

# ECONOMICS, GLOBALIZATION, AND THE POPULIST BACKLASH

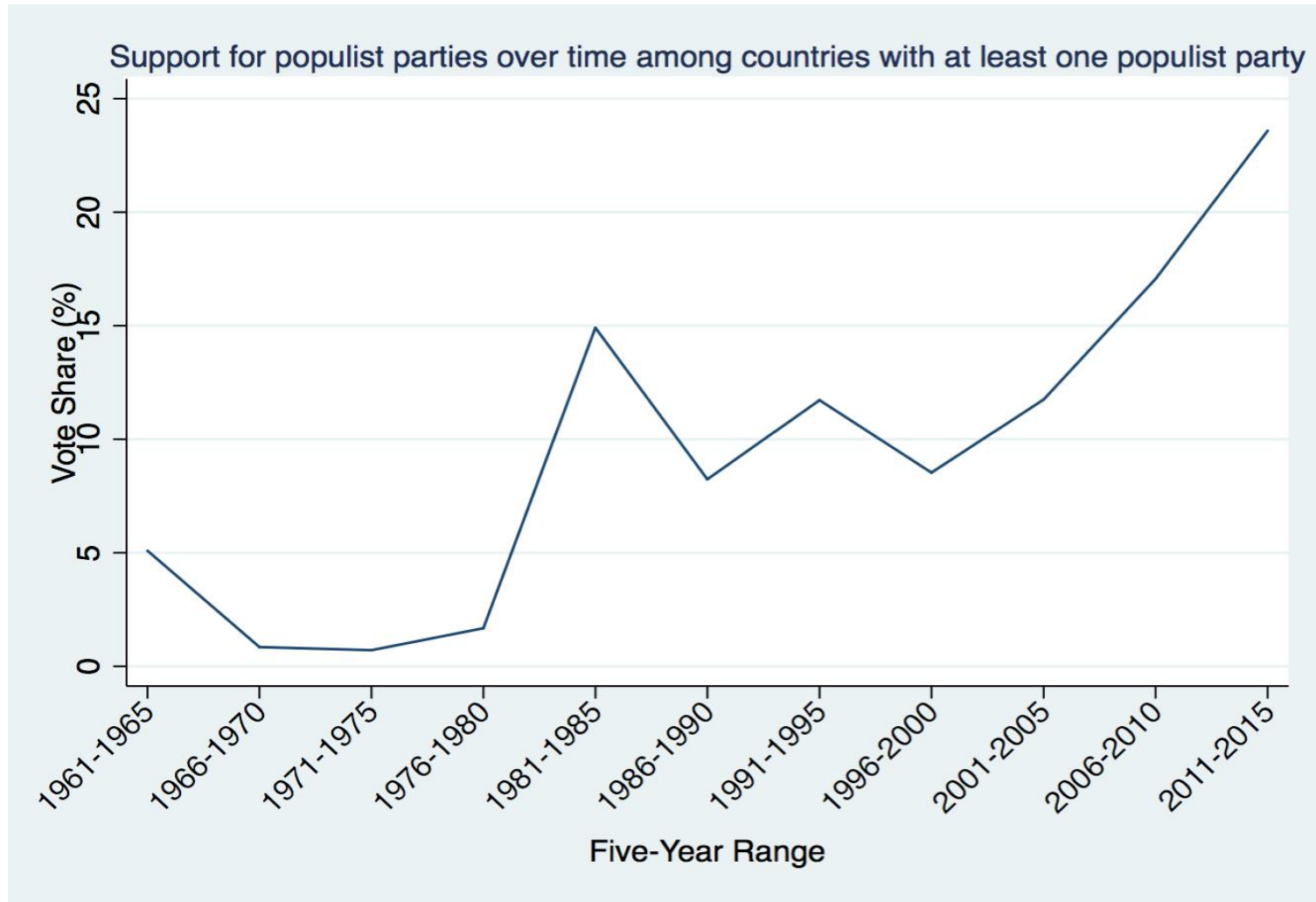
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Tinbergen Lecture

