Making Trade Globalization Inclusive

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There is a widespread sentiment that trade globalization has increased inequality, and possibly even lowered standards of living of a significant number of individuals in both developed and developing countries, even if it has raised income levels of many others, and perhaps even increased the GDP of most countries overall. Such sentiments have fed into protectionist and nativist politics, contributing to the electoral victory of Donald Trump whose Administration has been openly hostile to the rules based global international order, an order that the US itself played a critical role in creating in the seventy years since the end of World War II.

This paper argues that economic theory had, in fact, predicted that there might be adverse distributional effects, especially in developed countries. (It was in fact the adverse distributional effects in the developing countries that have come as a surprise to standard theories.) While changes in technology may have themselves have had significant adverse distributional effects, it may not be possible to easily parse the separate roles of technology and globalization. Even had there been no changes in technology, in the absence of active government policies, globalization would have led to a decrease in wages of unskilled workers. Moreover, globalization provided an easy and attractive target for critics of the existing economic order. We argue, moreover, that the simplistic models typically used by advocates of trade liberalization may have overestimated the benefits. With trade globalization was oversold, with both the aggregate benefits being exaggerated and the distributed costs under estimated (Stiglitz, 2017b), the question is, where do we go from here? Do we reverse course, deglobalizing, as Trump suggests, moving behind walls of protection?

Can trade globalization be made inclusive? This paper argues that it can be. The answer to those concerned with the adverse distributional effects of globalization is not protectionism, but a new social contract, one that embraces the consequences both of changes in technology and globalization, and entails active government policies to ensure that individuals can more easily move from declining to expanding sectors, aggressive full employment policies, to ensure that job destruction does not outpace job creation, and social protection, that ensures that individuals are protected, in the interim between losing their old job and acquiring a new one.

This is a prescription for what should be done in the future. It is attainable—some countries (the Nordics) seemed to have achieved some version of the social contract described above. Countries where the politics makes such a social contract infeasible should expect democratic resistance to openness. They may, in the end, pay a high price for their unwillingness to accept such a societal bargain. For those countries like the United States, where in the past, little attention was paid to the distributive consequences of globalization, there may still be hope, but what is required is a deep

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2 For an early discussion of what is at issue there, see Stiglitz (2006). More recently, Stiglitz (2017a) points out how preserving US agricultural subsidies hurt some of the poorest in Mexico, leading to a contraction of corn acreage there as corn acreage in the US increases.

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structural change in social institutions and perhaps in politics itself. In contestable democracies (Korinek and Stiglitz, 2008, 2009), it may be difficult to sustain policies where there is too large a division in views among the parties. Any policy change is evaluated in terms of how matters might play out when the opposition comes into power. There may thus be resistance to any trade agreement that appears to be more durable than the social contract intended to deal with its distributive consequences.

The paper has four sections. The first explains why the aggregate benefits of trade globalization were perhaps exaggerated; and why the distributive effects should have been anticipated to be large. The second explains why recent trade agreements may have made matters worse than this broad theoretical analysis might have suggested. The third explains why protectionism is likely to make matters worse—and these adverse effects have been compounded by a poorly designed tax bill. The final section argues that a new social contract can ensure inclusive trade globalization. Throughout the paper, we focus on the adverse distributive effects in advanced economies. A parallel analysis applies to developing countries and emerging markets.

I. Economic theory and inequality

The benchmark model used for analyzing the incidence of any policy change is the standard competitive model. Opening up of trade between a developed country like the US and a less developed country entails increased imports of unskilled labor intensive goods to the developed country, and thus a decrease in the demand for unskilled labor. Under certain limiting conditions, as trade expands, the demand for unskilled labor in the developed country decreases and that in the developing country increases, until wages of unskilled labor are equalized.3 But even if this limiting result didn’t obtain, possibly because of market imperfections, the direction and potential magnitude of the effect was clear. Notice that this result refers to the real wage of unskilled workers, taking into account the lower prices of imported goods.

