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Reconciling People with Trade

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This paper is part of the Growth and Reducing Inequality Working Paper Series, which is a joint effort of the G-24 and Friedrich-Ebert-Stiftung New York to gather and disseminate a diverse range of perspectives and research on trends, drivers and policy responses relevant to developing country efforts to boost growth and reduce inequality. The series comprises selected policy-oriented research papers contributed by presenters at a Special Workshop the G-24 held in Geneva (September 2017) in collaboration with the International Labour Organization and the Friedrich-Ebert-Stiftung, as well as relevant sessions in G-24 Technical Group Meetings.

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Abstract

The income gap between countries is narrowing; but within countries, income inequalities are widening. Trade is finger-pointed as the main culprit, and a backlash against globalization is shaping domestic politics in societies where income distribution used to be more egalitarian.

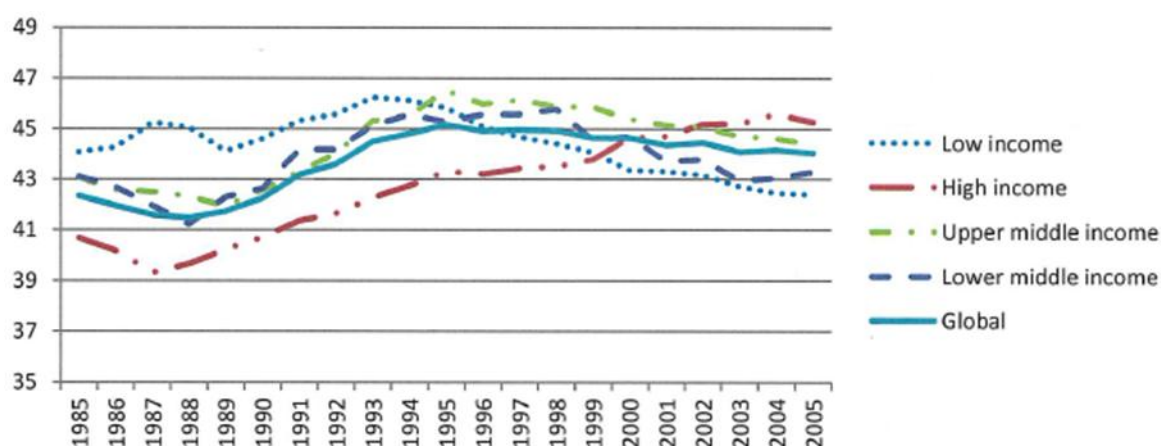
Reconciling people with trade will require structural reforms and fiscal distributional policies but, as both come at a cost, the first mover bears a risk. In an integrated world economy, policymakers must tone their policy choices with those of their trade partners. However, while promoting coherence in economic policymaking is crucially important, it is also increasingly difficult.

Identifying domestic reforms that could at the same time respond to national circumstances and minimize negative spillovers is a paramount challenge. The paper argues that this should be central to Group of 20 (G20)'s work and that the International Monetary Fund (IMF) could propose a blueprint that governments could use (before implementing domestic reforms) to assess, identify and minimize potential negative spillovers on their trading partners.

Introduction

The income gap between “developed and developing” countries has narrowed² but, in the former, inequality is at its highest level in decades.³

Evolution of Gini Coefficient for Countries in Different Income Groups



Note: Zero expresses perfect equality; 100 expresses maximal inequality.

Source: IMF Working Paper. “Capital Account Liberalization and Inequality,” by Davide Furceri and Prakash Loungani. WP/15/243; see footnote 42.

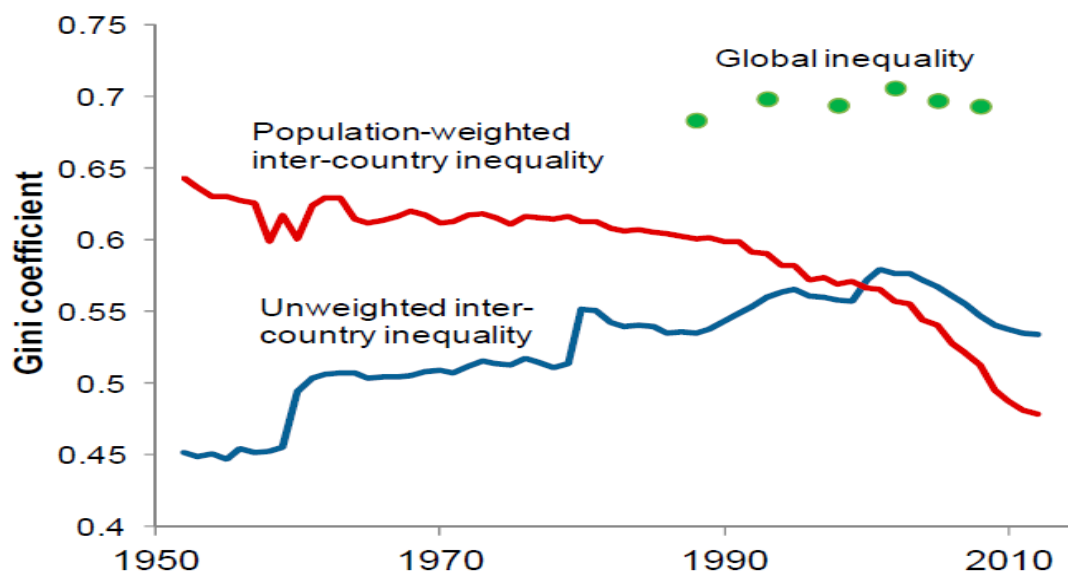
These two, apparently opposed, trends are in fact two sides of the same coin. The credit and the blame are to a large extent adjudicated to “globalization.” Trade between countries with very different endowments and wages entails economic benefits but also social and political consequences. While poverty dropped sharply in developing countries (prominently in China), the

² Milanovic, Branko. Global inequality: A new approach for the age of globalization. The Belknap Press of Harvard University Press, Cambridge, Massachusetts, 2016.

