

Making Trade Globalization Inclusive

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Should have expected that trade globalization would have hurt unskilled workers in US and other advanced countries

- Reduced demand for unskilled workers
- In limiting case: factor price equalization theorem, unskilled wages in the US converge to that in the developing world
 - Results take into account benefits of globalization from comparative advantage—increase in GDP
 - Results take into account benefits of globalization from reduced costs of certain imported goods

Standard theory overestimated benefits by extreme simplifying assumptions

- **No risk**

- With risk and imperfect risk markets, trade globalization can make everyone in both countries worse off: Pareto inferior trade

- **No adjustment costs**

- With costly adjustment, job destruction may outpace job creation
 - If export sector less labor intensive
 - If there is more market power in export sector, output expansion may be less
 - Globalization leads to more rents
 - Empirical evidence that surge of Chinese imports into US led to unemployment, lower wages (Autor *et al*, 2013)
- Especially so if there are imperfect capital markets and costs of reallocating labor
- In that case, trade liberalization can also be welfare reducing
 - Non-traded sector also adversely affected
 - Even more so if owners of firms benefitting from lowering prices live abroad or are very rich

Endogenous technology

- With learning by doing, gap in technology between developing country/emerging market and advanced country reduced
 - Reducing differential rents enjoyed by advanced countries
 - Typically those rents are shared (to some extent) with workers
- Response in export sector may be asymmetric
 - Developing countries have more to learn—closing the knowledge gap
 - Advanced sectors rely more on R & D, expenditure may not be very sensitive at margin to increased sales
 - Export sectors may be marked by more market power—less expansion of output

Exchange rate management

- **Problems just described exacerbated if developing country intervenes to lower exchange rate (“exchange rate manipulation”)**
 - In an attempt to promote learning by doing/development
- Long term budget constraint means that at later date China’s imports will exceed exports
 - But this is of little benefit to today’s workers in US
 - And besides, learning benefits may be large enough that it may pay to build up reserves indefinitely
 - When first best interventions are precluded, e.g. by trade agreements

Distributive effects even worse in imperfect labor markets

- **Globalization weakens workers' bargaining power**
 - Especially so with investment agreements
 - Which give firms greater property rights abroad than at home
 - Allowing them to sue states in investor friendly process for any change in regulation (no matter how consonant with public purpose) that adversely affects profits

May be that lowering wages was not just a matter of collateral damage

- May have been real objective
 - **Why would a country give away one of its key comparative advantages (rule of law) through investment agreements?**
 - Why would advocates of globalization oppose trade assistance or other forms of compensation which would have helped ensure that all benefit from globalization?
 - Strengthening long term political support
 - But without such assistance, workers' bargaining power weakened even further

Trade agreements may have worsened the calculus

- Not just investment agreements
 - Which have a chilling effect on regulations which protect consumers, workers, health, and the environment
- IPR provisions
 - Which reduce access to generic medicines
 - And give large corporations an advantage over small firms

Summary: globalization left large parts of the country behind, not just relatively, but absolutely

- Predicted by standard neoclassical model, in the absence of redistributions, and there was inadequate assistance
- Overall gains small, potential distributional effects worse because of a variety of “market and political failures”: imperfect risk and capital markets, wage and price rigidities, costs of intersectoral reallocation of resources, inability to maintain economy at full employment
- Further adverse effects as a result of endogeneity of technology
- So called free trade agreements (really managed trade agreements) made matters worse, especially through weakening workers’ bargaining position
- Pace of globalization made matters worse—beyond capacity of system to adjust, with long run hysteresis effects

Protectionism won't work

- **Deconstructing efficient global supply chains may be as disruptive as constructing them in the first place**
 - Industrial workers (“Trump supporters”) will be among the losers
 - Job destruction may again outpace job creation in import substitution industries
 - E.g. American car companies become less competitive
- **Even if manufacturing *output* returns, jobs won't**
 - Will be with more advanced technologies
 - And at locales different from where old jobs were lost

New Social Contract is needed to ensure inclusive growth

More than just “globalization with compensation”

- That agenda is not credible
- Besides: individuals want not just money, but jobs

Promoting efficient utilization of resources/filling in for missing risk markets

- Active labor market policies
- Commitment to full employment
- Social protection