November 2017

# Populism has been on the rise for some time

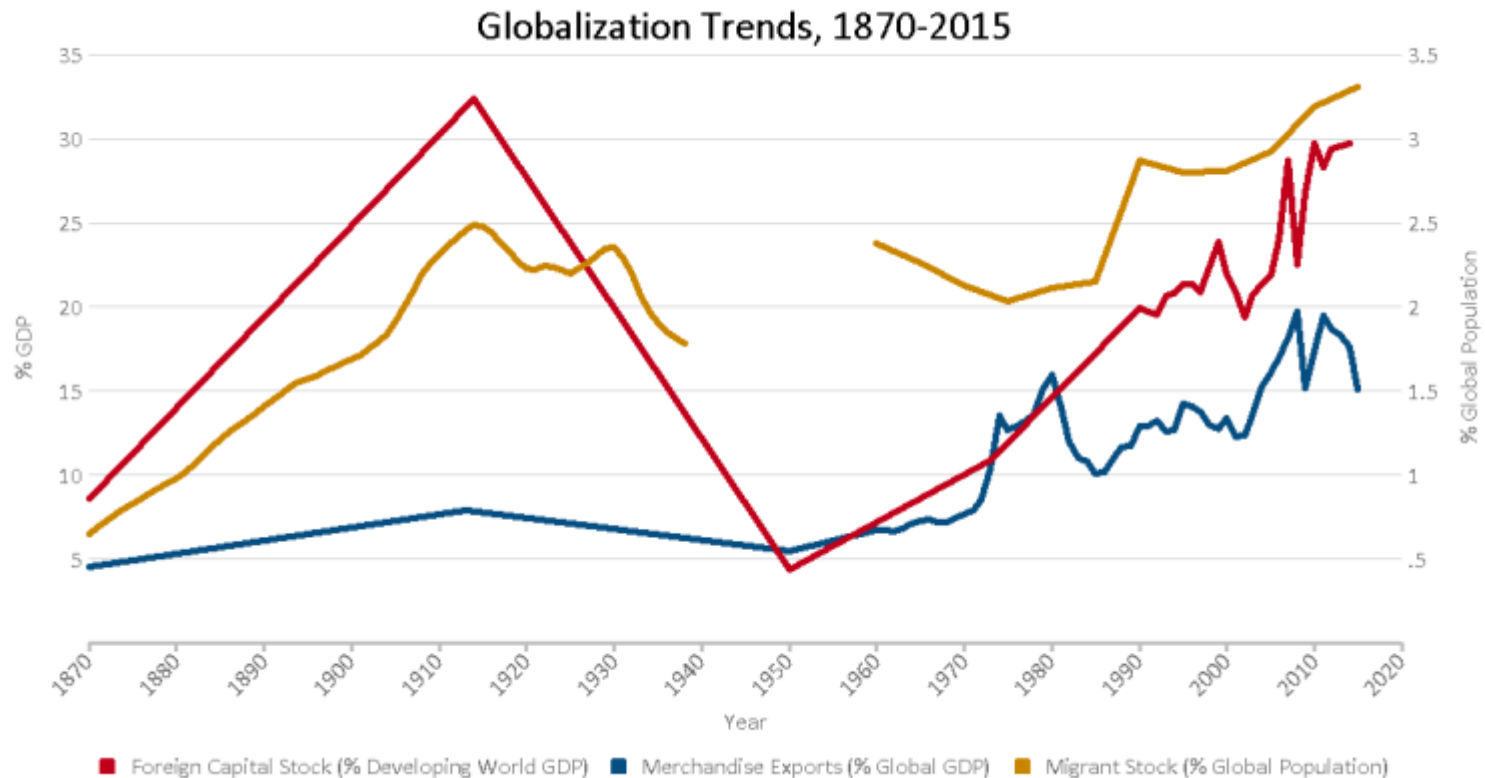


Source: Rodrik (2017)

# Rise of populism is not a surprise...

- From perspective of either
  - economic history, or
  - economic theory

# Long-term trends in globalization



Source: Chandy and Seidel (2016)

# Long-term trends in globalization



# What economics says about impacts of globalization

- Openness to trade
- Financial globalization

# 1. Distributional impacts of trade openness

- What economics says:
  - reducing barriers at the border generally enlarges overall economic pie
    - with some important caveats...
  - but not everyone wins
    - less-skilled workers and import-competing sectors lose out
  - and as trade barriers get smaller, redistribution looms larger compared to the magnitude of aggregate (efficiency) gains
- Last point particularly important
  - as it helps explain why trade agreements become politically more contentious as trade and financial barriers get smaller