³ Dabla-Norris, Era, Kalpana Kochhar, Nujin Suphaphiphat, Frantisek Ricka and Evridiki Tsounta, “Causes and Consequences of Income Inequality: A Global Perspective,” IMF Staff Discussion Note, SDN/15/13, June 2015, page 4. <https://www.imf.org/external/pubs/ft/sdn/2015/sdn1513.pdf>

average income in developed countries remained stagnant and inequality increased.⁴ Unsurprisingly, many rich societies where income distribution used to be more egalitarian are experiencing a backlash against globalization.⁵

Global Inequality and the Distribution of Income



Note: Coefficient of 1 expresses maximal inequality. Blue line calculated across GDPs obtained from household surveys of all countries in the world, without population-weighting. Red line considers population weights. Green line focuses on individuals instead of countries (calculated based on household surveys with data on individual incomes or consumption).

Source: IMF Staff Discussion Note. “Causes and Consequences of Income Inequality: A Global Perspective”, by Era Dabla-Norris *et al*; see footnote 3.

Trade liberalization and the resulting economic interdependence between countries are presumed to be the culprits. Several authors have tried (in my view unsuccessfully) to stand for trade by adjudicating most of the blame to technological innovations. However, technological progress and trade are intimately intertwined.⁶

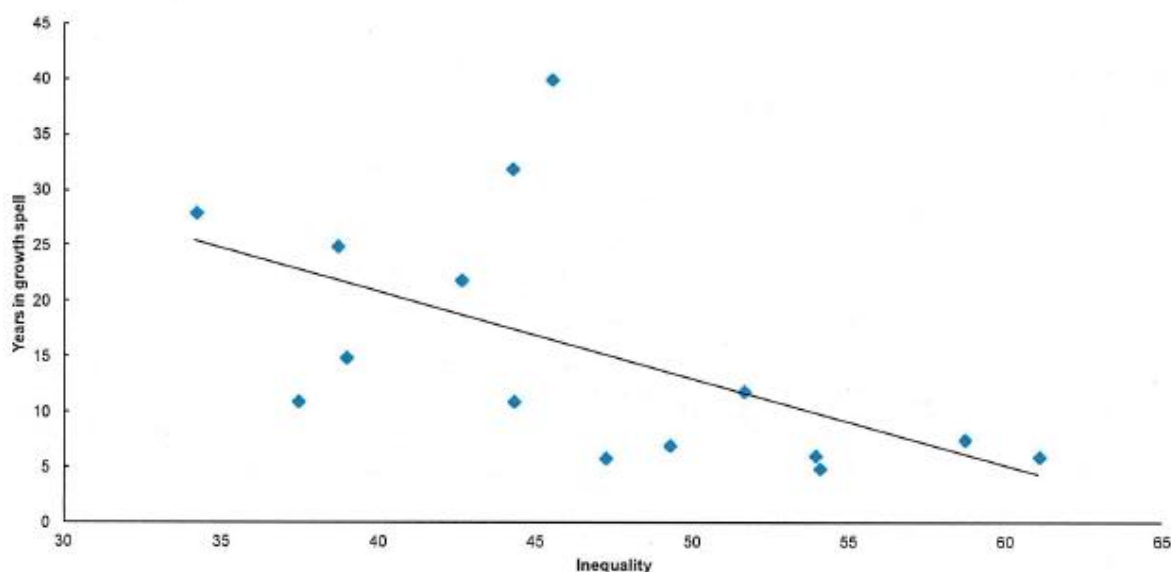
⁴ McKinsey Global Institute estimates that between 65 and 70 percent of households in 25 developed countries, about 580 million people had their incomes -wages and income from capital- flat or reduced in 2014, compared with 2005. This compared with less than 2 percent (about 10 million people) who experienced a similar phenomenon between 1993-2005. “Poorer Than Their Parents? Flat or Falling Incomes in Advanced Economies”, July 2016. <https://www.mckinsey.com/~media/mckinsey/featured%20insights/Employment%20and%20Growth/Poorer%20than%20their%20parents%20A%20new%20perspective%20on%20income%20inequality/MGI-Income%20Inequality-Executive-summary-July-2016.ashx>

⁵ Pavcnik, Nina. “The Impact of Trade on Inequality in Developing Countries”, Dartmouth College and NBER, August 2017. <http://www.nber.org/papers/w23878>

⁶ Nina Pavcnik notes that even if the “relationship between trade and technology is highly intertwined (but) trade’s adverse effects (on income distribution) appear to be highly geographically concentrated; *ibid.*, footnote 5.

Regardless of trade's share of responsibility for income inequality, the real issue is that both income and wealth inequality have been steadily rising; undermining growth⁷ and acceptance for globalization, and breeding potentially dangerous nationalistic and nativist sentiments.

Duration of Growth Spells and Inequality



Note: based on Penn World Tales and Wider World Income Inequality Database, includes completed spells only.

Source: IMF Discussion Note, "Inequality and Unsustainable Growth: Two Sides of the Same Coin?" by Andrew G. Berg and Jonathan D. Ostry; see footnote 63.

If those with a higher marginal propensity to consume could get a bigger share of national income, it would be easier to rebalance global demand and to wean the economic recovery in advanced economies from monetary stimulus.⁸ Unfortunately, the concentration of wealth has reached such obscene levels,⁹ that it is inciting political instability, compounding the risk of a new financial crisis¹⁰ and challenging sustainable growth.¹¹

⁷ Dabla-Norris, Era, Kalpana Kochhar, Nujin Suphaphiphat, Frantisek Ricka and Evridiki Tsounta show that when the income share of the richest 20 percent increases by 1 percentage point, GDP growth declines by about 0.08 percent in the following five years, suggesting that there is no (or very little) "trickle down." In contrast, a similar increase in the income share of the bottom 20 percent (the poor) is associated with 0.38 percentage higher growth, *ibid.* footnote 3, page 7.

⁸ Dervis, Kemal and Zia Qureshi note that chronically deficient demand constraints GDP and productivity growth, producing so-called "secular stagnation." See "Probing the Productivity Paradox," Project Syndicate, September 14, 2016. <https://www.project-syndicate.org/commentary/productivity-growth-and-technological-innovation-by-kemal-dervis-and-zia-qureshi-2016-09?barrier=accessreg>. See also Lawrence Summers, "Demand Side Secular Stagnation," *American Economic Review: Papers & Proceedings* 2015, 105(5): 60–65. <http://dx.doi.org/10.1257/aer.p20151103>

⁹ Almost half of the world's wealth is now owned by just 1 percent of the population, *ibid.* footnote 3, quoting the "Global Wealth Report" by Credit Suisse, Zurich, 2013.