This result was, of course, never highlighted in discussions of trade liberalization in advanced countries—in spite of its simplicity. This omission was particular noteworthy for those who believed in “markets,” in the hypothesis that, by and large, markets worked well. Rather, the advocates of trade liberalization seemed to appeal to a form of trickledown economics, that the economy overall would gain, and that somehow, workers would be better off. But Samuelson (1938, 1948) himself had explained how trade could benefit the country as a whole, but unless compensation was paid, unskilled workers would be worse off. The fact that trade was good for the country as a whole simply meant that the gainers could compensate the losers, not that they would. And they typically didn’t.

In fact, a closer look at the standard argument that trade liberalization was good for the country as a whole reveals at least three critical assumptions: (a) there is no risk; (b) there are no market imperfections leading to unemployment, even transitional unemployment; (c) technology is fixed.

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3 This is Samuelson’s famous factor price equalization theorem, Samuelson (1948). Note that in the case of developing countries, it predicts that trade liberalization will be associated with a decrease in inequality. In practice, that is not the case, and a large literature has developed explaining why that might not be the case, and what might be done. This paper focuses on the relationship between trade and inequality in developed countries. See Stiglitz (2006), Harrison McLaren, and McMillan (2011), and Helpman, Itskhoki and Redding. 2010, 2013.

4 Though the results could be extended to cases where there are perfect risk markets—which there are not.
Removing any one of these assumptions weakens the case for liberalization. Indeed, in simple theoretical models, it can be shown that everyone can be worse off as a result of trade liberalization. For instance, with imperfect risk markets, the opening of trade increases risk, and firms in both countries thus shift production away from high risk-high return investments towards lower return-lower risk, so much so that everyone in both countries is worse off.\(^5\)\(^6\)

With market imperfections, trade liberalization may increase unemployment\(^7\), and it is typically the unskilled that suffer the most from unemployment. (Furman and Stiglitz (1998)). The intuitive reason that trade liberalization may increase unemployment is simple: cheap imported goods destroy jobs quickly, while it takes time to expand production in export sectors which have become more competitive. (Trade liberalization may, in the interim, allow the export sectors to enjoy high rents, which redound disproportionately to the rich.) These asymmetries are particularly pronounced when there are imperfect capital markets, impeding the ability of those who would like to expand to do so; or where there is more market power in the export sectors, which may respond to the outward shift in the demand curve for their products with only limited increases in production. Trade liberalization will then increase their rents even in the long run.

There is a broader reason to expect employment to decrease, unless there are offsetting macroeconomic policies. Assume there is trade balance. Then imports increase in tandem with exports. But advanced country exports are less (especially unskilled) labor intensive than their imports, so overall the demand for (unskilled) labor decreases. Normally, when there is overall good macroeconomic management, this should not be a problem (that is, aggregate demand can ensure full employment; there still may be wage effects). But there is evidence that for long periods of time fiscal and monetary policy are not able to quickly restore full employment. Thus, trade liberalization in a time of high unemployment (say in the immediate aftermath of the 2008 crisis) can lead to still higher unemployment. The higher unemployment in the traded good sector leads to less demand for goods in the nontraded sector, and overall aggregate demand can fall even more.

Delli Gatti \textit{et al} (2012a, 2012b) have shown that in the presence of rigidities in labor mobility, a technological advance—and globalization can be modeled as a technological advance—can lead the entire economy to be worse off. Those in the import-substitution sectors can’t move to the more productive export sector—they lack the human capital, and access to resources to make the requisite investments; if there are limits to the expansion of the export sector, and especially if the increased

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\(^5\) See Newbery and Stiglitz (1984). This can be viewed as a special case of the more general theorem of Greenwald and Stiglitz (1986) and Geanakopolos and Polemarchakis (1986) that whenever risk markets are incomplete, markets are not (constrained) Pareto efficient.