# Stolper-Samuelson and generalizations

- In a 2x2 model with full inter-sectoral mobility of the factors, owners of one of the two factors are made necessarily worse off with the opening to trade
  - the factor which is used intensively in the importable good must experience an absolute decline in its real earnings.
- Generalization: as long as an importable good continues to be produced at home – that is, ruling out complete specialization – there is always at least one factor of production that is rendered worse off by the liberalization of trade
  - using importable as numeraire, this follows from  $c = \varphi(w_1, w_2, \dots, w_n) = 1$  and  $\hat{c} = \sum \theta_i \hat{w}_i = 0$  and  $\sum \theta_i = 1$
  - since factor price changes must bracket factor price changes, there is at least one factor  $k$  such that  $\hat{w}_k \leq 0 < \hat{p}$
  - the “magnification effect”



# How much redistribution? The political cost-benefit ratio of globalization

- Let PCBR = ratio of redistribution to efficiency gains generated by the removal of trade barriers in partial equilibrium
- PCBR rises as trade liberalization tackles progressively lower barriers
- because import tariffs are a tax, and hence their efficiency costs rise with the square of the tax rate
  - efficiency gains of trade liberalization become progressively smaller as the barriers get lower
- meanwhile redistribution is linear in the price changes generated by trade liberalization
- the losses incurred by adversely affected groups per dollar of efficiency gain are higher the lower the barrier that is removed
- globalization becomes naturally more divisive as it advances
  - how much? (see simulations)

# The PCBR in partial equilibrium

- Ratio of redistribution to efficiency gains of removing trade barriers in partial equilibrium =  $\frac{1}{\mu\varepsilon t}$ 
  - where  $\mu$  = share of imports in domestic consumption,  $\varepsilon$  is the (absolute value) of the price elasticity of import demand, and  $t$  is the size of the trade barrier (in percent terms).

$\mu$	$\varepsilon$	$t$	redistribution per dollar of aggregate gain
0.25	2	<b>0.4</b>	<b>5</b>
0.25	2	<b>0.3</b>	<b>6.7</b>
0.25	2	<b>0.2</b>	<b>10</b>
0.25	2	<b>0.1</b>	<b>20</b>



as trade is liberalized further and further...

# The PCBR in general equilibrium

initial tariff being removed	change in low-skill wages (A)	increase in real income of economy (B)	absolute value of ratio (A)/(B)
40%	-19.44%	4.00%	4.9
30%	-15.22%	2.25%	6.8
20%	-10.61%	1.00%	10.6
10%	-5.56%	0.25%	22.2
5%	-2.85%	0.06%	45.5
3%	-1.72%	0.02%	76.6

Notes: Column (B) is computed using the standard formula for the gains from trade (e.g. Feenstra 2016, p. 220), assuming an import-GDP ratio of 25% and an import demand elasticity of -2. Column (A) is generated using a model with two factors (low- and high-skilled labor) and two goods with mobile factors, assuming the import-competing sector is low-skill-intensive. The cost shares of low- and high-skill labor in the import-competing sector are taken to be 0.80 (denoted  $\theta_l^L$ ) and 0.20 ( $\theta_h^L$ ), respectively. The factor cost shares in the exportable sector are symmetric – 0.20 ( $\theta_l^H$ ) and 0.80 ( $\theta_h^H$ ). To compute the change in real wages ( $\hat{w}_l$ ), I assume low-skilled workers spend 75 percent of their budget on the importable and 25 percent on the exportable. The corresponding derivation yields  $\hat{w}_l = \{[\theta_l^L - \theta_h^L \frac{\theta_l^H}{\theta_h^H}]^{-1} - 0.75\} \hat{p}$ , where  $\hat{p}$  is the percent change in the relative price of the importable implied by the tariff reduction.

# What about the real world: effects of NAFTA

## Large trade effects

*Trade effects from NAFTA's tariff reductions*

	Mexico	Canada	U.S.
Mexico's imports	-	116.60%	118.31%
Canada's imports	58.57%	-	9.49%
U.S.'s imports	109.54%	6.57%	-

## Small real income effects

*Bilateral welfare effects from NAFTA's tariff reductions*

Country	Terms of trade		Volume of Trade	
	NAFTA	Rest of the world	NAFTA	Rest of the world
Mexico	-0.39%	-0.02%	1.80%	-0.08%
Canada	-0.09%	-0.02%	0.08%	-0.04%
U.S.	0.03%	0.01%	0.04%	0.00%

# The political cost-benefit ratio of globalization in the real world

- NAFTA

- small on average worker or economy as a whole
  - estimated aggregate “welfare” gains between 0 and 0.2%
- but wage growth in in the most affected industries was reduced by 17 percentage points (relative to other industries) (Hakobyan and McLaren 2016)
  - so a small group of workers was hit very hard