¹⁰ Dabla-Norris, Era, Kalpana Kochhar, Nujin Suphaphiphat, Frantisek Ricka and Evridiki Tsounta, *ibid.*, footnote 3, note that increased inequality intensifies leverage, the overextension of credit and a relaxation in mortgage-underwriting standards; referring to Ragu Rajan, "Democracy, Inclusion and Prosperity", speech at the D.D. Kosambi Ideas Festival, Goa, India, February 20, 2015.

¹¹ Florence Jaumotte and Carolina Osorio Buitron, "Inequality and Labor Market Institutions", IMF Staff Discussion Note, SDN/15/14, July 2015, page 5.

Global top 1% shares in <i>global income</i> and <i>global wealth</i>		
Estimate of <i>income</i> and <i>wealth</i> share	Around 2000	Around 2010
Top 1% share in global <i>income</i> based on household surveys alone	14.5	15.7
Top 1% share in global <i>income</i> based on surveys and adjustments for underreporting	29	28
Top 1% share in global <i>income</i> based on surveys, adjustments for underreporting, and adjustment for hidden wealth	--	29
Top 1% share in global <i>wealth</i>	32	46
<p><i>Note:</i> Top 1% for wealth refers to the richest 1% of adult individuals <i>Source:</i> Branko Milanovic, <i>Global Inequality</i>; see footnote 2.</p>		

In our integrated world economy, policymakers have an increasingly complex job. The viability of domestic policies hinges on international policy coordination. Policymakers will not just need to calibrate domestic policies to national circumstances, but also ensure that their policy choices match those of their trade partners.

To redress income inequality, policy makers will need to implement structural reforms and use fiscal instruments. However, as both come at a cost, the first to move bears a risk. Leading countries can afford it because others will follow; but the “America First” doctrine has left global leadership vacant and the world wondering if the name of the new game is “each country for itself.”

In such circumstances, promoting policy coherence in economic policymaking is both crucially important and extremely difficult. In the absence of leadership, could the G20 broker coherent domestic responses to our common policy challenges? How could international organizations buttress G20’s efforts? The reader may find in this note some elements for reflection and recommendations.

Economic Nationalism: An Aberration in an Integrated World Economy?

Information and communication technologies (ICT) are making the world a much more integrated place. Trans-border data flows are growing at staggering rates,¹² and a significant part of trade is already being delivered digitally. “Bytes” can cross national borders and materialize, dodging our

¹² According to CISCO, a networking company, Internet traffic in 2019 is projected to be 64 times that of 2005; between 2010 and 2014 Global Internet bandwidth has more than quadrupled (from less than 50 terabytes per second to more than 200 terabytes per second) and total cross-border Internet traffic increased 18-fold from 2005 to 2012. See “Cross-Border Data Flows, Digital Innovation, and Economic Growth”, Global Information Technology Report, 1.2, World Economic Forum 2016, referring to report authored by J. Manyika, J. Bughin, S. Land, O. Nottebohm, D. Poulter, S. Jauch, and S. Ramaswamy from McKinsey Global Institute, 2014. “Global Flows in a Digital Age: How Trade, Finance, People, and Data Connect the World Economy.” http://www3.weforum.org/docs/GITR2016/WEF_GITR_Chapter1.2_2016.pdf

trade “radars”¹³ tracking goods (atoms) and services.¹⁴ Determining the origin of what we consume is daunting, as data flows are progressively becoming more important than physical trade.¹⁵

Ironically, while this happens, protectionist pressures, economic nationalism, and political nativism are on the rise. Countries that were traditionally open to immigration and championed trade liberalization are today raising walls and trade barriers. Others that at least rhetorically stand up for free trade and the liberal rules-based system, are using centrally-planned policies to prop up “national champions.”

Trade has pulled millions out of poverty,¹⁶ which has narrowed the income gap between “developed” and “developing” countries.¹⁷ Nevertheless, open markets to trade and capital movements has intensified competition and augmented income inequality within countries.¹⁸

Productivity has been rising much faster than real wages,¹⁹ and middle classes have been squeezed in many countries, developed and developing alike. The share of national income going to labor has declined in almost all G20 countries²⁰ and wages are no longer performing the central redistributive role that they used to.²¹ Many feel cheated, as the “social contract” on which political consensus in liberal economies used to rest has been breached.²² This entails far-reaching social and political consequences.

The entry of labor-abundant countries into the world economy has benefited consumers. It also capped and repressed labor’s share of income in high- and middle-income economies.²³ Not surprisingly, economic nationalists have made strides promising to renegotiate or pull out their countries from “unfair” trade agreements and impose trade restrictions to “abusers” (i.e., countries

¹³ Our “trade radars” are prepared to detect “atoms” (moving volumes) and their associated services (transportation, insurance, trade finance). However, bytes have no volume and are ubiquitous. Determining their “origin” and asserting their commercial “nature” without interfering with data flows is quite challenging.

¹⁴ Digital flows can eventually “materialize” in a good form of service (say know-how transmitted to a machine that produces ball-bearings) or a traditional one (say payment and insurance allowing for Airbnb accommodation).

¹⁵ Lagarde, Christine. “Creating a Better Global Trade System,” speech in Portland, USA, May 14, 2018. <http://www.imf.org/en/News/Articles/2018/05/14/sp-lagarde-creating-a-better-global-trade-system?cid=em-COM-123-37061>

¹⁶ World Trade Organization and World Bank Group, *The Role of Trade in Ending Poverty*, 2015. https://www.wto.org/english/res_e/booksp_e/worldbankandwto15_e.pdf

¹⁷ Milanovic, Branko, *ibid.*, footnote 2.

¹⁸ Lang, Valentin and Marina Mendes Tavares note that while globalization has narrowed the income gap between countries, unambiguously conclude that “economic globalization [trade & capital flows] is strongly and robustly related to rising income inequality,” “The Distribution of Gains from Globalization,” IMF Working Paper, March 2018, WP/18/54, pages 4 & 26.

¹⁹ ILO, IMF, OECD and World Bank Group, “Income inequality and labour income share in G20 countries: Trends, Impacts and Causes,” prepared for the G20 Labor and Employment Ministers Meeting and Joint Meeting with the G20 Finance Ministers, Ankara, Turkey, 3-4 September 2015.

