

Globalization in the era of Trump: A New World Order?

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I. Protectionism and nativism played a central role in Trump's campaign

- Labeled NAFTA as worse deal ever, Korean U.S. Trade Agreement as a “horrible” deal
- Alleged that trade agreements were unfair to US
 - Lead to large trade deficits
 - Contributing to plight of American workers
- Demanded US abandon TPP, renegotiate NAFTA, questioned WTO, raised prospect of 45% tariff on China, 20% tariff on Mexico

What has been “accomplished”?

What have been the effects so far?

What are likely to be long term effects?

Will it lead to new global order?

II. “Accomplishments”

- **Left TPP**

- A flawed trade agreement, with little economic benefits to US
- Controversial IPR and investment provisions
- Other 11 countries going forward without the US, and without noxious provisions insisted on by US
- Increased opportunities for China to exercise influence in region

- **Began renegotiating NAFTA—talks gridlocked**

- Unreasonable demands—“agreement to be renegotiated every five years”, “half of auto to be made in US to be eligible for zero tariff”
- Possible area of agreement—repeal of chapter 11 (investment agreement)
 - But US big corporations insist provision be retained
- Beyond updating (e.g. new digital issues—using TPP template) not clear where negotiations will go
- Has not built the wall with Mexico—and no agreement with Mexico for paying for it

“Accomplishments”

- **Korea (KORUS)**
 - Complained about goods deficit, even though there is a services surplus offsetting more than one third of that amount (large auto deficit-Korea produces cars Americans like, but not vice versa—not a problem of trade barriers)
 - Aggressive US economic stance tamed by realities of security concerns.
- **WTO**
 - Blocked appointment of new judges
 - Complained about use of “litigation” rather than “negotiation”
 - Contributed to deadlock in WTO—stalemate at Buenos Aires

“Accomplishments”

- **China**

- Has not raised tariffs to 45%
- During campaign, accused China of exchange rate manipulation, in office, did not

- **Standard trade cases**

- Has brought a number of cases (including first “self-initiated” case since 1991, slightly faster pace, and first national security case (section 232) in 35 years—steel and aluminum
 - Not clear it will stand up to judicial scrutiny
 - Not clear it will be implemented
 - Likely managed tit-for-tat response

Overall assessment

In short: rhetoric remains fierce, but

No real accomplishment

No trade war

- But this is only his first year
- And he has increasingly surrounded himself with economic nationalists, pushed out traditional Republican free market economists

III. Why the anti-globalization sentiment?

- Globalization was mismanaged and oversold
 - At a time when ordinary American and European workers were not doing well
 - Would have had problems simply from changes in technology
 - But globalization made things worse
 - And even if there had been no technological change, mismanaged globalization would have made them worse off
 - Easy to blame globalization—easy to see effects
 - One can do something about globalization—one can't do much about technological progress

Argument for Free trade

- The desirability of free trade has been one of the longest and strongest held tenets of economics
 - Ricardo, Smith
 - Modern mathematical formulation: Samuelson (1938)
- Based on simple models
 - Comparative advantage
 - Advantages of specialization
- Benefits of trade: higher standards of living
 - Keeping the economy at full employment was the responsibility of monetary and fiscal authorities
 - We had the knowledge, tools, and will to do that

The selling—or overselling—of free trade

- But that was hard to explain
- So politicians told another story—often supported by economists
 - Trade creates jobs
 - But if exports create jobs, imports destroy jobs
 - If trade is relatively balanced, then since exports are capital intensive, trade agreements that leave trade balance roughly unchanged destroy jobs
 - Trade balance is determined by macro-economic fundamentals, gap between domestic savings and investment, only slightly affected by most trade agreements

The selling—or overselling—of free trade

- Real support for trade agreements came from special interests, who saw trade agreements as opportunity to *distort* economy in their favor and increase their profits (rents)
 - These were managed trade agreements, not free trade agreements
 - Managed for the interests of large corporations
 - Provisions went beyond trade to IPR and regulation
 - Special interests especially represented in these provisions
 - With distortions, ambiguous effect on welfare
 - Corporations gained for higher unemployment and unbalanced trade agreements—workers' bargaining power reduced, wages weakened

The selling—or overselling—of free trade

- Consider TPP, sold as the most important trade agreement in history, embracing 44% of global trade
- Using standard models, government (optimistic) effect on GDP, when fully implemented (15 years), net effect miniscule (.15% of GDP)
 - Better models suggest effects even smaller, or negative
- But these calculations use GDP
 - GDP is not a good measure of well-being
 - International Commission on the Measurement of Economic Performance and Social Progress
- With broader measure of well-being, better models, benefits likely smaller, or more negative