- China’s entry into WTO

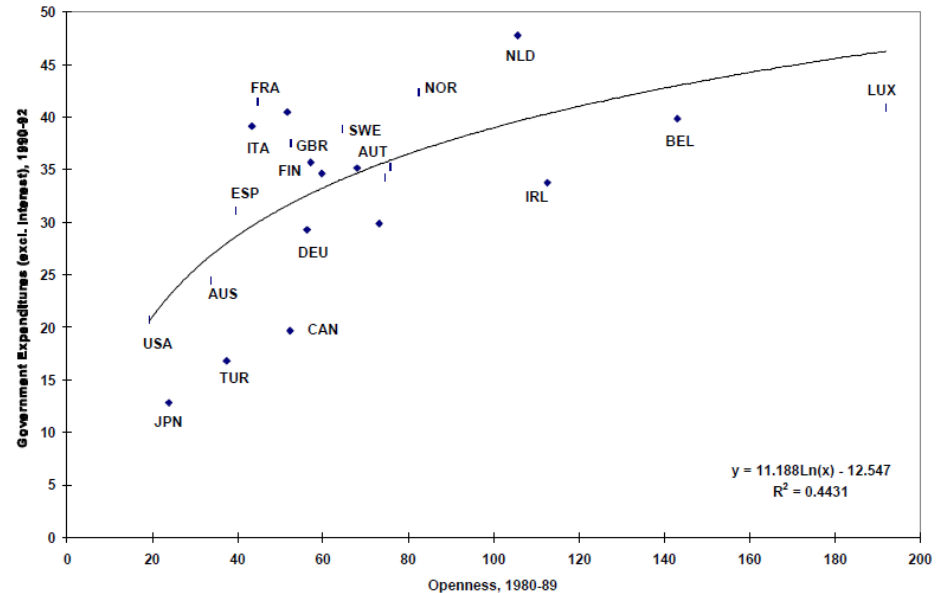
- large, sustained employment/wage effects in hard-hit communities (Autor et al., 2016)
- without corresponding employment/wage gains in other places
- large aggregate gains hard to pick up over relevant time horizon,
- but large price/distributional effects, as U.S. manufacturing prices fall by 7% (Amiti et al., 2016)

## 2. It's not just about incomes...

- Domestic market competition too creates losers in the process of generating wider economic opportunities
- But globalization is dissimilar insofar as it forces competition under ground rules that have been prohibited at home
  - e.g. “unfair” labor practices, tax havens, subsidized goods, ...
- Such competition can undermine:
  - tax rules (corporate taxation, top income tax rates)
  - regulations (financial regulations, product safety rules)
  - domestic norms (“what’s an acceptable redistribution?, employer-employee bargaining norms”)
- Legitimate concerns about level playing fields, fairness of trade
- “Inequality is felt most acutely when citizens believe that the rules apply differently to different people.” (Pierre Rosanvallon, 2016)

# 3. Reduced governmental capacity to respond

- Traditionally, openness has been accompanied by expansion of government responsibilities
  - open economy and welfare state as two sides of same coin
  - this bargain allowed high levels of openness in Europe
- The push for hyper-globalization has broken the link
  - both as real constraint (inability)
    - taxes shift from mobile K to immobile L
  - and as ideology (unwillingness)
    - “govts are incompetent, inefficient...”
- Result has been greater economic insecurity with weaker safety nets



