

Rethinking Globalization and Responding to the Challenges of the Trump Presidency

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The world has benefitted enormously from the post WWII global economic order

- Fastest rate of global economic growth
- Successes of emerging markets
- Hundreds of millions moved out of poverty

That order is now being challenged

- Even threatened to ignore adverse WTO rulings
- Unclear the extent of discretion of President
 - Can take more aggressive stance in using dumping, countervailing duty, safeguard, currency manipulation provisions
 - But there are procedures that have to be followed
 - There can (and will be) challenges within the Court system
- And other countries can take countervailing measures
 - They can take a more aggressive stance using similar procedures
 - They can and will challenge in WTO
- Worry is that this will set off a trade war

A key problem: globalization was oversold, and “mis-sold”

- Argued for in terms of jobs created
- But if exports create jobs, imports destroy jobs
- US exports are capital intensive, import competing sectors labor intensive
- Net job loss
- Job losses are concentrated, more visible in many cases than job gains
- Trade is about living standards—not jobs
- Employment is responsibility of monetary and fiscal policy

Since 2000, adverse effects in US have become more apparent

- Even with overall good employment, certain areas may be adversely affected
 - 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
- Key problem was that the US did nothing to help these areas

Opposition to globalization

- Disparity between the “promised” jobs story and real jobs story undermined confidence in elites
- Good jobs performance after NAFTA quickly forgotten with poor jobs performance after 2000
- Major structural changes associated with globalization—without appropriate assistance in making necessary resource reallocations—had the effect of shifting the Phillips Curve
- Little comfort to know that on the other side of the world, many people have never seen it so good.
 - contrast is likely to fuel the view that the gains of those elsewhere have been at their expense.
 - reinforces a zero-sum view of the world, where one country’s gain is another’s loss.

Reality: Most Americans have not been doing well

- Bottom 90% have seen their income stagnate for a third of a century
- Median male real income *of a full time worker* (i.e. if he can get a job) lower than 42 years ago
- Stress, insecurity, and income inequality showing up in life expectancy
 - For first time in 2015, life expectancy of Americans began to decline

Paradox

- Globalization was supposed to increase well-being of *everyone*
 - Rising tide lifts all boats (trickle-down economics)
- So too for technological progress
- Gives little comfort to those in the middle who have seen their incomes stagnate to say that only part of their suffering is due to globalization, that most of the decline of the middle class is due to technological change.
- Globalization particularly paradoxical
 - Told that to compete, have to accept wage cuts and cuts in government services
 - How does that add up to an increase in living standards

Key analytic mistakes

Overestimated benefits of globalization

- 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

Underestimated distributive consequences

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)

VI. 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
- Some conservatives argue that redistributions and assistance are costly (deadweight loss) and/or ineffective
 - Implication: Trade liberalization is not a Pareto Improvement
 - Have to weigh losses of losers and gains of winners
 - Losers were at the bottom and middle, winners at the top
 - Managed (free) trade agreements also introduced distortions
 - Net calculus: Likely that trade agreement was welfare decreasing *unless one took no or little note of distributive consequences*

Standard argument

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

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

New Protectionism: Breaking the Rule of Law

- Research has shown the importance of having a *rule of law* for economic growth
 - Introduces huge new uncertainties at global level
- 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

New protectionism will not work

- Can't go back to world as it was
 - 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 *production* were brought back, it will be capital intensive: different skills, different people, different places—and not many jobs
- Voluntary export restraints won't work

- 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
- Equilibrating: increase in the value of the dollar
 - With significantly adverse effects on emerging markets
 - The effects of which may ricochet back to US
- Not even President of US can "order" dollar down