²⁰ *Ibid.*, footnote 19.

²¹ According to McKinsey Global Institute, the average wage share as a percentage of GDP has fallen by 5 percent on an indexed basis since 1970 (except for a spike during the 1973-74 crisis) in six countries covered by a recent study (France, Italy, Netherlands, Sweden, U.S. and UK). This decline took place despite rising productivity, suggesting a disconnection between productivity and incomes. *Ibid.*, footnote 4, Executive Summary, page 10.

²² Muñoz, Manuel. “Economic Growth Is No Longer Enough,” Project Syndicate, October 25, 2017.

²³ ILO, IMF, OECD and World Bank Group, *ibid.*, footnote 19, page 21.

that run bilateral trade surpluses). However, using trade barriers would “forego aggregate welfare benefits from globalization, thereby failing to improve living standards at large.”²⁴

Restoring the “social contract” and reconciling people with trade will rather require a combination of structural reforms and income distribution policies.²⁵ However, taxing “trade winners” to compensate “trade losers” comes at a cost and if a country implements such policies in isolation, it could hinder its international competitiveness. Calls for protectionism could resound even louder.

Is It Just Trump?

International trade is at a crossroads and the negative sentiment towards trade cannot be blamed on World Trade Organization (WTO)’s (many) weaknesses.²⁶ All flagship negotiations have faced serious domestic opposition, questioning their fairness and capacity to promote inclusive growth.

It would be comfortable, yet wrong, to believe trade problems started in the United States on January 20, 2016. Admittedly the Trump administration has compounded trade tensions, but the wave of protectionism is more a symptom of distributional tensions than an aberration.²⁷

By the same token, it is only fair to acknowledge that China is also challenging the world trade system, albeit in a much subtler manner. While President Xi stands for the rules-based trading system, China’s “centrally-planned capitalism” bodes ill with a set of rules that was designed to regulate relations between private actors, which are meant to pursue profits and commercial interests only.

To make things more complicated, the European Union (EU), perhaps the other most likely candidate to take over leadership from the United States, does not have the internal cohesion to take up that position. Although Brussels is committed to defend multilateralism, prominent EU members appear to be undetermined to stick to EU regulations and pursue deeper integration.²⁸

In sum, while the country that used to be the driving force behind the global architecture of international institutions and economic agreements is today tearing down that system,²⁹ the EU is engulfed in its own existential tribulations and China, the largest economy in the world in terms of purchasing power and the number one exporter,³⁰ is prospering on an economic model that antagonizes principles on which the liberal rules-based system was founded. Not surprisingly, trade uncertainties are dominant and resonating in the financial markets.

²⁴ Dewan, Sabina and Jens Suedekum show that whereas a protectionist agenda could shield certain groups from trade losses, it would come at the cost of foregoing aggregate welfare benefits from globalization, thereby failing to improve living standards at large. “The Global Deal and Trade: Harnessing the Benefits for Greater Development, Equality and Growth”, Discussion Paper, November 2017.

http://www.theglobaldeal.com/app/uploads/2017/11/2017-11-20-Charting-a-New-Path_FINAL-21-nov.pdf

²⁵ Lang and Mendes Tavares note that governments have two main channels to affect the distribution of gains from globalization. On the one hand, the fiscal channel, this is taxes and transfers. On the other hand, structural reforms, these are policies that alter the distribution of “market income” (e.g. education); *Ibid.* footnote 18, pages 34-36.

²⁶ Torres, Hector. “Argentina: An Opportunity to Rethink the WTO’s Working Practices,” CIGI Papers No. 143, September 2017.

²⁷ Torres, Hector, *ibid.* footnote 26, page 2.

²⁸ Financial Times. “Multilateralism without American leadership”, June 6, 2018.

²⁹ Haley, James. “How Trump Tariffs Will Dismantle Decades of Economic Progress”, Center for International Governance Innovation, June 5, 2018. <https://www.cigionline.org/articles/how-trump-tariffs-will-dismantle-decades-economic-progress>

³⁰ WTO, <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Country=CN>

Globalization's Time-inconsistency

Globalization brought many economic advantages. It fostered technological innovation and exponentially increased consumer choices. Global value chains have allowed many developing countries to increase their exports and develop world-class industries that created new, better-quality jobs.³¹ While this pulled millions out of poverty (mostly in developing countries), those that saw their jobs off-shored found little or no consolation in such facts.

In advanced economies (and some middle-income countries), many manufacturing jobs were lost.³² Displaced workers often found it hard to be rehired as the equipment they used to operate was obsolete and their skills were no longer in demand. Long periods of unemployment were quite common as new job openings in distant places were out of reach, either from lack of skills or unaffordable real property prices and rentals.³³

To be sure, over the long run, opening markets for trade boosts growth and increases welfare³⁴ but, in the short run, it creates losers. By itself, trade cannot ensure a socially acceptable distribution of benefits. It is no wonder that frustration with globalization is gaining ground.³⁵ Some well-respected scholars believe that it has been pushed too far.^{36 37}

Has Globalization Gone Too Far?

In a recent paper, Dani Rodrik argues that when trade barriers are already low, the distributional effects of further trade liberalization can be larger than the net efficiency gains. In other words, lowering already low trade barriers may produce more income inequality than net efficiency gains.³⁸

Whereas two recent IMF Working Papers respectively confirm³⁹ and deny⁴⁰ Rodrik's hypothesis on trade liberalization; there is more agreement in the IMF regarding the distributional consequences

³¹ Baldwin, Richard. *The Great Convergence: information technology and the new globalization*, Cambridge Massachusetts, The Belknap Press of Harvard University Press, 2016.

³² IMF, "World Economic Outlook," Chapter 3, April 2017. The decline in manufacturing jobs and labor's share in income in the U.S. was deeper in industries more affected by increasing imports and the participation in global value chains is one of the factors explaining the offshoring of labor-intensive activities from advanced economies to emerging markets and developing countries. (See "Technology and the Future of Work", prepared by the IMF for the Group of Twenty, March 2018, <http://www.imf.org/external/np/g20/pdf/2018/041118.pdf>).

³³ Avent, Ryan. *The Wealth of Humans*, Penguin Books, UK, 2017.