\(^6\) The standard argument applies to models with two countries. In a world with many countries, there can be large distributional effects amongst countries. While it is true that trade (for each country as a whole) is better than autarky, trade liberalization (changing the rules of trade) may leave some countries worse off, in the absence of cross-border subsidies. This may help explain the nature of “managed trade agreements,” where trade concessions serve the role of cross-border compensation.

\(^7\) Autor \textit{et al} (2013) show that after the surge of imports from China in the beginning of this century, those places producing goods which competed with Chinese imports experienced an increase in unemployment and a decrease in wages.
rents in that sector accrue to the rich and those outside the country, overall demand for non-traded goods decreases, and again aggregate demand falls.⁸

A third assumption in the standard framework is that technology is fixed, or at least not affected by trade. But trade affects technology, and equally important for our purposes, differences in states of technology. When there is learning by doing, the expansion by, say, China in its exports leads to an improvement in its technology; while the reduction in US production in those sectors leads to a reduction in the pace of learning in the US. Of course, there may be more learning in those sectors in the US which increase production. But there is no reason to believe that those effects are symmetric, for three reasons. First, China has to catch up; it has more to learn. Secondly, US exports may be dominated by sectors in which learning by doing is less important; research is more important, and there may be little if any expansion in investments in research. And third, as we have noted, many of the sectors in which US exports are marked by market power, so the expansion of their production may be more limited. Others (Grossman and Helpman, 1991, 2015) have argued that the interactions associated with trade and the standards that have to be satisfied by a successful exporter help facilitate the transfer of technology.

The transfer of technology itself has large intercountry distributive effects, which can be seen by thinking of a full competitive equilibrium (i.e. a world in which there has been an elimination of all trade barriers). Producers in the United States initially would have earned large rents associated with their superior technology. But the elimination of that technological superiority means the elimination of those rents, increasing incomes in the lagging economy relative to the advanced economy. Even if the rents associated with superior technology accrue mostly to capitalists/entrepreneurs, there is some evidence of significant amounts of rent sharing (workers in high productivity/high rent firms enjoy higher wages than comparable workers in lower productivity/lower rent firms.)⁹ Thus, US workers would be hurt by the reduction in the technological rents received by US firms.

The problems just described—both those relating to aggregate output (welfare) and distribution—can be exacerbated in the presence of actions by trading partners to “manipulate the exchange rate.” Though it may be difficult to ascertain whether a country has, in fact, engaged in exchange rate manipulation given the range of instruments that affect the exchange rate and the multiple objectives which adjustments in those instruments might serve¹⁰, consider a direct intervention, the purchase of dollars for reserves which leads to a depreciation of the US exchange rate. In that case, there can be a large trade imbalance, with even more job destruction than described earlier. Of course, given the intertemporal budget constraint, the other country (say China) may want at some later date to import more than it exports. But that is of little benefit for today’s workers: they have lost their jobs, and with long term unemployment, there will be attrition of skills. Worse still, it may pay China never to increase its imports, i.e. to let its reserves simply build up: the learning benefits described earlier exceed the losses in potential consumption. (This is, of course, a second best solution: there are typically better ways to move down the learning curve. But trade agreements may have proscribed the more efficient ways of doing so.)¹¹

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⁸ See Guzman and Stiglitz 2016a, 2016b.
¹⁰ Bergsten and Gagnon (2017) argue that there are some clear indications of currency manipulation.
The adverse distributive effects are even worse, once one recognizes that labor markets are far from competitive. Globalization weakens the bargaining power of workers—firms can threaten to move their factory unless workers moderate their wage demands.

II. How trade agreements may worsen the distributive calculus

Recent trade agreements go well beyond just lowering tariffs. Under the guise of reducing non-tariff barriers, there is often an attempt at regulatory harmonization, but the harmonization agenda tends to be towards less regulation (i.e. not harmonizing at the highest standards, but at the lowest.) Regulations typically are put in place to protect ordinary citizens and broader societal interests. At least in the US, there is typically a requirement that the benefits exceed the costs. But in the trade negotiations, all of this is shunted aside. With producers at the table, but not those representing consumer interests and civil society, the requisite balancing is missing.

