

# Trade, Inequality, and Populism

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**WORLD BANK GROUP**

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# Themes from research on trade, growth, and inequality

- Trade and Inequality
  - Trade and poverty reduction
  - Trade and the middle class
  - Superstar firms, trade, and extreme wealth creation
- Backlash against globalization
  - Policy
  - Identity politics

# Common narrative on trade and inequality

- Globalization allowed poor countries to export more labor intensive goods
  - Less skilled workers in rich countries lost their jobs
  - Bottoming out of the middle class and rise in inequality
  - Leading to a backlash against globalization
- 
- Suggests development of poor countries has come at the expense of low skilled workers in developed countries

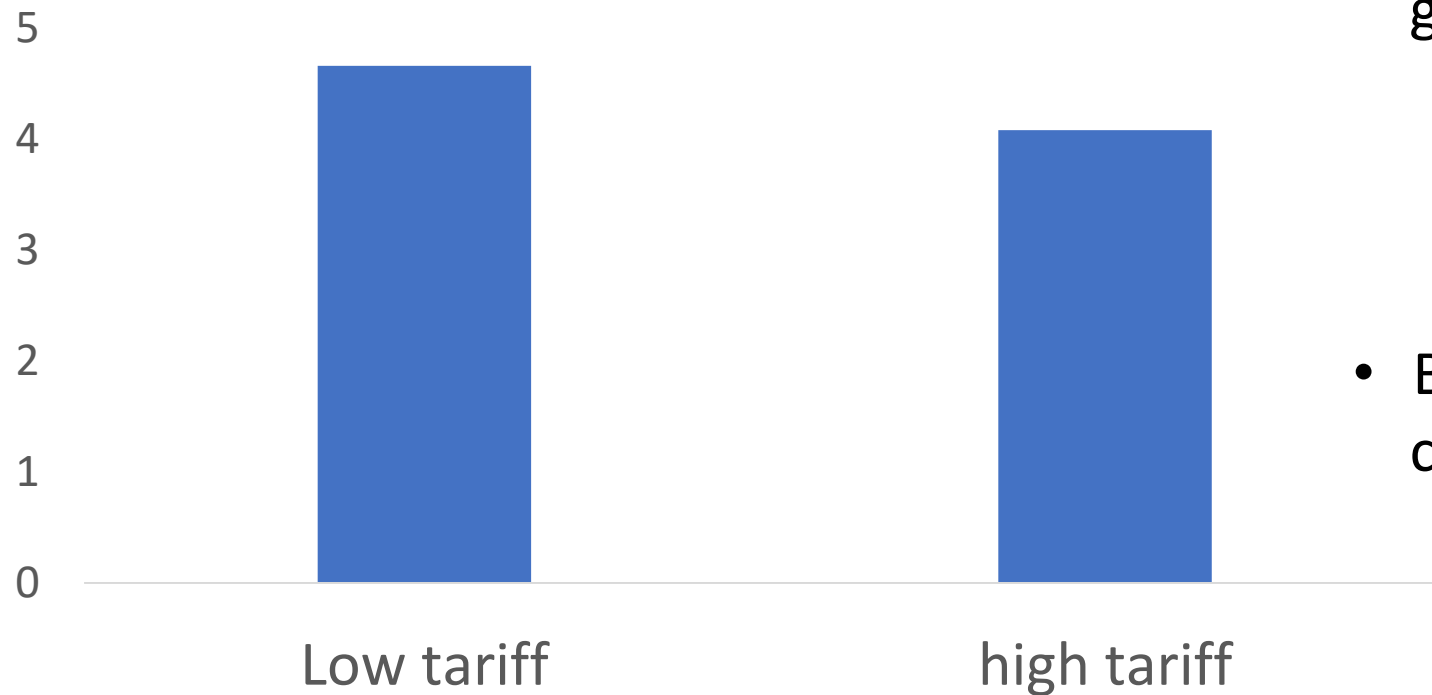
# True narrative is more nuanced

- Trade contributed significantly to drop in global inequality
  - Trade helps poor countries grow, as resources shift to productive uses
- Less evidence that trade contributed significantly to increase in within-country income inequality
  - Trade helped create a class of superrich, but also lowers prices disproportionately helping the poor
- Populism/Protectionism responds to confluence of factors, among which rhetoric on trade exceeds the reality