## 4. Trade agreements are no longer about free trade

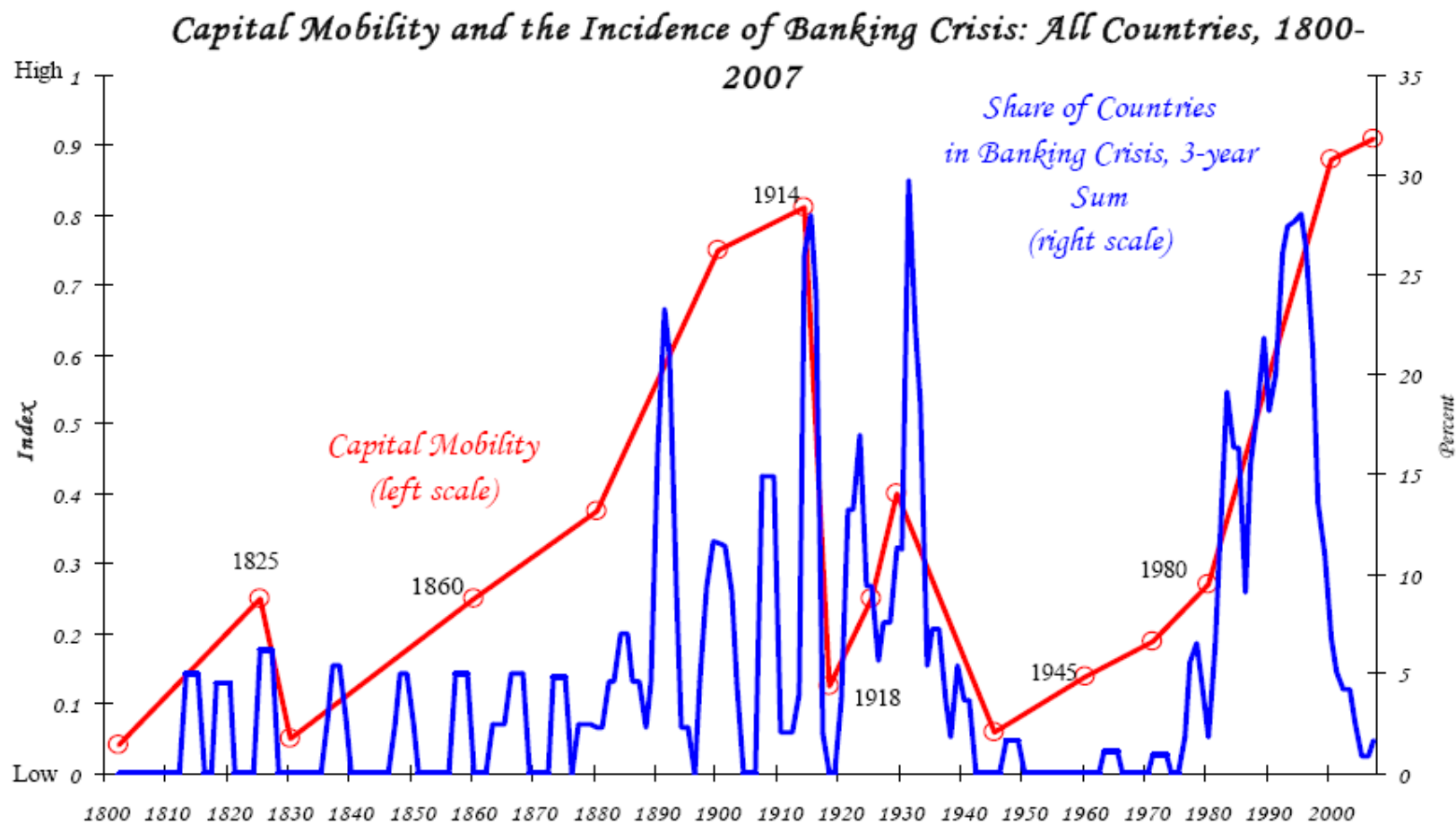
- Post-WTO: from reducing barriers at the border to reducing/harmonizing domestic regulations
  - shallow to deep integrations
- From reducing import protectionism to promoting export/investment protectionism
  - TRIPs
  - ISDS
  - restrictions on CFMs
- From efficiency enhancing agreements to redistributive agreements, again
  - and increasing clash in values (e.g. over safeguarding regulatory autonomy and diversity)