³⁴ If the price of tradable products reflects the true cost of production (e.g., not distorted by subsidies or the manipulation of exchange rates and other policy interventions).

³⁵ New York Times, "I.M.F. Warns of Anti-Trade Sentiment Amid Weak Global Growth", October 4, 2016. <https://www.nytimes.com/2016/10/05/business/dealbook/imf-economic-growth-forecast-trade.html>

³⁶ Summers, Larry. "How to embrace nationalism responsibly", *The Washington Post*, July 10, 2016. https://www.washingtonpost.com/opinions/global-opinions/how-to-embrace-nationalism-responsibly/2016/07/10/faf7a100-4507-11e6-8856-f26de2537a9d_story.html?noredirect=on&utm_term=.ec78a307641e

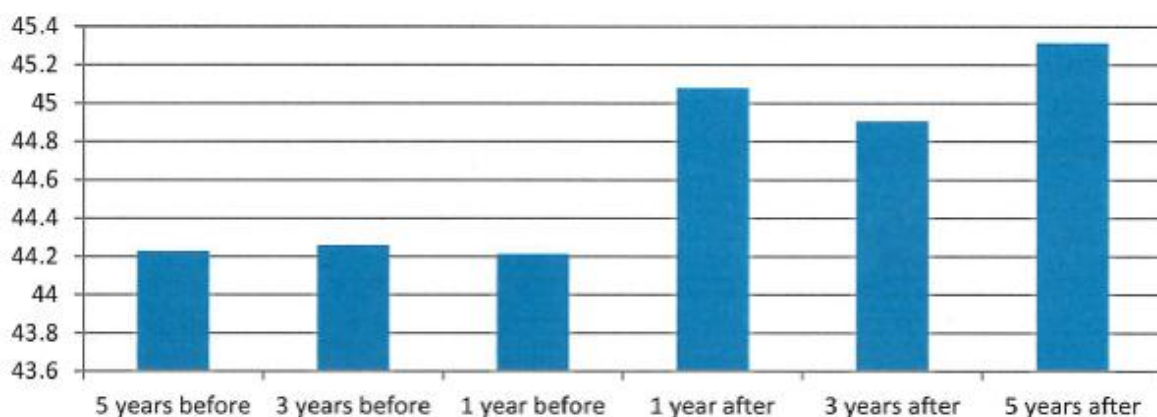
³⁷ Haley, James. "Did Trade Liberalization Go Too Far?", CIGI Papers No. 168, April 2018. <https://www.cigionline.org/sites/default/files/documents/Paper%20no.168web.pdf>

³⁸ Rodrik, Dani. "Populism and the Economics of Globalization", John F Kennedy School of Government, Harvard University, Cambridge, MA 02138, June 2017, page 7.

³⁹ Lang, Valentin and Marina Mendes Tavares, *ibid.*, footnote 18, confirm that globalization has "diminishing marginal returns", showing that in most globalized countries further liberalization has no statistically significant effects. Furthermore, they conclude that globalization "increases income inequality by lifting absolute incomes for the (very) rich without significantly affecting the incomes of the poor." While this result is valid for "many countries," they also conclude that in "developing countries where the gains from

of facilitating capital mobility.⁴¹ Capital account liberalization reforms are associated with statistically significant and persistent increases in inequality.⁴²

Evolution of Inequality Before and After Capital Account Liberalization



Source: IMF Working Paper. “Capital Account Liberalization and Inequality” by Davide Furceri and Prakash Loungani. WP/15/243; see footnote 42.

While workers are increasingly affected by policies that limit their capacity to find jobs across national borders, capital account liberalization makes threats to relocate production abroad more credible. No wonder the labor’s share in income is decreasing,⁴³ despite the constant “flexibilization” of market regulations.⁴⁴

Besides increased income inequality, there is another important aspect that helps explaining diminishing support for globalization. The scope of international trade commitments has progressively expanded to subjects that used to be left to the discretion of national legislation. Trade agreements are now loaded with “beyond-the-border regulations” on issues that range from obligations to ensure the free movement of capital to rewards to patent-holders and health and environmental protection. Even a privilege for foreign investors to drag governments to international courts is frequently granted in trade agreements. Such creeping expansion of trade agreements has inevitably eroded the realm of domestic political decisions, raising the perceived

globalization are generally larger (...) they also reach the bottom of the income distribution and reduce poverty,” pages 8-9, see also pages 24-26.

⁴⁰ Gnutzmann-Mkrtchyan, Arevik and Christian Henn. “Peeling Away the Layers: Impacts of Durable Tariff Elimination,” IMF Working Paper, WP/18/109, May 2018. Based on WTO’s Information Technology Agreement experience, the authors compare benefits stemming from zero Most Favoured Nation (MFN) tariff commitments with MFN tariff reductions and they conclude that with minimal fiscal revenue losses, zero commitments produce non-linear benefits (a premium).

<http://www.imf.org/en/Publications/WP/Issues/2018/05/10/Peeling-Away-the-Layers-Impacts-of-Durable-Tariff-Elimination-45824>

⁴¹ Dabla-Norris, Era *et al*, in their IMF Staff Discussion Note, find that greater financial openness and technological progress are associated with rising income inequality, *ibid.*, footnote 3, page 23.

⁴² Furceri, Davide and Prakash Loungani. “Capital Account Liberalization and Inequality,” IMF Working Paper, WP/15/243, November 2015. <https://www.imf.org/external/pubs/ft/wp/2015/wp15243.pdf>

⁴³ Furceri, Davide and Prakash Loungani, *ibid.*, footnote 42, page 5.

⁴⁴ Dabla-Norris, Era *et al*, in their IMF Staff Discussion Note, argue that the easing of labor market regulations is associated with higher market inequality and income share of the top 10 percent, *ibid*, footnote 3, page 26.

political costs of globalization.⁴⁵ Not surprisingly populism is gaining traction amongst those that, rightly or wrongly, believe that trade agreements erode their capacity to shape their societies, while allowing the very rich to get even richer.⁴⁶

Unfortunately, their mistrust is not entirely unjustified,⁴⁷ and the Global Financial Crisis has compounded their suspicions. Taxpayers in advanced economies were forced to bail-out financial speculators, while central banks pumped money into bonds in the secondary market. Increased demand for government bonds boosted their prices and curved down long-term interest rates. The strategy was not perverse. Cheapening the cost of capital⁴⁸ prevented the financial melt-down and stimulated investment.⁴⁹ However, it also fattened the pockets of those holding public bonds (mostly the rich). Moreover, artificially cheap capital has facilitated the substitution of labor,⁵⁰ weakening its relative bargaining power vis-à-vis capital.⁵¹ Unsurprisingly, the crisis has disproportionately benefited those holding the top 1 percent share of global wealth.⁵²

Is It Just About Income Inequality?

