UNIVERSITAT ROVIRA i VIRGILI

Challenge of globalization

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This essay is the summery of

Dani Rodrik's article and his speech in Manchester

About: **Populism and the economics of globalization**

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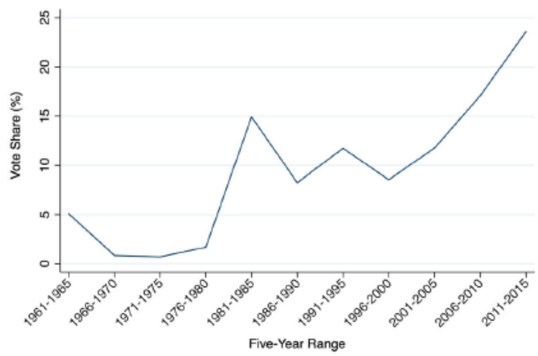
International Markets

THE ROOT OF POPULISM :

It may seem like populism has come out of nowhere. But the populist backlash has been on the rise for a while, for at least a decade or more.
Populism actually gets its name from the first self-consciously populist movement in political history that was the US populist movement at 19 century and US populace where essentially a coalition of farmers and mining interests in southern and western part of united states and a lot of grievances which they thought banking elites, New York elites and wall street was responsible for and among most important grievances were the tight money policies and high interest rate policies that they thought the gold standard was responsible for.



Economic history and economic theory both give us strong reasons to believe that advanced stages of globalization are prone to populist backlash.
Populism comes in different versions. Rodrik distinguishes between left-wing and right-wing variants of populism, which differ with respect to the societal cleavages that populist politicians highlight and render salient. The US progressive movement and most Latin American populism took a left-wing form. Donald Trump and European populism today represent, with some instructive exceptions, the right-wing variant.

The factors that affect the emergence of right- versus left-wing populism:

Rodrik believes that it is important to distinguish between the demand and supply sides of the rise in populism. The economic anxiety and distributional struggles exacerbated by globalization generate a base for populism, but do not necessarily determine its political orientation. The relative salience of available cleavages and the narratives provided by populist leaders is what provides direction and content to the grievances. Overlooking this distinction can obscure the respective roles of economic and cultural factors in driving populist politics.
Rodrik emphasizes the effect of economic determinants and in particular the role of globalization on populism.
When we look at the rise of populism and try to quantify it, first, it becomes clear that populism is not phenomenon that is come out from nowhere. It is some think that has been increasing over time, at least since 1980s.

Second, populism is a global phenomenon among the advanced countries.

TRADE AND REDISTRIBUTION:

One of the most remarkable theorems in economics is the Stolper–Samuelson theorem. In a model with two goods and two factors of production, with full intersectoral 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 a decline in its real earnings. Applied with some amount of hand-waving to the US economy, the result predicts that low-skilled workers are unambiguously worse off as a result of trade liberalization.
Particular, advanced country which is abundant with skills and capitals, the looser are going to be individuals with restively fewer skills or individuals who are employed in the import competing sectors.
The second implication of trade theory is also that as trade barriers tent to get smaller and smaller , the amount of redistribution that happen from losers to winners tent to get large compared to overall or efficiency benefits that trade generates.
The Stolper–Samuelson theorem has very specific assumption in particular. There are only two goods and two factors of production, one of the two factors there are low skilled worker or high skilled worker that low skilled workers will experience decline in absolute level of real earnings.
In relative terms, the redistributive effects of liberalization get larger and tend to swamp the net gains as the trade barriers in question become smaller. In other words, the ratio of redistribution to net gains rises as trade liberalization tackles progressively lower barriers.