Trade helped poor countries grow

# Trade and Growth Are Positively Correlated

Average Annual Growth Since 1995  
Low and Middle Income Countries



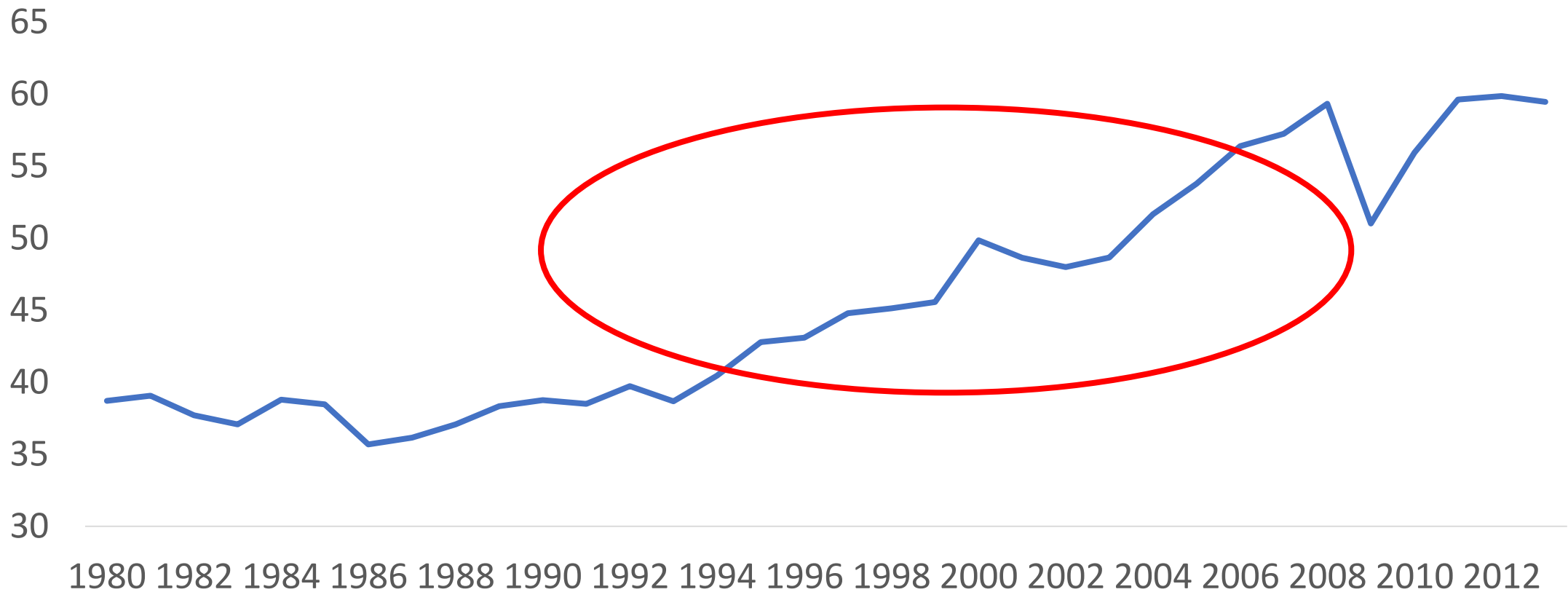
- Countries more open to trade grow faster

One percentage point increase in the trade/GDP increases income per person by at least one-half percent (Frankel and Romer 1999).