Intellectual property (IPR) and investment provisions make matters worse, and typically are even more reflective of the interests of certain large multinationals. Central to IPR is disadvantaging generic medicines relative to big Pharma, upsetting behind closed doors the balance achieved in the Hatch-Waxman Act of 1984. The effect of this and other related provisions is to raise costs of and lower access to affordable medicines. For countries where governments bear a significant fraction of the costs of medicines, funds available for other purposes, including development, health, and education have to be reduced. In the United States, there can be serious adverse effects on those without adequate insurance coverage.

The details of the IPR provision may also adversely affect smaller businesses in their competition to get patents with large corporations—which was why Jim Balsillie, one of the founders of Blackberry, opposed the IPR provisions of TPP (Blachford, 2015).

Perhaps the worst non-tariff non-trade provision included in most trade agreements are the investment agreements (e.g. Chapter 11 of NAFTA) which allow corporations to sue governments when governments take actions which adversely affect their profits—even when those actions are clearly in the public interest, and where the corporation is engaged in actions which are clearly adverse to the public interest and the government action is only intended to circumscribe those actions. There have been suits over minimum wages, affirmative action, cigarette regulation, the shipment of toxic wastes, and a variety of other environmental regulations. Many of these suits have been successful. These provisions allow corporations to sue for what are called regulatory takings—even though both Congress and the courts in the US have come to the view that corporations do not have the right to sue for regulatory takings. Thus, foreign corporations are given more rights than domestic corporations, and American corporations investing abroad have better property rights protection than they do investing in the US.12

These provisions affect inequality in two ways. First, they have a chilling effect on welfare enhancing regulations. And secondly, one of the sources of comparative advantage of the United States and other advanced countries is their rule of law and security of property rights. Not only do these investment

12 For a broader discussion of these provisions see Stiglitz (2017c, 2008).
agreements give away this advantage, by giving corporations more property rights abroad than at home
they encourage American firms to move investment abroad. Equally important, they weaken workers’
bargaining power. They make the threat of a corporation moving abroad if workers don’t accept a wage
cut more credible.

Indeed, the importance given to these agreements by large corporations combined with widespread
opposition to Trade Adjustment Assistance by Republicans suggests that the weakening of workers’
wages may not have been just a matter of collateral damage in the process of globalization. It may have
been (from their perspective) one of the main benefits of globalization. Declining wages did contribute
to high levels of corporate profits, even if the short sighted opposition to trade adjustment assistance
may eventually have contributed to the growth of protectionist sentiment so evident today. ¹³

Summary of analysis so far

So far, we our analysis has helped explained why the opposition to globalization may at least partly be
well-deserved. (a) Even in the standard neoclassical model, large swaths of society would be made
worse off, in the absence of adequate compensation, which was not provided; (b) that model doesn’t
incorporate an adequate analysis of market and political realities (some refer to them as market and
political failures) which may imply that the adverse distributive effects are larger and the aggregate
benefits smaller—imperfect risk and capital markets, costs of redeployment of resources from one
sector to another, wage and price rigidities, and the failure of governments to maintain the economy at
full employment; (c) some of the problems are related to the pace of change, with excessively rapid
change having especially adverse effects, with long term hysteresis consequences; and (d) trade
agreements that were called free trade agreements, but were really managed trade agreements, were
managed for corporate interests, with provisions which may have increased the adverse distributional
consequences more than would have been the case in a simple “free” trade agreement.

III. Protectionism won’t work

While there are large distributive effects of globalization, protectionism and deconstructing global
supply chains won’t restore the well-being of workers who have been hurt to where they would have
been. History matters. There are large hysteresis effects.