# The perils of financial globalization

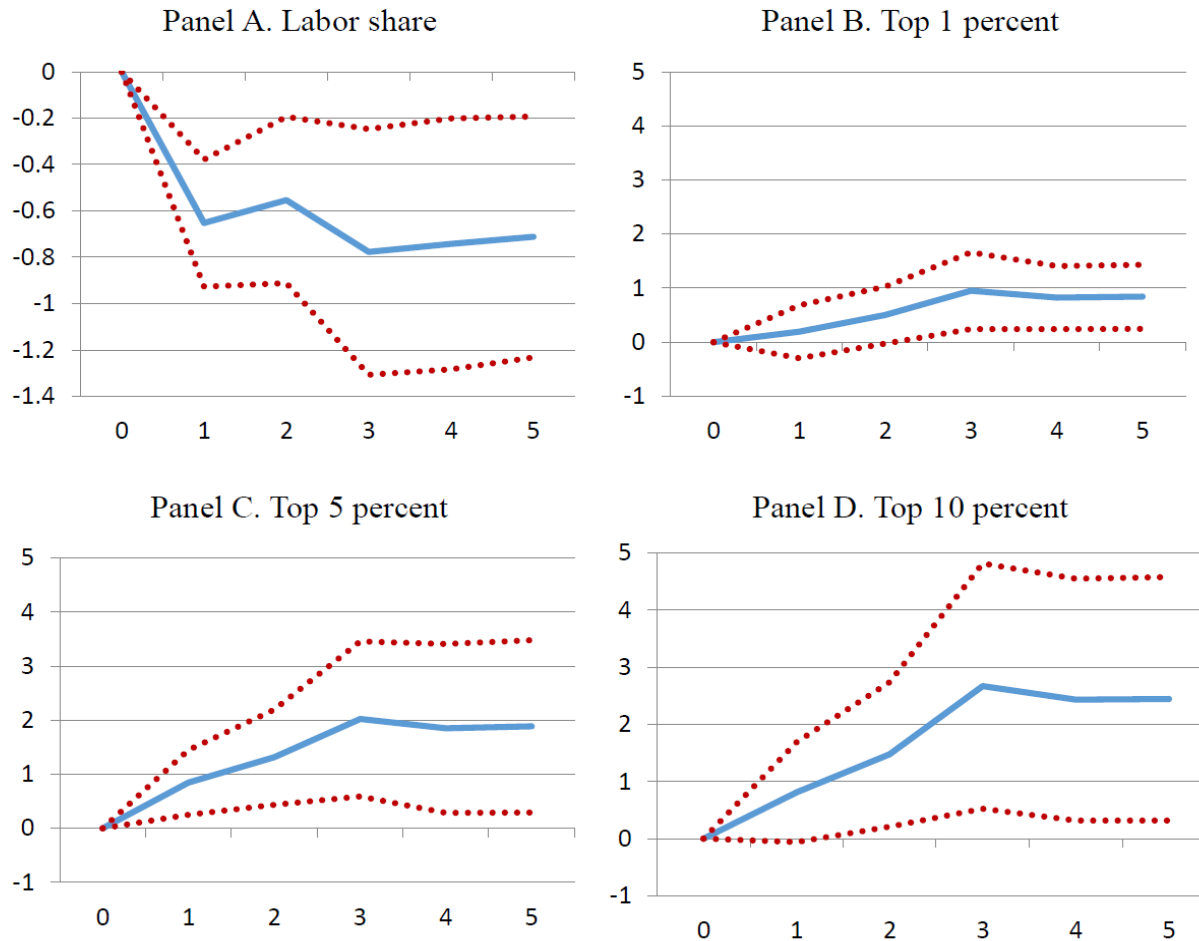
- In principle financial globalization, like trade, generates important economic benefits
  - channel savings to countries where returns are higher
  - enable intertemporal consumption for nations through international borrowing and lending
  - allow global portfolio diversification
- Nevertheless economists' views on capital mobility have been more ambiguous and prone to cycles
  - Bretton Woods, 1990s, post-global financial crisis
- Principal concern: access to foreign finance aggravates domestic market imperfections, in
  - prudential regulation
  - contract enforcement
  - tradable markets (Dutch disease)

# Financial globalization and financial crises



Source: Reinhart and Rogoff (2008)