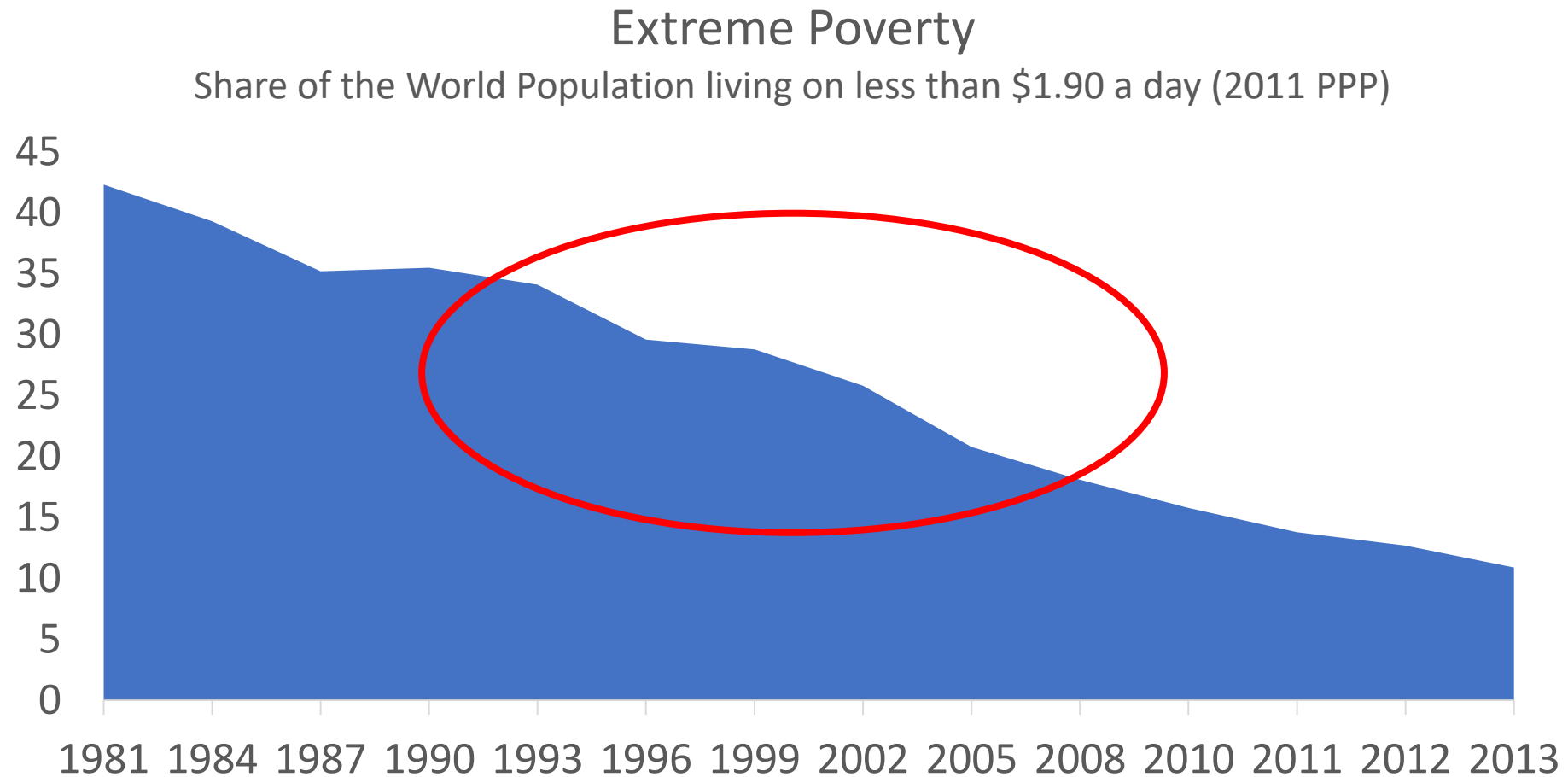
- But, not the only factor and need complementary policies