Overestimating aggregate gains: The True Jobs Story

- Jobs are often destroyed in import competing sectors and in non-traded goods sectors than jobs are created in export sectors
 - Especially when financial sector is not well-functioning
 - Especially when there is an overall insufficiency of aggregate demand
 - This was what I saw as Chief Economist of the World Bank (and described in *Globalization and its Discontents*)
 - This is what has been documented to have happened in US in recent years
 - Areas producing goods competing with those where there was a surge of imports from China have lower wages and more unemployment
 - Whole communities affected, as property values decrease and those in non-traded sectors serving traded goods sector affected
 - Lowering of property values inhibited creation of new small businesses, especially with dysfunctional financial markets

Overestimating aggregate gains: Much was missing from the models

- Assumptions of standard model were wrong—sufficiently wrong that they led to wrong conclusions
- Problem not just with assumptions concerning employment
- Opening of trade may **increase risk**
 - Problem sufficiently serious that under plausible assumptions, free trade (without good risk markets) may lower well-being of everyone
 - Free trade is Pareto Inferior (Newbery-Stiglitz, 1984)
- **Imperfect competition**
 - May provide more scope for monopsony/monopoly—exercise of market power
- Standard model ignores ***dynamics of comparative advantage***, learning
 - Korea would not be where it is today had it not intervened in trade
 - Infant *economy* argument for protection (Greenwald-Stiglitz, 2006)

Trade liberalization has large distributive effects

- Standard discussions overestimated aggregate benefits, ignored or underestimated distributive effects
- **A more balanced accounting would have noted that *without government assistance* most individuals may be worse off**
- Distributive effects were large
 - Samuelson-Stolper/factor price equalization effects
 - Changed bargaining power
 - Impacts of budgetary cuts (tax cuts) allegedly to enhance competition
- Just at time when government spending was *more needed*
 - Scope for government action was seemingly more constrained
 - Globalization provided new ways to avoid and evade taxes
 - Which some of our most innovative firms took full advantage of
 - Globalization's rules did nothing about this

Standard argument

- Winner could compensate the losers
 - Not that they did
 - And they typically didn't

IV. New Protectionism not the answer

- Just as globalization may have led to net job losses and stress to communities and individuals, so too for deglobalization
- We have created a world in which firms believed borders didn't matter
- Created global supply chains
 - Now everyone is on notice: borders do matter
 - Consequences even if Trump does not follow through on threats
 - Damage will be long lasting
- Recreating new supply chains will take time, increase costs
- Again, job losses will take place faster than job gains
- New protectionism sets in motion a negative sum game

Underlying flawed hypotheses

- Neo-mercantilism
 - “because US is better than others” should export more of all goods
 - Only reason that this is not so is unfair trade practices
 - Failed to understand principle of comparative advantage
 - Exception: exchange rate manipulation
 - But China has been intervening mainly to increase value of exchange rate
 - Trump views out of date
- Obsessed with bilateral trade deficits
- Sees trade balance in goods as different from that in services
- Thinks of trade as zero sum
- Ignores the importance of the rule of law
 - Contributes to certainty in economic transactions

New Protectionism: Breaking the Rule of Law

- America's success is based on the strength of its *rule of law*
- New protectionism violates basic principles of the rule of law
- If society (government) wants individuals or firms to act in a particular way, it passes laws and regulations
 - To incentivize desired behavior
 - To discourage and proscribe undesirable behavior
- It does not pick out for attack particular firms or individuals
 - That is the way of despots and demagogues
- Undermining the rule of law will lower growth both in the short run and the long
 - Make the US a less attractive place to invest
 - Introduce large new uncertainties

New protectionism will not work

- Can't go back to world before Reagan
 - Global employment in manufacturing is decreasing
 - With natural entry of emerging markets, they will get a larger share of this global employment
 - US will only recapture jobs by converting manufacturing into poorly paid jobs (as we have done in the auto sector)
 - Even if US brings back output, it will be capital intensive: different skills, different people—and not many jobs
- Reagan style voluntary export restraints won't work

New Protection Won't even lead to lower trade deficits

- That's determined by macro-economics: domestic savings, investment
- Administration's budget will lead to larger trade deficits, loss of manufacturing jobs
 - Especially so after tax bill
- Equilibrating: increase in the value of the dollar
 - With significantly adverse effects on emerging markets
 - The effects of which may ricochet back to US

Why Trump is likely to fail in meaningful trade renegotiations (e.g. NAFTA)

- **Overestimates US bargaining power**
 - Large costs to US of failure to achieve agreement
 - In some cases (China), government has more levers than the US
- **Underestimates legal constraints**
 - Implementing legislation would have to be repealed
 - WTO tariffs would benefit Mexico
 - Leaving WTO would take another vote of Congress

Cont'd...