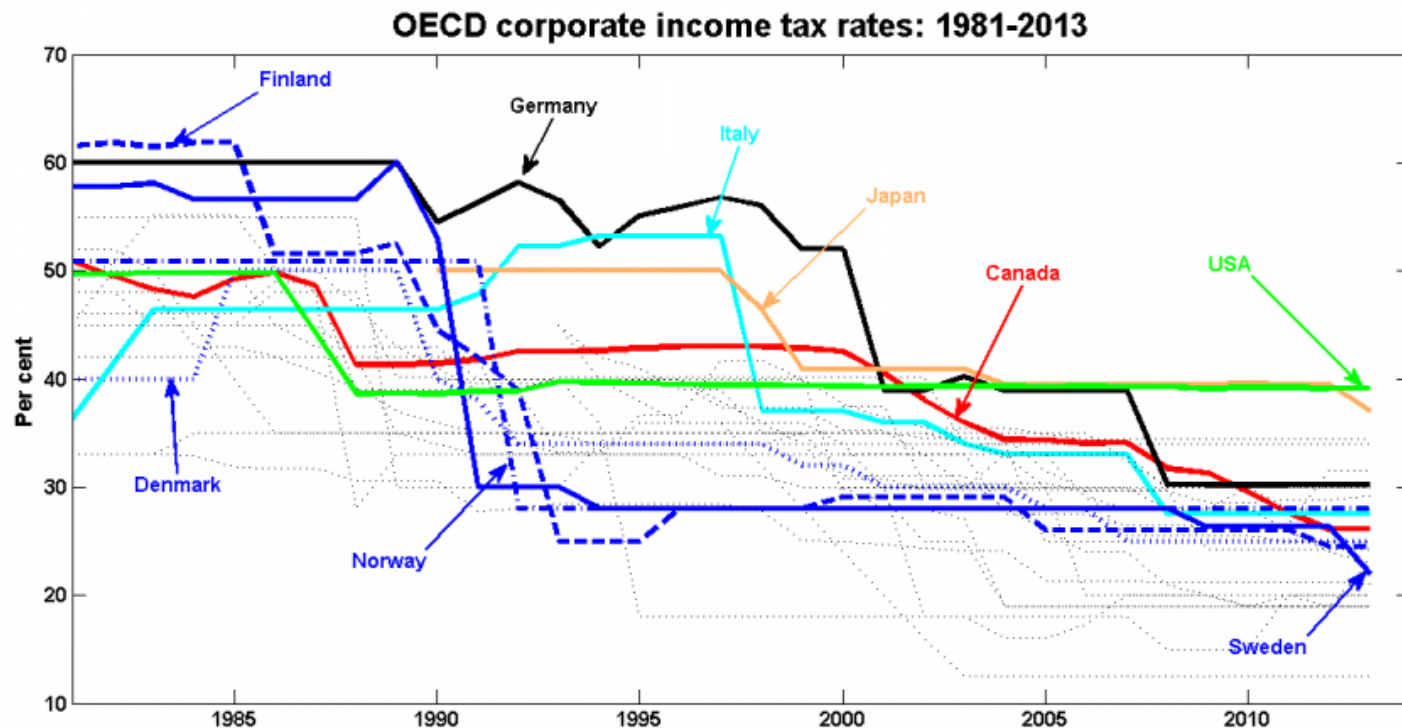
# Redistributive effects of capital-account opening



Note: The solid line corresponds to the IRF; dotted lines correspond to 90 percent confidence bands. The x-axis denotes time.  $t=0$  is the year of the reform.

Source: Furceri et al. (2017)

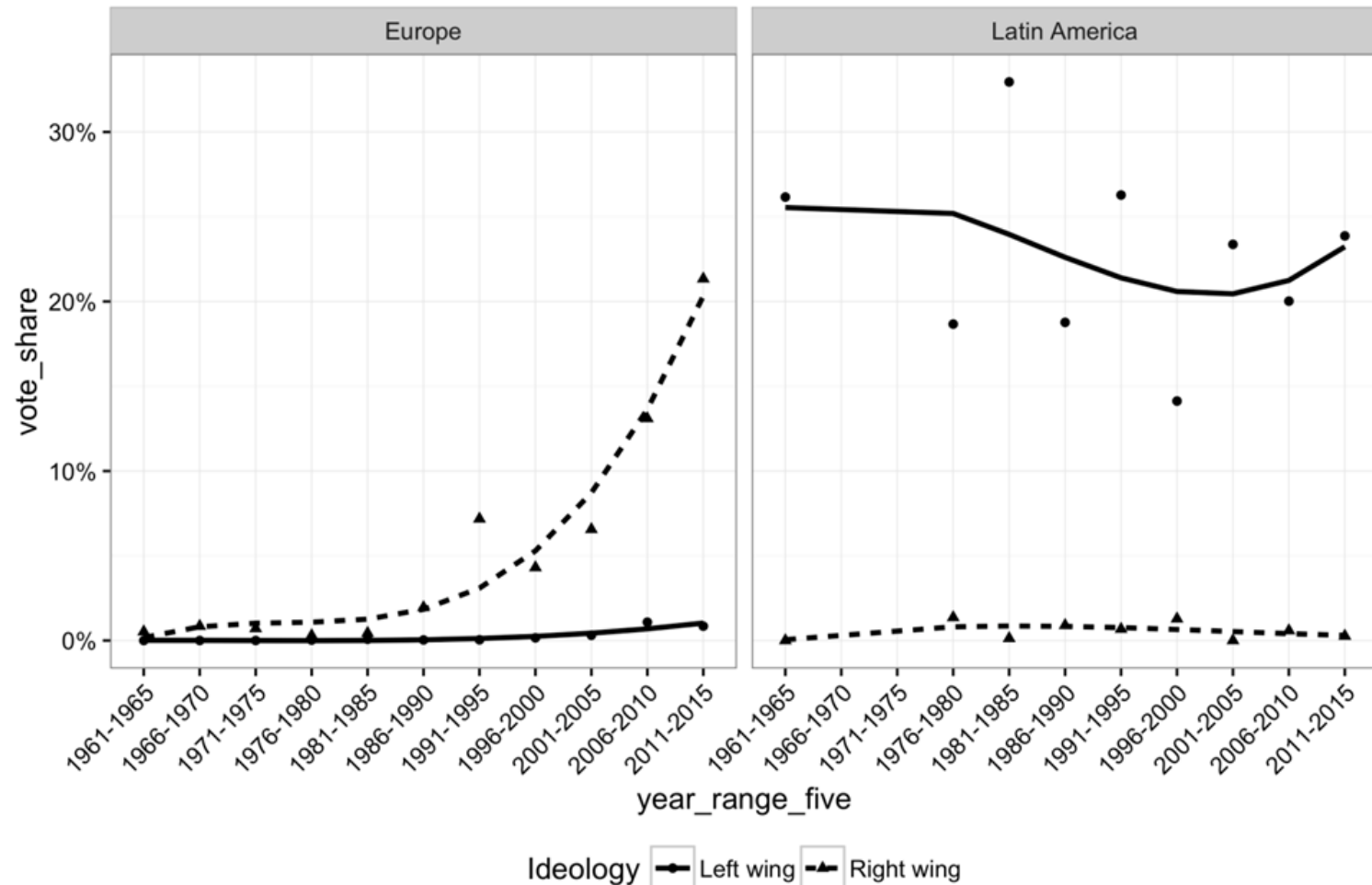
# The global decline in corporate income taxes