There is no question that income inequality can breed frustration. However, immigration pressures have amplified that feeling, blending it with mistrust for “outsiders.” In many countries, mostly high and middle-income, workers fear “unfair competition” from foreigners, ready to work under harsh conditions and for a fraction of local salaries.

Imports and immigrants are then perceived as a menace to relatively well-paid jobs and the benefits of the welfare state. This could have serious political consequences⁵³ because, despite startling technological innovations, nationality and jobs still are the cultural “moorings” that define people’s place in society.⁵⁴

⁴⁵ See Haley, James, *ibid.*, footnote 37, pages 5 and 18.

⁴⁶ Democratic governments will ultimately need to articulate this tension, otherwise the global expansion of markets could be perceived as causing the retrenchment of democracies. James Haley argues that the quid pro quo for trade and financial liberalization was a constraint on domestic policy space, *ibid.*, footnote 37.

⁴⁷ Dani Rodrik argues that, as the agenda of international trade negotiations was shaped by multinational corporations and investors, the results have disproportionately benefited capital at the expense of labor, “In Defense of Economic Populism,” Project Syndicate, January 9, 2018. <https://www.project-syndicate.org/commentary/defense-of-economic-populism-by-dani-rodrik-2018-01?barrier=accessreg>

⁴⁸ The 5,000-year history of interest rates shows that US rates were at historically low levels. Business Insider France, 17 June 2016. <http://www.businessinsider.fr/us/chart-5000-years-of-interest-rates-history-2016-6>

⁴⁹ Much was used by firms to buy-back their own stock.

⁵⁰ As the IMF notes, given degree of substitutability of labor by capital, making capital more affordable increases the capital intensity of production (more machines and fewer workers to produce greater output). IMF, “Technology and the Future of Work,” prepared for the Group of Twenty, March 2018, *supra*, footnote 32, page 16.

⁵¹ Branko Milanovic argues that the distribution of rents and ultimately the whole economy depends on the relative bargaining power of capital and labour, *ibid.*, footnote 2, page 106.

⁵² Florence Jaumotte and Osorio Buitron, Carolina show that “declines in union density are followed by an increase in top income shares in seventy five percent of the cases,” *ibid.*, footnote 11, pages 4 & 14.

⁵³ Ryan Avent notes that “the better countries are at sharing social wealth among members, the greater the pressure to shrink the circle of social membership,” *ibid.*, footnote 33, page 22.

⁵⁴ When somebody is asked to describe herself or himself, she/he will usually start by underscoring national origin and job or profession: “I am from this or that country and I do this or that job.”

Frustration with relatively flattened or falling income and fear of challenges coming from the outside make a politically corrosive cocktail.⁵⁵ In this context the “my-country-comes-first” doctrine sounds appealing despite its implications for an international trading system where players are expected to engage in cooperative relations and abide by common rules.

Fiscal policies to tax trade-winners and compensate trade-losers can help, but they may not suffice. This was eloquently explained in just a few characters by Peter Navarro, President Trump’s main trade advisor: “We prefer paychecks to welfare checks for the American people.”⁵⁶

Is it more Technology than Trade?

People easily understand that globalization and trade go hand-in-hand, but it is not equally evident that trade and technological innovation are also inseparable.⁵⁷

Some authors try to preserve trade by putting most of blame for job losses⁵⁸ and increased income inequality⁵⁹ on technological innovations. However, disentangling their effects requires complex modeling,⁶⁰ and allocating discrete shares of “responsibilities” is highly speculative.⁶¹

Both trade and technology provoke “frictions” stemming from the adjustments they induce in the allocation of labor and capital. However, neither trade nor technological developments are endogenous to any country. Economic openness encourages innovation and technological developments facilitate economic integration. Both are synergic⁶² as they largely depend on global consumption.

The global economy’s interdependence and technological innovation are therefore very much intertwined. Efforts to “demonstrate” that technology has more distributional consequences than trade are no more than an intellectual distraction. For those whose jobs were off-shored, only trade is sitting at the dock, and no politician would ever reach office by proposing to stop technological innovation, whereas some have won elections by promising to stop imports (and migrants).

Despite its thin popularity, trade can make growth more sustainable⁶³ and preserving it is indispensable for reasons that well exceed its economic benefits. While nationalism and “economic patriotism” can stop legal imports, they are not good at stopping illegal immigrants. If would-be

⁵⁵ According to McKinsey Global Institute, citizens (in rich countries) who held the most negative views on trade and immigration were those that felt that their incomes were not advancing and did not expect the situation to improve for the next generation, *ibid.*, footnote 4, page 6 of the Executive Summary.

⁵⁶ See https://www.brainyquote.com/quotes/peter_navarro_824155

⁵⁷ WTO, World Trade Report: Trade, Technology and Jobs, 2017.

https://www.wto.org/english/res_e/booksp_e/world_trade_report17_e.pdf

⁵⁸ Financial Times, “Most US manufacturing jobs lost to technology, not trade”, December 2, 2016.

<https://www.ft.com/content/dec677c0-b7e6-11e6-ba85-95d1533d9a62>

⁵⁹ Jaumotte, Florence, Subir Lall and Papageorgiou, Chris. “Rising Income Inequality: Technology, or Trade and Financial Globalization?”, IMF Working Paper, WP/08/185, July 2008.

⁶⁰ IMF, World Economic Outlook, Globalization and Inequality, October 2007,

<https://www.imf.org/external/pubs/ft/weo/2007/02/>

⁶¹ WTO, *ibid.*, footnote 57.

⁶² Branko Milanovic, *ibid.*, footnote 2, argues that lower price of capital goods, technological change and replacement of routine labor “could have only occurred under conditions of globalization”, noting that technological change and globalization are “wrapped around each other, and trying to disentangle their individual effects is futile,” pages 109/110.

