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POLICY BRIEF

Make Globalization More Inclusive or Suffer the Consequences

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The Issue Confronting Us Today

With globalization, we have seen the traditional barriers to trade and finance progressively lowered, and in this process, many have gained. Indeed, globalization has been responsible for large increases in world trade, fluid flows of capital seeking higher returns, imports of final products at lower cost to consumers, jobs and escapes out of poverty for hundreds of millions, and profits for the business community in both advanced and emerging market economies. In this clamor for greater connectivity, issues of the distribution of the gains from globalization were largely ignored, except for the work of some like Joseph Stiglitz, largely because gains were large and benefitted many on both sides of the transaction.

Yet, the benefits incurred costs as well. Although it is difficult to do a thorough net cost-benefit analysis of globalization, it clearly enabled many in the developing world to increase their incomes, and many in the advanced economies to consume more at lower prices. Accompanying the process of globalization was a process of technological advancement. New technology has enabled many to increase access to seemingly free information and to connect to the new and expanding global digital economy, while for others it has meant job losses and retrenchment. While the net gains still prevail from both phenomena, the process for compensating losers has been inadequate, and in some contexts largely foregone (see Estache and Leipziger 2009 for an early warning).

This discontent has turned progressively into frustration and anger, and we now hear loud complaints about the course of globalization. Some, like Dani Rodrik (2011), have argued that there is an inconsistency among hyper-globalization, national economic interests, and democracy, and some recent political developments on both sides of the Atlantic support this view. Our aim in this policy brief is to examine what went wrong, what was swept under the rug, and where governments have failed in dealing with globalization. We believe that inclusive economic growth is currently at risk in many countries. Why is this a problem? First, it encourages a backlash against globalization that can in fact make most worse off (viz., a poor Pareto outcome). Second, it can inhibit the positive contributions of what is being dubbed the Fourth Industrial Revolution—that is, gains in technology which have the potential for enhancing global welfare. And third, a failure to deal with worsening inequality threatens to undermine the socio-political fabric of countries, affecting the governability of nations.

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What Went Wrong?

In hindsight, it is easy to say that warning signals were missed, that we suffered from collective amnesia, that we were seduced by the efficiency gains of better-integrated markets, or that powerful interests prevailed while those of the median worker were largely ignored. It is a valid observation, however, that some countries (advanced economies) did better than others in protecting their citizens from declines in real or relative living standards. It is also true that among those countries gaining the most (emerging economies), there were differences with respect to the value placed on distributional aspects of income gains. The process of disentangling the dynamics of relative incomes is complicated by a number of factors. Among them are the rapidity with which capital can move compared to labor, the degree to which skill requirements can change over the course of a citizen's working life, the nature of winner-take-all markets and the size of rents earned in certain markets, and the powerlessness of workers when confronted with cross-border competition. All of these factors have been magnified by the weaknesses of the global economy post Great Recession. Or, put differently, many of the problems that were decades in the making were easily obscured by the abnormal period of expansion in the period preceding the global collapse.

The nature of this massive underlying political and social failure can be seen through different lenses. One lens highlights impediments to the amelioration of losses. These impediments include inadequate and/or ineffective active labor market policies; weak regulation of the world's financial sectors, which allowed the socialization of losses and the concentration of gains; corruption in some countries, and the use of political influence in others; and the inability of parts of society to effectively voice their discontents. In some countries, like the United States, physical mobility has fallen, skills have not kept pace, and wage earners have lost purchasing power. This has led to calls for protectionism and a withdrawal of support for an open world economic order.

Another lens through which to see globalization is abuse of the system. Abuse can take the form of global arbitrage when it comes to the parking of profits, locating headquarters so as to gain tax advantages, or transfer pricing, all aimed at gaining at the expense of national economic authorities. These abusive practices, which some may call hyper-globalization, limit the ability of national governments, even if they were so inclined, to manage the downsides of globalization and invest more in safety nets, re-skilling, relocation, and the like. Firms that engage in these practices, either to gain supposed shareholder value or to feather their corporate nests, have done globalization a large disservice. Governments that ignored warning signals or were lobbied to allow abusive practices are also at fault; and, of course, those firms that curried favor and attracted illicit profits are even more at fault.