# Period of Hyperglobalization

World Trade as a Share of GDP



# Large Drop in Extreme Poverty

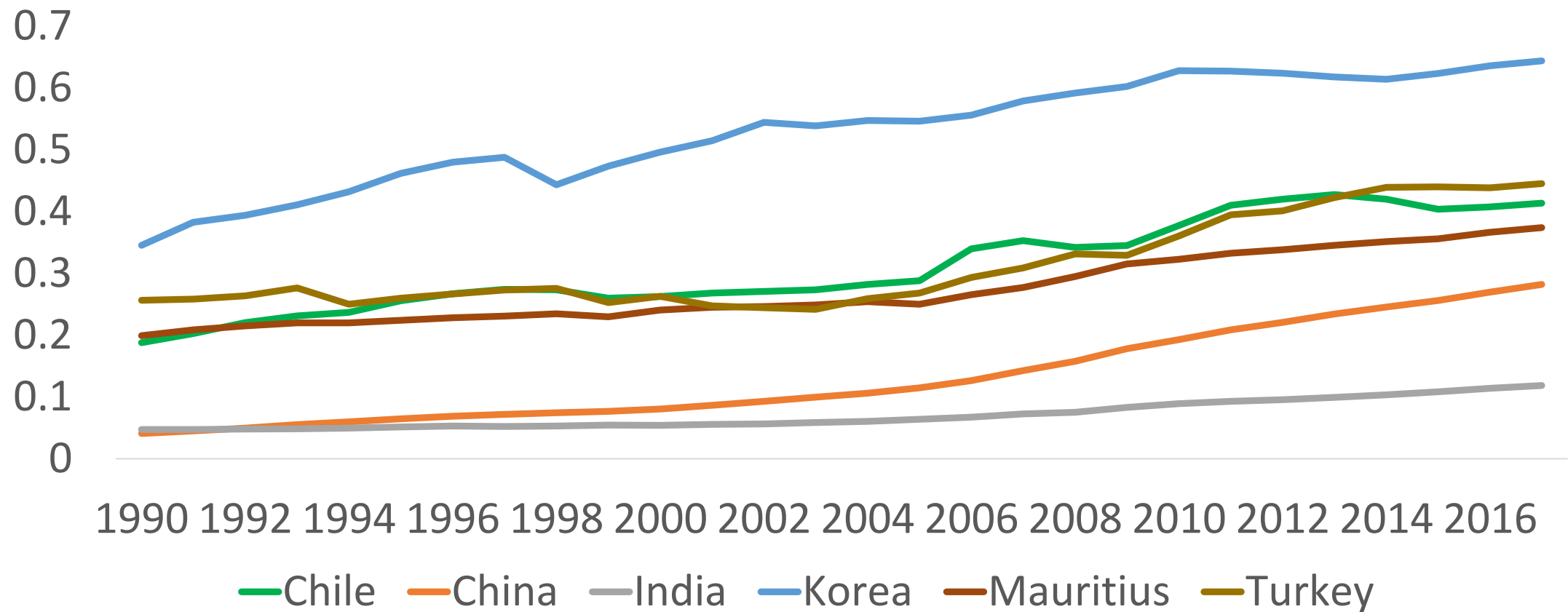


Source: World Development Indicators



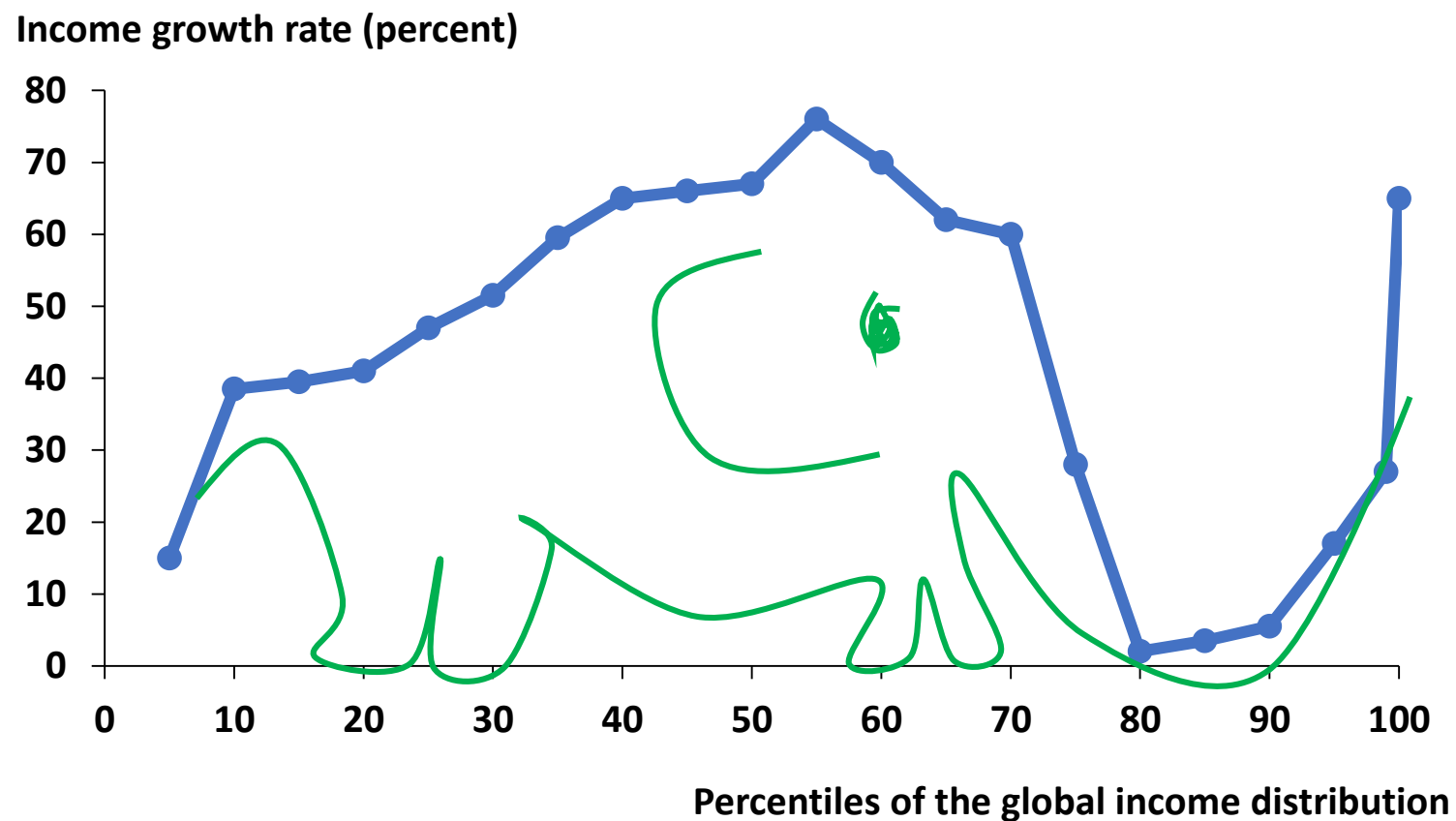
# Convergence

GDP Per Capita at PPP/ US GDP Per Capita at PPP



