all the nontradables that poor countries produce, like local services and ordinary foodstuffs. So, if we are looking for ways that trade might foster (or inhibit) growth, we need to look at the magnitude and duration of exogenous changes in the country's terms of trade, not trade shares.

The next source of confusion is this. If the share of exports in GDP is only, say, 10 percent, and if the terms of trade improves by only 10 percent (by a rise in the export price facing local producers), would this simply translate in to a once and for all 1 percent increase in GDP (10 percent times 10 percent equals one percent)? No! The external terms of trade shock will permanently change all relative prices in the economy, thus causing labor, skills, and capital to move to sectors where prices are improving and flee sectors where they are deteriorating, thus causing growth effects to the extent that the structure of the economy has an impact on growth.

1.5 *Trade and Poverty*: Looking over the Terrain

Trade and Poverty begins in the next chapter by describing the first global century between 1820 and 1913. It then moves on in chapter 3 to report the behavior of the terms of trade facing the poor periphery over that century. The price of their primary product exports relative to their imports (mainly manufactures) boomed everywhere in the poor periphery. In some places the terms of trade increased by a factor of three, probably the biggest sustained terms of trade boom the world has ever seen. Since trade fosters specialization, resources flowed in to the export sector and out of the import-competing sector in the poor periphery, the import-competing sector being industry. So chapter 4 explores the economics of de-industrialization and what is called Dutch disease in the poor periphery. Because de-industrialization is thought to have had a negative impact on growth, the book spends three chapters exploring how India, Ottoman Turkey, and Mexico dealt with it. Chapter 9 raises another issue: Did the trade boom create greater inequality in the poor periphery, and did this fact serve to reinforce anti-growth institutions as many have argued (Engerman and Sokoloff 1997)? Chapter 10 brings another potential anti-growth factor to the table: Did greater price volatility for primary products add another drag to growth in the poor periphery? With this background, chapter 11 is then able to offer an historical assessment of the central question of the book: Was the globalization and great divergence correlation causal? Furthermore, if the terms of trade boom (a fall in the relative price of manufactures) across most of the 19th century caused