⁶³ Berg, Andrew and Jonathan Ostry find that trade is correlated with longer growth spells. “Inequality and Unsustainable Growth: Two Sides of the Same Coin?” IMF Staff Discussion Note, April 8, 2011, SDN/11/08, pages 10-11.

economic migrants cannot sell abroad what they produce at home, they will keep jumping on boats or paying “coyotes” to smuggle their families into promised lands.

Affording Local Costs for Global Benefits?

Trade can bring important benefits, but also “frictions” such as the distribution of economic activity and income across regions or industries within an economy.⁶⁴ Mitigating these adjustment costs is essential to buttress political support for trade. However, in a globally integrated economy, this is not just about choosing the appropriate mix of policies according to domestic circumstances. Stemming the backlash against globalization will require an international concerted effort.

A recent joint report prepared by the WTO, the IMF, and the World Bank, has put forth a menu of structural reforms and fiscal compensatory policies that countries could implement to mitigate adjustment costs and improve the public attitude towards trade.⁶⁵ Yet, the proposed structural reforms trade immediate costs for long-term benefits and fiscal compensatory policies may require new taxes and increased debt. It may be risky for governments to do this if their trading partners do not move in the same direction. Furthermore, there is not sufficient research on governments’ capacity to tax winners to compensate losers, without infringing on international competitiveness.⁶⁶

In sum, the economic interdependence resulting from globalization makes it dangerous for countries to “go it alone.”⁶⁷ The success of domestic policies increasingly depends on trading partners’ policy choices and synchronizing their implementation. Otherwise, the “first-mover” could be undercutting its competitiveness and compounding its citizen’s anti-globalization sentiment.⁶⁸

Who is Brokering Policy Coherence?

Promoting policy coherence in economic policy-making should be at the top of the agenda. International gatherings such as the G20 are well suited to facilitate the exchange of experiences and concerted efforts to minimize negative spillovers of divergent policies. However, as the G20’s chairmanship changes every year, and as the group has avoided setting up a permanent bureaucracy, it largely depends on the support of international organizations.

The WTO is the only global international organization dealing with the rules of trade between nations. It is central to preserving an international trade cooperative environment and it has a mandate to promote policy coherence.⁶⁹ However, it is a “muzzled” organization. Its (quasi) judicial role in adjudicating trade disputes inhibits its staff from recommending policies that could eventually be legally challenged. Undoubtedly, the WTO can (and should) play an important role in helping countries understand the potential trade spillovers of different policy choices, but it cannot lead the

⁶⁴ IMF Cluster Report – Trade Integration in Latin America and the Caribbean, March 2017.

⁶⁵ IMF, World Bank and WTO, “Making Trade an Engine of Growth for All,” prepared by the G20 Meeting of Sherpas, March 23-24, 2017. Frankfurt, Germany.

https://www.wto.org/english/news_e/news17_e/wto_imf_report_07042017.pdf

⁶⁶ Goldberg, Penny lecture at the World Bank (video), March 13, 2018. <http://live.worldbank.org/dec-lecture-series>

⁶⁷ Dani Rodrik, *ibid.*, footnote 38, argues that “time consistency” is, perhaps, the most serious difficulty to implement compensation policies: “[A]s long as reversing trade agreements is costly, governments always have the incentive to promise compensation, but rarely to carry it out,” page 12.

⁶⁸ The IMF argues that governments need to distribute the benefits of technology more evenly, but also acknowledges that the redistribution of gains tends to imply losses in efficiency. *Ibid.*, footnote 32.

⁶⁹ WTO, Article III (5) of the Marrakesh Agreement.

effort to promote concerted structural reforms and fiscal policies, lest compromising its “neutrality” to adjudicate disputes that could stem from their implementation.

Both the World Bank and the IMF have competence and skills to help countries choose and implement policies with potential trade implications, and the WTO agreement acknowledges their responsibilities in promoting coherent macroeconomic policies.⁷⁰

Fostering trade and development are central to the World Bank.⁷¹ However, as the World Bank is focused on combating poverty, its remit on trade is focused on helping developing countries take advantage of trade opportunities to foster development and combat poverty.⁷²

The IMF has a broader mandate. According to its Articles of Agreement, the IMF must “promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments” and “exchange (rate) stability to maintain orderly exchange arrangements among members, and to avoid competitive (...) depreciation(s).”⁷³

Furthermore, recommending policies is the bread and butter of the IMF’s business. The Fund annually scrutinizes the economies of each of its 189 members⁷⁴ and produces reports focused on multilateral issues, showing how individual economies fit into the global picture and the risks associated with their policies (e.g., excessive current account surpluses or deficits).⁷⁵

This puts the IMF in a privileged position to help countries gradually pace in the domestic structural reforms and fiscal policies that may respond best to their national circumstances while minimizing negative spillovers.

Moreover, the Fund’s Managing Director, Christine Lagarde, has shown a strong determination to defend trade and the system of multilateral rules. Despite the fact that the United States is the Fund’s largest shareholder (the only country that holds a quota large enough to veto key decisions), Mme. Lagarde has been increasingly assertive in criticizing Washington’s upsurge in protectionism.⁷⁶ Unfortunately, her display of independence in standing for trade and multilateral institutions does not offset the absence of IMF’s staff from trade debates at the WTO.⁷⁷

⁷⁰ Ibid. footnote 69.

⁷¹ World Bank, Article I (iii) of the Articles of Agreement.

⁷² The World Bank Group (IBRD, IFC, MIGA and IDA), is the main multilateral provider of Aid for Trade, development assistance designed to help developing countries more effectively engage in international trade.

⁷³ IMF, Article I (ii) of the Articles of Agreement. The same could be said for another of the Fund’s central purposes: “to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation,” see Article I (iii) of the Articles of Agreement.

⁷⁴ Normally “Article IV consultations” take place once a year. However, occasionally the Executive Board can decide to carry them out once every two years.

⁷⁵ Beyond the publication of annual Article IV reports on individual country economies, the Fund produces the World Economic Outlook (arguably the Fund’s flagship bi-annual publication), and the “External Sector Report.” The latter analyzes in detail multilateral issues, showing how each of the 28 world’s largest economies plus the euro area (representing over 85 percent of global GDP) fit into the global picture, discussing associated risks and policies needed to reduce excess imbalances and promote global stability.