First, we noted the large adjustment costs associated with globalization. There will be equally large
adjustments costs with de-globalization. And some of the adverse effects will again be borne by the
same or similar workers that were disadvantaged by globalization. For instance, the prices of auto parts
will rise, making America’s cars less competitive. The resulting loss of sales may lead to greater loss of
employment than the gain in employment from the hoped for import substitution.

Secondly, the uncertainty to the global trading order resulting from Trump’s protectionist rhetoric
discourages job creating investment.

¹³ And more broadly to opposition to trade agreements. For two trenchant criticisms of the NAFTA investment
agreement (chapter 11) see Public Citizen’s 2005 report: https://www.citizen.org/sites/default/files/chapter-11-
report-final.pdf, and more recently a report from a big Canadian social action organization, The Council of
Canadians, available at: https://canadians.org/nafta-isds
The third effect relates to the evolution of technology: American firms and workers are less competitive now than they would have been had we not gone through the process of deindustrialization of the last third of a century. One cannot undo this disadvantage quickly—and especially so without government assistance.

Of course, while deglobalization is likely to lower standards of living overall, some will lose more than others, and I suspect that among the big losers will be the very people who have lost from globalization. Even if some forms of manufacturing returns to the United States, it will be high tech manufacturing using robots and few workers, more likely to be located at locales where there are high levels of skilled labor and research facilities than in the old manufacturing centers. The new tax law (as complicated as it is) further favors “capital” over labor, distorting relative factor prices in favor of capital, and thus encouraging robotization.

If there was a moment of reflection in the hurried pace of passing the tax bill, one could imagine a moment of discussion: do we want to encourage manufacturing or manufacturing jobs. At the level of sloppiness of much of the bill, they may have quickly passed on beyond this seeming nicety. But it is more than a nicety. There can be massive increases in production with little increase in employment, and even if there is a nod towards employment, it is drowned out by the massive “subsidy” to capital goods. In short, to the extent that the bill saves manufacturing output, it does so in ways that provide little if any help to workers.

The move to the territorial system was heralded as encouraging firms to bring back money stashed abroad. This was always a myth. American firms could almost always make any investments or do anything else with this money stashed abroad that they wanted. Apple paid a massive dividend, simply by borrowing money (backed of course by the stashes of money abroad.) Already, these firms stashing dollars abroad do so by holding dollar loans from the US government. The tax bill simply affects where the profits are “booked.”

Most simply, the foreign subsidiary can lend money to the US subsidiary for building a new plant. The provisions fail to address the fundamental concerns—actions by American firms to choose where they locate to reduce taxes, and the complicity of tax jurisdictions to give favorable tax treatment. On the positive side, companies no longer have to go through the financial charades that they went through in the past (cf. Apple). But it should be clear that the tax bill is a large Christmas gift to most corporations. Especially with so many firms sitting on so much free cash, it is not clear whether the tax bill will lead to significant increases in investment, and if it does lead to more investment, whether there will be more investment abroad or more investment at home.14

The Tax Bill is heralded as moving the US towards a territorial tax system, where economic activities are taxed in the jurisdiction where they occur. Firms will seek low tax jurisdictions to produce. This will encourage the race to the bottom, and there will always be some country willing to outcompete the US in the race. It would have been far better if there had been a global minimum tax; and or the tax benefits would have been extended only to firms that invested in the US and created jobs in the US.