A third lens through which to examine where globalization has failed is state capitalism—that is, the combination of participation in global markets without any of the possible checks and balances of the market. Weak regulation of markets can yield similar outcomes; however, when unfair practices are employed by state actors, there are neither domestic remedies to force adherence to market principles nor global accountability. Forced joint ventures with state-owned enterprises, for example, have led to technology thefts, and state financing has allowed for non-market-based strategic acquisitions. To be fair, variants of state capitalism have produced tremendous national gains in terms of poverty reduction and global convergence of incomes to the global citizen. Following the work of Branko Milanovic (2016), we see that the large gains registered by those in emerging market economies have come at the expense of those in the middle class of advanced economies (viz., the so-called Elephant Curve). There has been insufficient recognition of globalization's losers, who suffer either directly through job losses or indirectly through financial misdealings that rob national coffers. Moreover, no global compensation system exists to manage the distortions emanating from of state capitalism.

Possible Solutions and Implications for the Fourth Industrial Revolution

Solutions can be found at the individual, local, national, and international levels. At the individual level, the globalization narrative needs to include the household benefits of globalization and access to objective and accurate information from reliable sources. Education and skills acquisition need to be both encouraged and subsidized, since without them opportunities are limited. This is all the more important given the disruptive nature of technology going forward and the speed with which it may occur. At the local level, depressed areas and lagging regions require effective transfers and investment. National policies can learn from successful experiences in seeking effective solutions. Government spending on innovation (e.g. R&D/GDP) compared with spending on economic adjustment (e.g., active labor market spending/GDP) may be a useful indicator of the relative effort placed on creating new industries versus managing the impact of declining ones.

Adequate income redistribution ex post depends on public policy, including effective taxation and collection on firms and individuals and its efficient use. This is where globalization has largely failed, as many highly successful corporations have avoided paying their fair share. Beyond redistribution, however, it is fair to say that because there are both monetary and non-pecuniary rewards to work, governments, at various levels, need to be in a position to create new jobs. This does not necessarily imply the need for an industrial policy. But like the WPA after the Great Depression in the United States, jobs programs would have been useful following the Great Recession, perhaps linked to deficiencies in national infrastructure. It can be argued that effective labor market programs need to be found going forward to deal with future dislocations due to disruptive technology. This can be seen as part of preparedness for the Fourth Industrial Revolution.

Effective cross-border regulation has come too little too late. Many countries turn a blind eye to existing tax havens. Stashing of illicit funds is commonplace and efforts to curb them lag. Many aspects of hyper-globalization can be seen as antithetical to effective national policy, while national economic policies themselves can be justly criticized for not dealing with the excluded, the marginalized, and the under-skilled. Inequality beyond a certain point becomes poisonous because economic opportunity becomes skewed and limited. In the same way that economic prospects should not be determined at birth by gender or race, there must be the prospect of economic advancement.

Concluding Remarks

The goals of more equitable economic growth and of social inclusion can either be facilitated or hindered by the shape of globalization. If globalization moves, as it has, with few effective limits on bad behaviors, and if national economic policies are either captured by vested interests or are simply powerless to stop the excesses

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of globalization, then a wholesale retrenchment is inevitable. This would be a global loss in economic efficiency and would also condemn the poor regions of the globe to persistent poverty. Making globalization work for a greater number of people in the advanced countries is indispensable to help fight poverty in developing countries. Furthermore, the way in which inequality is dealt with in the advanced economies is a useful guide to middle-income countries facing diminishing growth prospects and rising inequality.

Put positively, we find ourselves in a low growth situation at present and also in a poor place with respect to economic and social inclusion. The set of available policy choices can be improved by recognition that globalization has reached a stage where its benefits have been captured but its costs have been ignored. This is bad for economic growth—both directly from the demand side, but also from the supply side, since human endeavors are thwarted and productivity is low. Most critically, rising inequality is socially uncomfortable and the persistence of exclusion creates political forces that are detrimental to growing the pie and benefitting from technology's potential. While rising incomes is not the only goal, stagnant or declining incomes limit the abilities of governments to effectively redistribute.

Finally, there is evidence that globalization is slowing down when viewed from the vantage point of international trade and global value chains. The IMF's World Economic Outlook (2016) examines the factors behind this slowdown; Constantinescu, Mattoo, and Ruta (2016) look even more deeply into shifting import propensities and changes to global supply chains. These trends, probably in train for a while, have been exacerbated by poor global economic conditions and a lack of confidence. If we add to this outlook the new pressures to de-globalize that emanate from the distributional impact on some productive sectors in advanced economies, the political constellation becomes worrying. Breaking this cycle requires that governments address inequality and social inclusion, boost global investment and restore confidence. Moreover, governments must deal with the abuses of the system by checking those who have extracted too much and contributed too little.

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