<http://www.imf.org/en/Publications/SPROLLs/External-Sector-Reports>

⁷⁶ Christine Lagarde, *ibid.*, footnote 15.

⁷⁷ The IMF is regularly invited to attend certain meetings (e.g., where Balance of Payment exceptions are discussed) but the Fund closed its office in Geneva. The IMF would be in a better position to provide accurate policy advice on trade related matters, and insights on negative potential spillovers if IMF staff could attend regular WTO meetings. It may be time to reverse that decision.

This is not to ignore that the IMF's governance structure provides the opportunity to exercise undue pressure on the Fund's "technical" recommendations. Weighted voting (i.e., "one dollar- one vote") could translate into "weighted influence," allowing IMF's most influential members to press for "technical" recommendations that fit their political expectations.⁷⁸ This explains (and occasionally justifies) secular concerns of developing countries with the Fund's lack of "evenhandedness."⁷⁹

Limiting the capacity to exercise influence on the IMF's policy advice is essential to buttressing its capacity to play the role of a trusted and independent broker. Weighted-voting (the allocation of votes in proportion to Member's quotas) should only be used for decisions concerning the actual use of IMF resources (i.e., providing financial support). All other decisions, particularly those that define IMF policies, the way it conducts surveillance and provides policy advice, should be consistent with the principle that all IMF members are equals in rights and obligations.

At the same time, it is necessary to wean exaggerated optimism from IMF forecasts. As the Fund's Independent Evaluation Office noted,⁸⁰ the IMF staff tends to be over-optimistic in forecasting the results of compliance with conditionality (read, mandatory policy advice) included in "exceptional access programs."⁸¹ This may be so because those that design conditionality included in IMF programs are also responsible for forecasting their expected results. To gain objectivity, a firewall should separate staff responsible for preparing technical policy recommendations from staff responsible for forecasting the expected economic outcomes from their implementation.

Having said this, it is fair to acknowledge that the IMF has substantially scaled back the use of conditionality on trade policies⁸² and moderated its bias against the use of capital regulations.⁸³

Conclusions

Trade between countries with very different endowments and wages entails economic benefits but also social and political consequences. While poverty dropped sharply in developing countries (prominently in China), inequality within countries has increased, and the average income in

⁷⁸ As country quotas to the Fund define their voting power, countries with larger quotas (more money in the Fund's pool of international resources) could arguably exercise more influence on the Fund's policy advice.

⁷⁹ The Group of Twenty-Four (an Intergovernmental Group that advocates for the interests of developing countries in the IMF and the World Bank) has traditionally insisted in the importance of ensuring evenhanded policies and their implementation. At a recent Ministerial Meeting (October 12, 2017) it issued a Communiqué calling for "(...) evenhanded surveillance and lending decisions, and for the extension of the mandate of the IMF's Evenhandedness Committee to include the Fund's lending activities,"

<https://www.imf.org/en/News/Articles/2017/10/12/cm101217-intergovernmental-group-of-twenty-four-on-international-monetary-affairs-and-development>

⁸⁰ IMF, Independent Evaluation Office. "IEO Evaluation of IMF Forecasts—Process, Quality, and Country Perspectives," February 12, 2014. The IEO report points out, in exceptional access programs (which represent over 80 percent of the use of Fund resources) projections at the time of approvals have been consistently over-optimistic and tend to be adjusted to more realistic scenarios from the first review. . Staff's forecasts tend to be overoptimistic because they are loaded with the conditionality the forecasters themselves designed.

⁸¹ Exceptional Access Programs are anything but "exceptional." They represent over 80 percent of the use of Fund resources; yet their "exceptionality" justifies stronger conditionality.

⁸² IMF, Independent Evaluation Office. "IMF Involvement in International Trade Policy Issues," 2009.

http://www.ieo-imf.org/ieo/files/completedevaluations/Trade_Main_Report.pdf

⁸³ The IMF has traditionally recommended the liberalization of capital movements. This position was nuanced after the adoption of a new policy in 2012. See IMF, "The Liberalization and Management of Capital Flows: An Institutional View," <https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/The-Liberalization-and-Management-of-Capital-Flows-An-Institutional-View-PP4720>

developed countries has remained stagnant or dropped. Unsurprisingly, many rich societies, where income distribution used to be more egalitarian, are experiencing a backlash against globalization.

The escalation of trade tensions is undermining international cooperation and no effort should be spared to preserve it. It is the responsibility of the chair of the G20 and that of managers of international organizations to strive to preserve a positive cooperative environment. They should be ready to do “whatever it takes” to de-escalate trade tensions.

Countries’ economies are interdependent and countries’ domestic policies, regardless of their consistency with WTO obligations, have spillover effects on all others. It would be wrong and hopeless to blame a particular country for the escalation of trade tensions.

Policymakers will need to implement domestic reforms to reconcile people with trade and economic interdependence. However, these may come at a cost and affect countries’ competitiveness. Facilitating these reforms by promoting coherence in their design and implementation is the G20’s most important challenge, and the IMF is the international organization best-suited to support the G20 in that endeavor.

Recommendations

- 1) The G20 could convey a high-level policy dialogue to build up consensus on the need to implement domestic reforms to reconcile people with international trade and interdependence. A roadmap of conversations led by the G20, but not necessarily limited to G20 members, could be agreed.
- 2) Managers of international organizations should stand by the G-20 chair and assist him/her by providing a toolbox of incremental domestic reforms that could redress increased income inequality without affecting trade competitiveness.
- 3) The IMF is the best-suited international organization to support the G20 in that endeavor. Accordingly, the Fund could design and submit a blueprint that policy-makers could use, *before implementing domestic reforms*, to identify and assess potential spillovers on trading partners. The blueprint could contemplate safeguards that governments could use in case reforms affect the economy’s international competitiveness.
- 4) To reinforce the Fund’s credibility in providing policy advice on the design and implementation of the aforementioned domestic reforms, two actions are recommended:
 - a) The Executive Board should refrain from using weighted-voting in adopting recommendations to promote international coherence in economic policymaking;
 - b) A firewall should separate staff responsible for preparing policy recommendations from staff responsible for forecasting the expected economic outcomes from their implementation.