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14 While the corporate tax rate is reduced, various provisions of the tax bill also affect the after tax cost of capital, with some provisions actually increasing it. For a discussion of the general theory, see Atkinson and Stiglitz (1980).
Moreover, little was done to preclude locating intellectual property in a low tax jurisdiction\textsuperscript{15}: the territorial system encourages such shenanigans. (The little that the bill attempts to do seems not to be WTO compliant.)\textsuperscript{16}

### IV. A New Social Contract

Another naïve response to the analysis of section I (which suggested that the benefits of globalization were less than was thought and the costs greater) is to have a little less globalization. We got the trade-offs wrong, they say, so let’s adjust—but of course not going to the “corner” solutions advocated by the protectionist. For the most part, I believe that that too is a misguided response, except in two respects. First, we noted that some of the adverse effects of globalization arose out of the pace of change; that economic systems have the capability of adapting to changing circumstances, but there are limits, and we may have stretched those limits. We need to be mindful of this as we change the rules of the game, and even mindful of this as we construct shock absorbers in the system (see the discussion below) to enable individuals to adapt better to the changing global environment. Secondly, as we emphasized in section II, many of the provisions of international trade agreements are not really about free trade; they represent a special interest agenda. If such agreements are to include an investment agreement—and it is questionable whether they should—they should be limited only to cases of discriminatory treatment.

With these two caveats, the maxim that free trade is welfare maximizing, provided that government undertakes policies to keep the economy at full employment (including providing capital to help facilitate the expansion of new export industries and reallocate labor and other resources), maintain the economy at the technological frontier, help individuals bear the additional risk associated with trade-openness, and most importantly ensure that the benefits are widely shared, is still true. The response to the problems discussed in earlier sections is not to weaken globalization so much as to strengthen public policy. In the remainder of this section, I focus my attention on one aspect of policy, aimed at ensuring that globalization is inclusive.

\textsuperscript{15} Profits obtained from exporting IP are taxed now at a lower rate of 13% (as against 21% earlier). This export subsidy is seen to likely violate WTO rules. (Article 3.1(a) of the WTO was invoked in rulings against the Foreign Sales Corporation regime, that was repealed in 2006.) The Bill itself calls these as export of “intangibles.” See https://www.reuters.com/article/us-usa-tax-trade-analysis/u-s-tax-bill-provision-likely-to-spark-eu-trade-dispute-legal-experts-idUSKBN1EF24X

\textsuperscript{16} The opposition of the corporate community to an alternative minimum tax said a great deal. A standard “reform” package (such as 1986) entailed lowering rates in exchange of base broadening and closing loopholes. If one did the latter perfectly, one wouldn’t need an alternative minimum tax, but neither would there be opposition to an AMT—but things are never done perfectly, so there is always scope for an alternative minimum tax. The 2017 bill was remarkable in that in opened up large new loopholes (especially entailing pass-through corporations) and new complexities (e.g. in depreciation and interest deductibility.) With rates and provisions changing year by year, the Bill is a tax lawyer and a tax account’s dream. Given the ambiguities, the underfunding of the IRS, and growing sentiment against voluntary compliance, the extent of full compliance by pass-through businesses and corporations may be disappointing.

The fact that there is no alternative minimum tax means that multinationals will still be able to avail themselves of a myriad of special provisions, so that such firms are likely to be advantaged relative to firms producing in and for the US, especially small firms that cannot avail themselves of expensive tax avoidance advice.
The answer to the plight of working Americans and workers in other advanced countries is thus not to shut down globalization. That, as we noted in the last section, would not only lead to lower equilibrium standards of living but entail large adjustment costs, with distributive costs as adverse as that initially associated with globalization. We cannot run the clock backwards.

What is required is a new social compact that ensures that every major group in society benefits from advances like new technology and globalization. To be credible, the new social compact has to promise more than just compensation if one loses one’s job. (This is called globalization with compensation, intended to ensure that there are no losers). There are three problems with this response. Individuals value jobs. There is dignity in work. Just paying individuals off is, I believe, not acceptable. Secondly, it is often difficult to distinguish a job loss to innovation or to globalization: Consider a new more modern plant that opens up in Mexico, leading to a shutdown in the US. But even if the plant hadn’t moved, the individual would have still lost his job. Bureaucrats, trying to keep spending down, may try to take the narrower approach: where there is ambiguity, blame it on technology, not trade. And thirdly (and relatedly), there may be no political economy that can sustain globalization with compensation. We saw that corporations have consistently opposed this assistance—they want workers at cheaper wages. Those with secure jobs may (at least in the US) feel too little solidarity with other workers to induce them to accept taxation to help these workers.