# From economics to politics

- Demand-side of politics
  - economic anxiety, discontent, loss of legitimacy, fairness concerns...
- Supply side of politics
  - populist politicians can mobilize support by exploiting one of two cleavages
    - the ethno-national/cultural cleavage => right-wing populism
    - the income/social class cleavage => left-wing populism

# Varieties of populism: Europe vs. Latin America



# From economics to politics

- Demand-side of politics
  - economic anxiety, discontent, loss of legitimacy, fairness concerns...
- Supply side of politics
  - populist politicians can mobilize support by exploiting one of two cleavages
    - the ethno-national/cultural cleavage => right-wing populism
    - the income/social class cleavage => left-wing populism
  - hypothesis:
    - it's easier to mobilize along the ethno-national/cultural cleavage when globalization shock takes the form mainly of immigration and refugees (Europe)
    - it's easier to mobilize along the income/social class cleavage when globalization shock takes the form mainly of trade, financial crisis, and foreign investment (southern Europe, Latin America)

# Comparing France and Spain

Table 2: Characteristics of immigration source countries (2013)

	host country			
	France		Spain	
Source country (only top 25 source countries included)	share of migrant stock	share of home population	share of migrant stock	share of home population
Predominantly Moslem	41%	5%	13%	2%
Sub-Saharan Africa	8%	1%	0%	0%
Other developing	4%	0%	3%	0%
Eastern Europe (incl. Russia)	3%	0%	18%	3%
Latin America	2%	0%	33%	5%
Developed Europe	24%	3%	17%	2%
<b>Total of included countries</b>	<b>82%</b>	<b>9%</b>	<b>83%</b>	<b>12%</b>

Source: World Bank Bilateral Migration Matrix, 2013.



# A more direct test (on European data)

Table 11: Populist parties orientation choice

	Left/right orientation (increasing in right)
Share of left oriented * Left-salient factor	-0.564* (0.319)
Share of right oriented * Right-salient factor	2.410*** (0.550)
Observation	46

The table reports regressions of the orientation of the populist parties in our sample on measures of relative entry space. The left hand side is a measure of party orientation defined on a scale between 1 (extreme left) and 10 (extreme right). Standard errors clustered at the country level, are shown in parenthesis. \*\*\* significant 1% or less; \*\* significant at 5%; \* significant at 10% confidence level.

Left-salient factor: Gini coefficient

Right-salient factor: share of Muslim immigrants in population

Source: Guiso et al. (2017)

## Conclusion: three possible future paths

- The bad: 1930's style collapse in global economic cooperation and rise of hard-right or hard-left regimes
- The ugly: creeping populism and protectionism, gradually eroding both liberal democracy and open world economy
- The good: a democratic rebalancing that steps back from hyper-globalization and restores greater national autonomy