There are some good empirical studies that support these sharp distributional predictions. These studies have taken a detailed look at the consequences of NAFTA and of China's entry to the WTO on labor markets in the US.
The most careful analysis of NAFTA to date has been carried out by Hakobyan & McLaren (2016). These authors use US Census data and focus on the 1990–2000 period. They measure the NAFTA ''trade shock'' by constructing an industry- and locality specific variable that measures vulnerability to NAFTA. This indicator is a weighted average of initial tariffs on Mexican imports, where the weights are both local employment levels in each industry and Mexico's revealed comparative advantage in those industries. To ensure they are capturing the effects of NAFTA proper, they also control for other trends that may be correlated with the NAFTA shock such as the general expansion of trade.
Hakobyan and McLaren find that NAFTA produced modest effects for most US workers, but an ''important minority'' suffered substantial income losses.
This reduction does not have effect just on workers; it creates ripple effect throughout the communities in which these workers live. It is not just that these individual workers lose their income. Also, they do not have enough income to spend and it affects other businesses.
China entry into the WTO was also a bigger deal for the US. United states were affected by imports from China had significantly lower level of employment.

Rodrik believes that if we were look to only these income losses or employment effect, we will miss other part of picture which said that how these income losers or employment losers are being processed by individuals. Technology changes skills and changes in demand patterns.

Companies move from one city to another city. All of these create dislocations which have similar effect of import from Mexico or China.

One of the major successes of the post war economic arrangements was that they allow a significant expansion of international trade and investment in post- war area after 1950s. The countries that opened up rapidly were the European countries. Because they are relatively small and they geographically close to each other. These countries created extensive system of social protection and social insurance.

United States was the late country to open up to trade. United States fundamentally opened up in 1990s.

In this period, United States rather than follow the European pattern of expanding openness alongside expanding social insurance and protection went exactly the opposite direction. In years between 1980s – 1990s welfare state had gone out of fashion. There was a belief that the government could not do so much social protection.

Also, as globalization advanced, it became more difficult to generate tax revenue that would fund social insurance program.

Therefore, as United States became more and more open economy, economic insecurity became greater.

TRADE, REDISTRIBUTION, AND FAIRNESS:

Economists understand that trade causes job displacement and income losses for some groups. But they have a harder time making sense of why trade gets picked on so much by populists both on the right and the left.

The usual answer is that trade is a convenient scapegoat, since politicians can point to identifiable foreigners – Chinese, Mexicans – as the source of the problem. This is no doubt true to some extent. But there is another, deeper issue that renders redistribution caused by trade more contentious than other forms of competition or technological change.

THE PERILS OF FINANCIAL GLOBALIZATION:

Even though there is a presumption in some textbooks that financial globalization is a desirable thing. Such as, financial globalization generates important economic benefits as well. It should channel savings to countries where returns are higher, enable intertemporal consumption for nations through international borrowing and lending, and allow global portfolio diversification.

But, in practice financial globalization aggravates certain market failure and domestic market imperfection.

A paper by Broner & Ventura (2016) captures well the mainstream perspective on the anomalous consequences of financial globalization. Opportunistic behavior by governments and low-quality domestic institutions make foreign finance subject to periodic debt crises.

In their model, when debt is domestic, debt contracts are enforced and defaults are rare. The entry of foreign creditors increases government incentives to default. And when governments cannot perfectly discriminate between foreign and domestic creditors, foreign and domestic debt crises occur together. This gives an incentive for domestic residents to send their savings abroad. Financial globalization therefore may result in the apparent paradox that countries that should be normally importing capital become exporters of capital