That is why I think what is needed is a new social contract, along the lines provided by some of the Scandinavian countries. (Stiglitz, 2014, Barth et al 2013) These were small countries that had to be opened if they were to be prosperous; but a dynamic global economy imposed enormous risks on workers. Markets don’t provide the requisite insurance against the loss of a job, or provide enough help to move the individual into a new job. Most of the elements of these government programs are well known. The different features are complementary with each other. The whole is more than the sum of the parts.

The first three provisions relate to the efficient utilization of resources: (a) there needs to be active labor market policies to help workers move from the old jobs to the new; (b) better general education enhances the ability of individuals to move from one kind of job to another, and thus lowers transitional costs; (c) there needs to be a tight labor market—that is, monetary and macro policy have to be run so that there is very low unemployment, the lowest possible consonant for non-accelerating inflation, or in these days where there is little concern about inflation acceleration, with inflation below say 4 or 6%. There is no evidence that overall economic performance is lower at 4% inflation or 6% than at 2%, and compelling arguments that with downward money wage rigidities, an unemployment rate of 4% or 6% accommodates more smooth adjustment in the labor market.

Even if the economy is at full employment and there are reasonably good training programs, some individuals may fall between the cracks. There have to be programs of strong social protection for such individuals.

The previous paragraphs focused on jobs, but one of the concerns of non-inclusive trade globalization is that it has resulted in many workers having wages below a livable wage. Here, there are two sets of interventions, on market income and on income after taxes and transfers. While both need to be used, there has been insufficient attention to the former--intervening in market processes to increase the equality of the distribution of market income. Minimum wages, employer wage subsidies, and government regulations concerning bargaining (nationwide bargaining vs. plant level bargaining.)
Corporate market power leads to higher prices, reducing worker living standards as much as lowering nominal wages. Unfortunately, in some parts of advanced countries there has developed a notion that the principal impediment to the efficient working of a market economy is wage rigidities, especially those associated with unions. A corollary has been weakening labor protection laws and restructuring bargaining in ways which weaken workers’ bargaining power. While in some countries, it may be the case that job protections and unions impede overall employment, it is remarkable how close this agenda aligns with the corporate globalization agenda described earlier, which entailed lowering wages.

Greater equality of market incomes can also be obtained by ensuring that there is less inequality in the intergenerational transmission of advantage—good inheritance taxes and a good public education system.

More equality in market incomes means, of course, lesser burden on redistributions through the tax and transfer and public expenditure systems. However, there are limits to the degree of equality of market wages, and progressive tax and transfers are then necessary.

Inclusive globalization also requires that most citizens have access to a middle class life style. The more that a society ensures full employment, access to education, a modicum of security in retirement, and access to reasonable health care and housing, then the less likely will it be that individuals, whatever their skills, will be very adversely affected by globalization: there is a basic living standard that is provided to all, at least to all who are willing to work full time.

We are far from this ideal. And we were far from this ideal during the rapid period of globalization of the past third of a century.

Advocates of globalization should rightly fear a backlash unless there are significant moves towards creating this new social compact.

V. Concluding Comments

Globalization was oversold. Confused analytics and wishful thinking led many to believe that globalization would be good for everyone—or almost everyone. Corporate realists pushing globalization probably had a better understanding: they had designed a system that would lead them to having higher profits, with workers, especially unskilled workers, having lower standards of living. It seemed that many corporate executives were not concerned with global social justice—only with an economic regime which maximized their wellbeing.

Government officials should have taken a more societal view. Globalization’s advocates ignored what standard theory said and instead argued that globalization would bring growth, and the benefits of growth would eventually trickle down to all. They had to counter early and convincing static analyses, which showed that even though trade might bring increases in standards of living—with gainers able to compensate losers—so long as those compensations are not made, unskilled labor will leave the table worse off. They were deluded in believing that, without better protections for those hurt, globalization would still be welfare enhancing— with the losers losing so much.