- **Underestimates political constraints in all countries**
 - Opens up questions which had been “settled”—investment agreement
 - At time of NAFTA few knew of its importance
 - Now widespread opposition from academics, civil society, some members of Congress
 - “Regulatory takings” provisions create new property rights system—opposed even by Clinton Administration even as it was pushing NAFTA
 - Canada, Mexico, and Trump favor repeal or major reforms—but big business adamant that any agreement include strong ISDS provision
 - Large vested interests affected by any renegotiation—winners and losers
 - If trade agreement is viewed to be an America First unfair trade agreement, may be difficult to get ratification in other countries
 - Longstanding opposition to many trade agreements
 - Ratification will be difficult if agreement is viewed as unfair, even if country overall gains
 - Poorest workers in Mexico, corn farmers, hurts, American farmers gained
 - Ultimatum game shows importance placed on perceptions of fairness
 - No trust that Trump has any concept of fairness—and would sign on to any agreement that is ultimately fair (America First rhetoric deeply harmful)
- **All negotiations based on trust—there has been an erosion of trust**

Lowered standard of living

- From distortions associated with trade policy
 - Increased costs of intermediate goods undermines “competitiveness”
 - Increases costs of final goods lowers standards of living
- Large costs associated with deglobalization
 - Job destruction may outpace job creation
 - May be significant adjustment costs
- Costs may be borne disproportionately by those who bore costs of globalization
 - As a consequence of increase in exchange rate, increased trade deficit
 - As a consequence of destruction of global supply chains
 - Costs increased further as a result of distortions associated with new tax bill
 - Adjustment costs associated even with the few “distortions” that have been eliminated
- Even if benefits of globalization were oversold and distributive costs underestimated, Trump has oversold deglobalization

Global response

- Basic US position—global trade agreements have been unfair and US got snookered in trade negotiations—looked at with derision
 - Trade agreements have actually been unfair to developing countries and emerging markets
 - US got most of what it wanted
 - US got larger tariff concessions than it gave
 - But it may have wanted the wrong thing: agenda set by large multinational corporations
 - Still, majority of US believe NAFTA has been good for US economy
- Workers in US were disadvantaged
 - Trade lowered demand for especially unskilled labor
 - And trade agreements weakened workers' bargaining power
 - Especially investment agreements—which gave away one of country's most important comparative advantages
 - By investing abroad received even more property rights protection than investing in US

Shifting global politics

- TPP 11 has moved ahead—without some of provisions US had demanded
- New emphasis on other trade alliances—Pacific Alliance
- Possibility of creating new alliances—Free Trade Area of Americas
 - US agricultural subsidies major stumbling bloc
- Shift to plurilateral agreements (“coalitions of the willing”)
 - While these initiatives may lead to some trade creation, there will be some trade diversion, at expense of US
- Trump’s anti-Mexican stance may result in election of Obrador
- America First rhetoric and other Trump actions undermine ability of US to take leadership role
 - Especially in advancing rule of law and democratic institutions
 - Especially given Trump’s affinity for authoritarian leaders

China likely to big winner in global landscape

- Position already increasing—Asian Infrastructure Investment Bank
 - Republican opposition to recapitalization of World Bank helped create conditions for creation of new multilateral institutions, NDB and AIIB
- President Xi's speech at WEF 2017 emphasizing China's commitment to multilateral system
 - Not likely to be same kind of globalization
 - Less emphasis on labor and environment
- Timing of US withdrawal for global leadership coincides with China's expanding influence, e.g. through One Belt-One Road Initiative
 - And President Xi asserting China's role in global leadership

Concluding comments

- **World would in any account have been moving towards a multi-polar world**
 - Diminished role of US in global economy, especially with rise of emerging markets
- **Trump has hastened that trend**
 - Undermining one of US core strengths, its soft power
- **But just as the rule of law is important for the functioning of any economy, an international rule of law—the rules based international trading system—is important for the functioning of the global economy**
 - There can be large gains from trade, if globalization is well managed
 - US may not have managed it well, but the response should be to manage it better, not to destroy the rules based system in a return to the law of the jungle

Concluding comments

- **While Trump was wrong in claiming that the trade agreements were unfair to the US, there is little doubt that globalization contributed to the weakening of wages of America's skilled workers.**
 - Insufficient attention to the distributive consequences of globalization—or other aspects of economic policy—was paid by the advanced countries.
 - The belief that policies that lead to higher growth would “trickle down” enough to offset such adverse effects was based on little more than blind faith.
 - Learning this lesson—if in fact the lesson is learned—may be the only silver lining in this dark cloud hanging over the global horizon.

Response from China

- It will be important for China to respond to Trump in a tempered but firm way
 - Not to start a trade war, but also to show that operating outside the rule of law does not pay
- It is important for China to continue along its path of moving towards domestically driven growth, away from export-driven growth
 - Sensitive to the costs of restructuring that will be imposed on individuals
- And to continue to expand its role in responsible global leadership
 - Helping poorer countries develop, without following neo-colonial policies
 - Aware of the importance of global environment and other global public goods
- Playing a central role in the creation of a new multi-polar globalization