Ensuring more equalitarian distribution of income

- Increasing equity of market incomes
 - Increased minimum wages
 - Wage subsidies (EITC)
 - Strengthening bargaining power of workers
 - Weakening market power of corporations
 - Decreasing inequalities in intergenerational transmission of advantage
 - Inheritance taxes
 - Better public education
- Doing so reduces burden on redistribution

Improved tax and transfer system and public expenditure system

- Including ensuring access to a middle class life for all
 - Education
 - Retirement security
 - Access to health
 - Access to housing
 - Modicum of job security
- Important not just to ensure that trade globalization is inclusive, but that other aspects of globalization, and technological changes, are inclusive

Concluding comments

- **Globalization was oversold**
 - Benefits were often smaller than claimed
 - And distributive effects larger
 - And little was done to protect the losers
- **General presumption is that trade globalization moved out the utility possibilities curve**
 - **To be sure of that one has to deal with certain market and political failures**
 - Ensuring full employment
 - Improving risk bearing
 - Supporting technology
 - Facilitating reallocation of resources, including labor
 - And possibly managing the pace of globalization
 - **But even then it would have left (unskilled) workers worse off**
 - Unless the inclusive policies just described were adopted

With redistributions, inclusive growth is possible

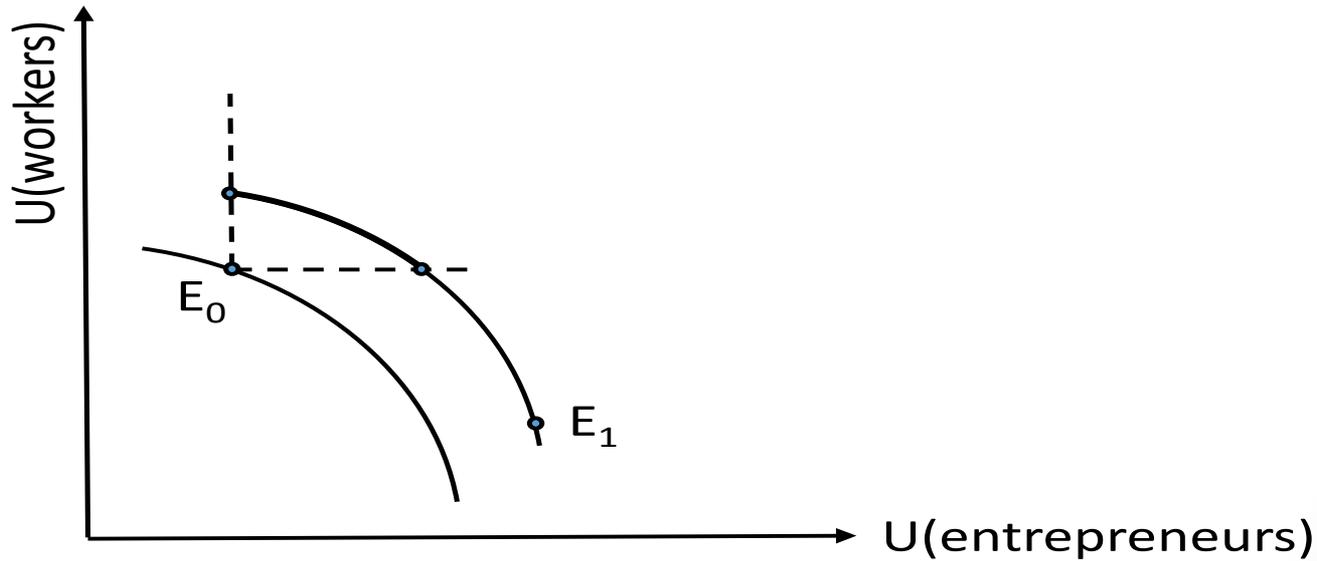


Figure 1