Figure 1 from Korinek and Stiglitz (2017) illustrates this simple idea. It assumes that trade globalization leads to an expansion in utility possibilities, i.e. that everybody could be better off.
The utility possibilities curve has moved out, but under existing institutional arrangements, workers, at $E_1$ are worse off than they were before globalization at $E_0$. Since an inequality averse social welfare function would value the loss of workers more than the slight gain of the welfare of the capitalists/entrepreneur, globalization (in this figure) is undesirable. Both workers and those concerned with social justice should oppose it—if matters were left there. Of course, the point of Figure 1 is that it is possible to make both groups better off.

How far wages fall is a matter of macro-policy, micro-policy, and trade-policy, as we have noted. If the economy is being run tightly, it is more likely that the gains will be large and the fall in workers wage may be small. On the other hand, with standard investment agreements weakening workers’ bargaining power, the fall in workers’ wages is likely to be even greater.

In fact we explained in section I that the potential gain from globalization might be very limited, once one took into account market imperfections. Indeed, then globalization might even move the frontier in, as in Figure 2.

Then, there is no way we can make workers “whole”—and still leave entrepreneurs/capitalists better off. This is the kind of situation where one would expect the capitalists to resist redistributions, precisely because they know if workers were fully protected, there is nothing left for them.
Ironically, some of the strongest advocates of globalization have been among those most opposed to the measures described in the previous section which would have ensured that workers would not be worse off. There are two interpretations to this opposition. Their “utility function” is simply maximizing the well-being of capitalists, and even when globalization moves the utility frontier in, that may be good for the capitalists. As we explained in section III, the weakening of workers’ wages was not just “collateral damage,” from globalization. It may have been the main “show.” Lower wages meant higher profits. It’s that simple. There is, in this analysis, no concern for social justice.

Alternatively, those who are not so brazenly selfish may claim that redistributions are costly, so costly, in fact that one cannot really fully protect workers. (The costs of doing so would far exceed the benefits.) Thus, they see the world as characterized by Figure 3

![Figure 3: Potential Pareto frontier with costly redistribution](image)

The only way that one can fully protect workers would leave capitalists/entrepreneurs worse off, as opposed to the first case (Figure 1), where the winners could give the losers some of their gains, and both are better off. If the world looks like this, then workers should be expected to oppose globalization. Inclusive globalization is not possible.

It should be clear that I do not believe that is the case. If we manage globalization well, the relevant diagram is figure 1, and the critical question is how the fruits of globalization should be shared, to ensure that everyone is better off. Section IV has outlined a program that can achieve inclusive globalization. The question is not a matter of what is economically possible. The question is one of politics. For those who are committed to democracy and to globalization, there is no alternative to creating a broad social consensus behind the new social contract. As we noted, trade agreements are long lasting and hard to reverse; in contestable democracies without a broad consensus behind the social contract, there can be rapid changes in policy—2017 saw the US adopt a more regressive tax policy in an era of almost unprecedented inequality. Indeed, some are increasingly seeing trade agreements as vehicles to accomplish durably what they could not achieve in normal parliamentary processes, and the recognition that that is the case has increased resolve on the other side against such agreements.

Even for countries, like those in Scandinavia, if they are able to sustain this social consensus, the prospects are cloudier than they have been for some time: for they will have to deal with the consequences of growing protectionism elsewhere. For those in more divided societies like the US, the
hope is that the “winner takes all the spoils” attitude so evident in 2017 is replaced with one aimed at developing more social cohesion and consensus. The full benefits of globalization can only be achieved if it is believed that the course of globalization won’t be reversed and curtailed; and it will be hard to achieve that sense of commitment in a deeply divided society without a social contract that evidences a commitment to inclusive globalization.

References