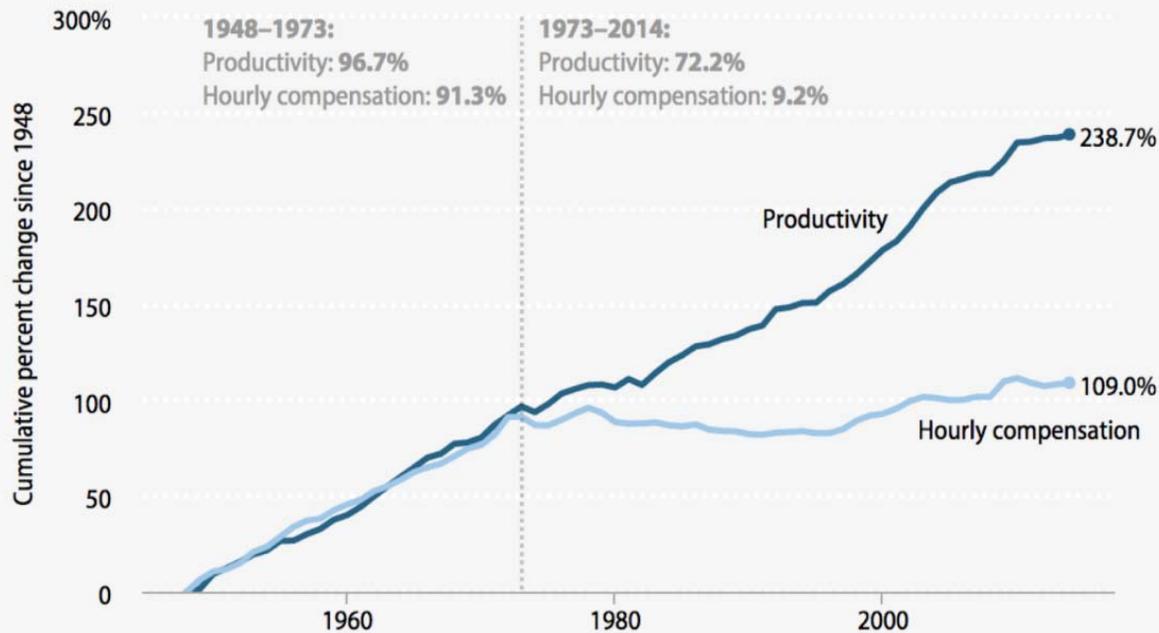
New Protection will lead to lower standards of living

- All of this will lead to lower living standards—especially for those that have already been suffering so much
 - High costs of the things they buy
 - Even possibly higher unemployment
 - Even possibly lower investment
 - Greater uncertainty—about the emerging geo-economic and geo-political order
 - Higher interest rates
- Net effect: even greater inequality

Appropriate Responses within US and other advanced countries

- Need to analyze broader causes of increases in inequality and take remedial actions
- Role of increases in market power in causing increases in market income inequality
 - Markets don't exist in a vacuum—they have to be structured by rules and regulations
 - In last third of a century, restructured in ways that have led to lower growth and more inequality
 - Need to rewrite the rules
- Major change in inequality associated with rising gap between growth in productivity and growth in wages

Disconnect between productivity and a typical worker's compensation, 1948–2014



Note: Data are for average hourly compensation of production/nonsupervisory workers in the private sector and net productivity of the total economy. "Net productivity" is the growth of output of goods and services minus depreciation per hour worked.

Source: EPI analysis of data from the BEA and BLS (see technical appendix for more detailed information)

Other actions

- Reducing intergenerational transmission of advantage and disadvantage
- Improving equality of after-tax distribution of income
- Helping economy adjust to new economy
 - Moving from manufacturing to a service sector economy
 - Markets don't do such transformations well on their own
 - Great Depression striking example
 - Trying to recapture manufacturing is largely a will-of-the-wisp
 - Enormous benefits from creating a learning economy and society

Social insurance

- **Protection without protectionism**
- **Market provides inadequate insurance for many risks—that's why we have social insurance**

Responses of China: some basic principles

- **Take high road, even if Trump takes the low.** This means respond *within the international rule of law*
- Recognize that **trade is a positive sum multilateral game.** Trump's policy will open up **new avenues of cooperation with other countries**
- **Take an active role in supporting existing international institutions and arrangements, helping fill the void created by the US withdrawal from active engagement**
- Respond in a way which is **consistent with a rule of law**
- Look for areas of **cooperation with the US**

Other principles

- Look for areas of **cooperation with the US**
- Be **resolute and act deliberately**
- Take advantage of the opportunity provided for China to advance its own agenda. **China already is engaged in a transition from export led growth to domestically demand driven growth. Trump's policies will only hasten that inevitable shift**
- **Go for the long play: One of the weaknesses in “capitalism and politics with American characteristics” is its short-sightedness.**

China and the international system

- As China forges its response, it should do so pursuing an **“enlightened self-interest.”**
- **China has an interest in preserving a rules based open international system.**
- What is at stake is not just the China-US relation, but the entire rules based system governing the international order

Critical moment in history

- The global geo-economic and geo-political order of the 21st century would, in any case, have to be different from that created in the aftermath of the Second World War.
- Trump's actions have only hastened the change, increasing the urgency for such change.
- That new order will be a much more multi-polar world and will need to be better managed for sustainable and equitable growth.
- This new 21st century globalization will continue to support the growth of countries and the improvements in the standards of living of citizens all over the world.