With market imperfections, utility possibilities curve may shift in

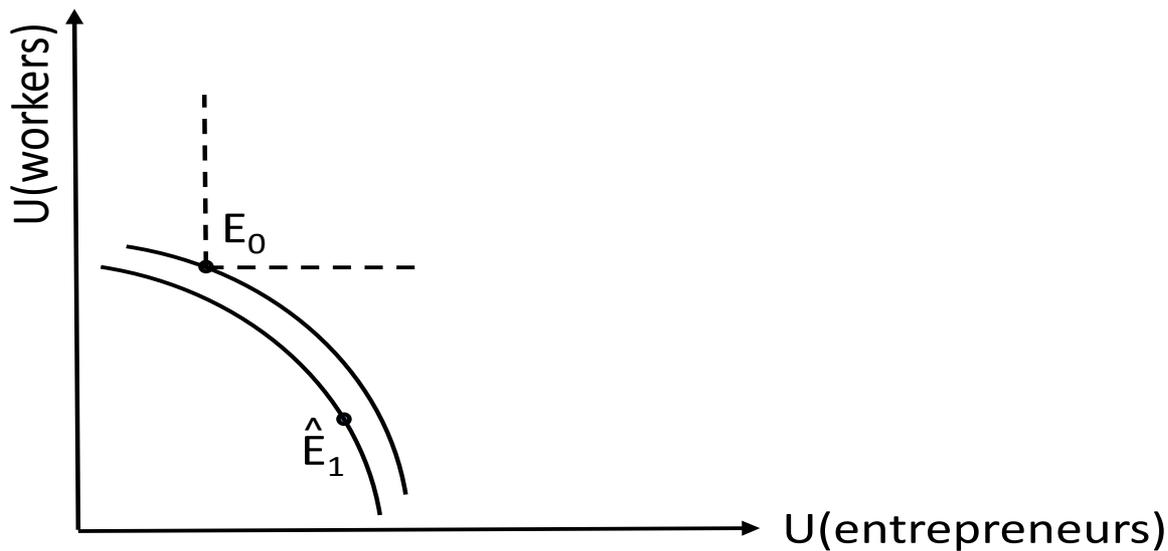


Figure 2

Some suggest that redistributions are very costly and oppose trade assistance

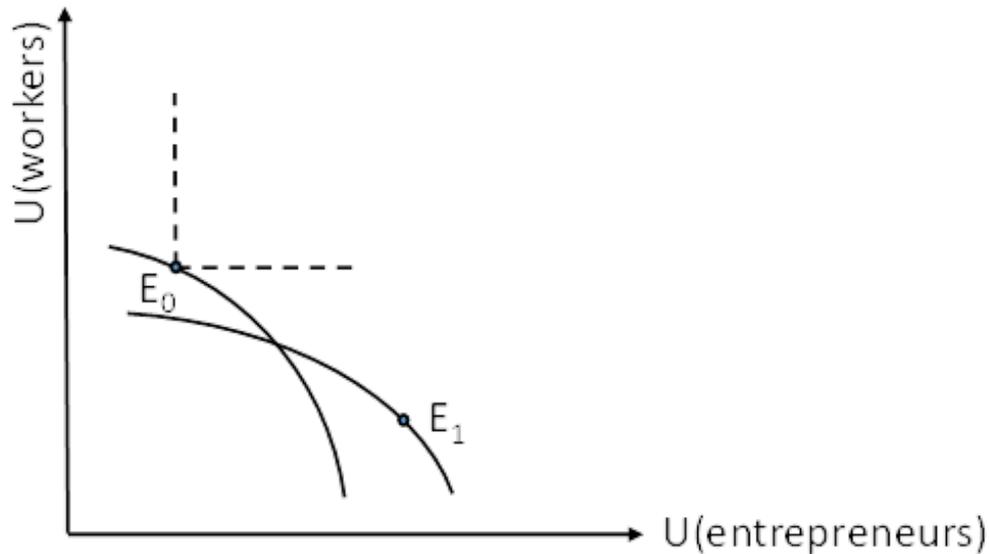


Figure 3

Concluding comments

- If that is the case, actions to protect workers would leave capitalists/entrepreneurs worse off
 - **But then we should expect opposition to globalization from workers**
 - **Globalization is *not* a Pareto improvement**
- I believe globalization, if well managed, can shift outwards utilities possibilities curve (i.e. Figure 1 applies)
 - Achieving inclusive trade globalization is economically feasible
 - The question of inclusivity is a matter of politics
- **It's important not just that welfare increasing redistributions are possible but that those redistributions actually are made**
- The new social contract ensures that that will be the case

There needs to be broad societal consensus

- Trade agreements are long lasting
- The social contract has to be at least as durable
- In a contestable democracy—this means that core provisions can't or won't be reversed in subsequent elections
 - And that means there has to be broad social consensus behind these policies
- **The more willing society is to support the necessary transition and to provide support to those who are “left behind,” the greater openness that society can accommodate, and still ensure that the outcomes are Pareto and welfare improvements.**
 - **A society that is not willing to engage in such actions should expect resistance to globalization**