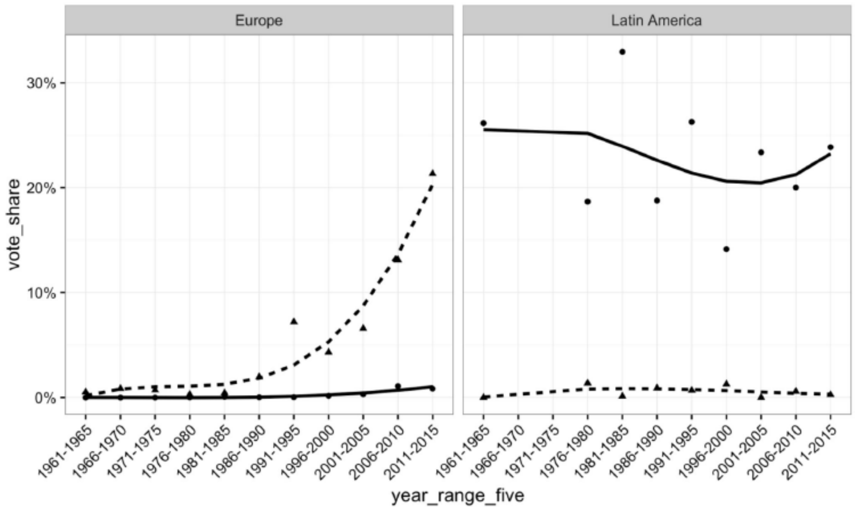
(Capital flight). Countries with deep financial markets where governments are loath to default opportunistically become safe havens for foreigners' savings, and receive excessive financial inflows.
The result of all of this is that the consequences of financial globalization for investment, growth, and financial stability are uncertain and cannot be presumed beneficial.

There is a close association with period of high financial globalization and periods of financial crisis or banking crisis.
In the euro zone, financial integration, on a regional scale, played an even larger role. Monetary unification and the introduction of the euro in 1999 drove down risk in countries such as
Greece, Spain, and Portugal, and led to the convergence of borrowing costs across member states. This enabled borrowers to run large current account deficits and accumulate problematic amounts of external debt. Construction and other nontradable sectors were boosted in the receiving countries at the expense of tradable activities. Such credit booms would eventually turn into bust and sustained economic collapses in Greece, Spain, Portugal, and Ireland once credit dried up in the immediate aftermath of the crisis in the US.
There is evidence that opening up to capital flows has been a very important predictor of increases in income inequality.
As long as wages are determined in part by bargaining between employees and employers, the outside options of each party play an important role. Capital mobility gives employers a credible threat: accept lower wages, or else we move abroad.

THE POLITICAL ECONOMY OF THE BACKLASH
Globalization has created a certain amount of inequality and feeling of unfairness economic instability.
Globalization had a big upside. It greatly expanded opportunities for exporters, multinational companies, investors, and international banks, as well the managerial and professional classes who could take advantage of larger markets. But the decline in global inequality was accompanied by an increase in domestic inequality and cleavages. Globalization drove multiple, partially overlapping wedges in society: between capital and labor, skilled and unskilled workers, employers and employees, globally mobile professionals and local producers and so on.

Why the backlash has taken the particular form it has in different countries?
Most populist movements in the current wave are of the right-wing variety. These emphasize a cultural cleavage, the national, ethnic, religious, or cultural identity of the ‘‘people’’ against outside groups who allegedly pose a threat to the popular will.
Cultural cleavage least largely to a kind of right- wing populism where the populist said that we the people are being exploited and harmed by the others. These others might be minority, different types of religious group or foreigners.
Left- wing populism states in the terms of an income or social classic image. They emphasize the income cleavage target and the wealthy and large corporations.

Figure below shows two parts of the world where populism is well represented.



What we find from this figure is that in Europe most of populism has taken a right- wing nature. The only sort of major left- wing movements can be seen in Spain and Greece. It is interesting that both of these countries were affected by financial cricis. Latin America is traditionaly the left- wing populism.

Politicians and populist movements essentially exploit the cleavages tend to be more salient. It is easier to mobilize along the ethno-national/cultural cleavage when globalization shock takes the form mainly of immigration and refugees (Europe)

Itis 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).

Conclusion:

If mainstream centrist political groups are unable to provide an adequate respond, we are likely to see creeping populism and increasing protectionism. That would gradually erode not just the word economy, also the kind of liberal democratic system that was created after Second World War.