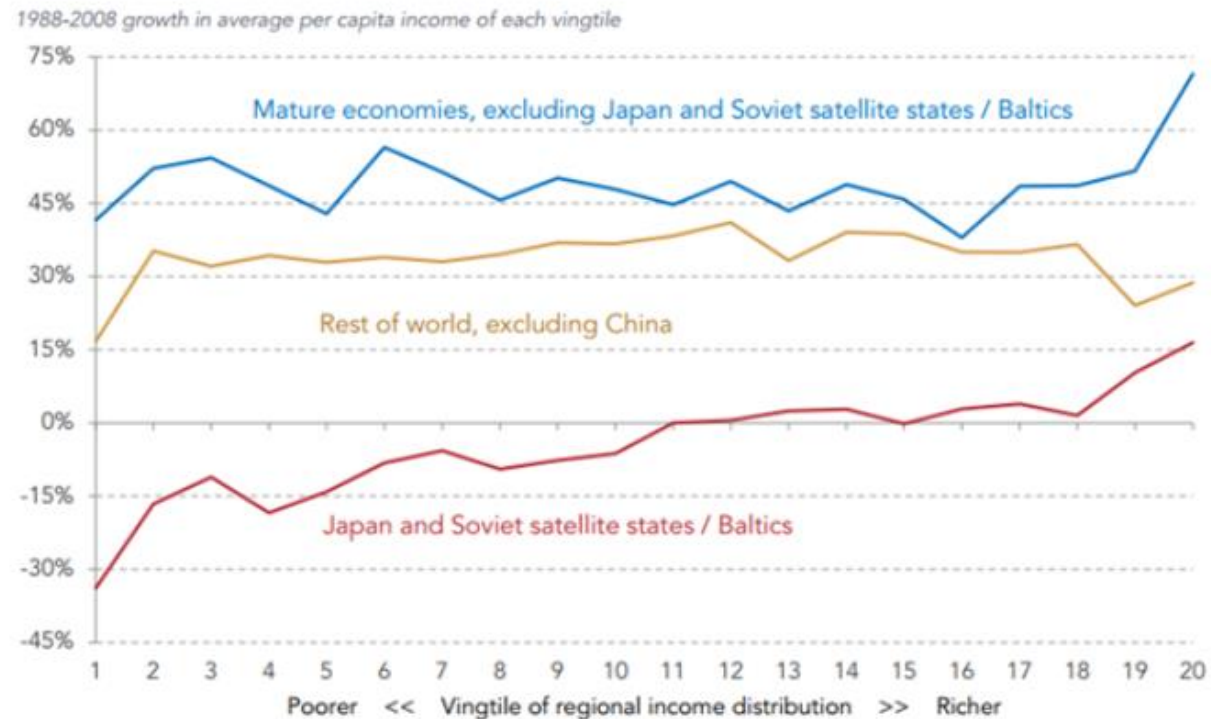
# Elephant Curve Seemed to Support Narrative

## Growth Incidence Curve, 1988-2008



Source: Lakner and Milanovic (2013)

# But, the trunk is really about Japan and Soviet satellite states



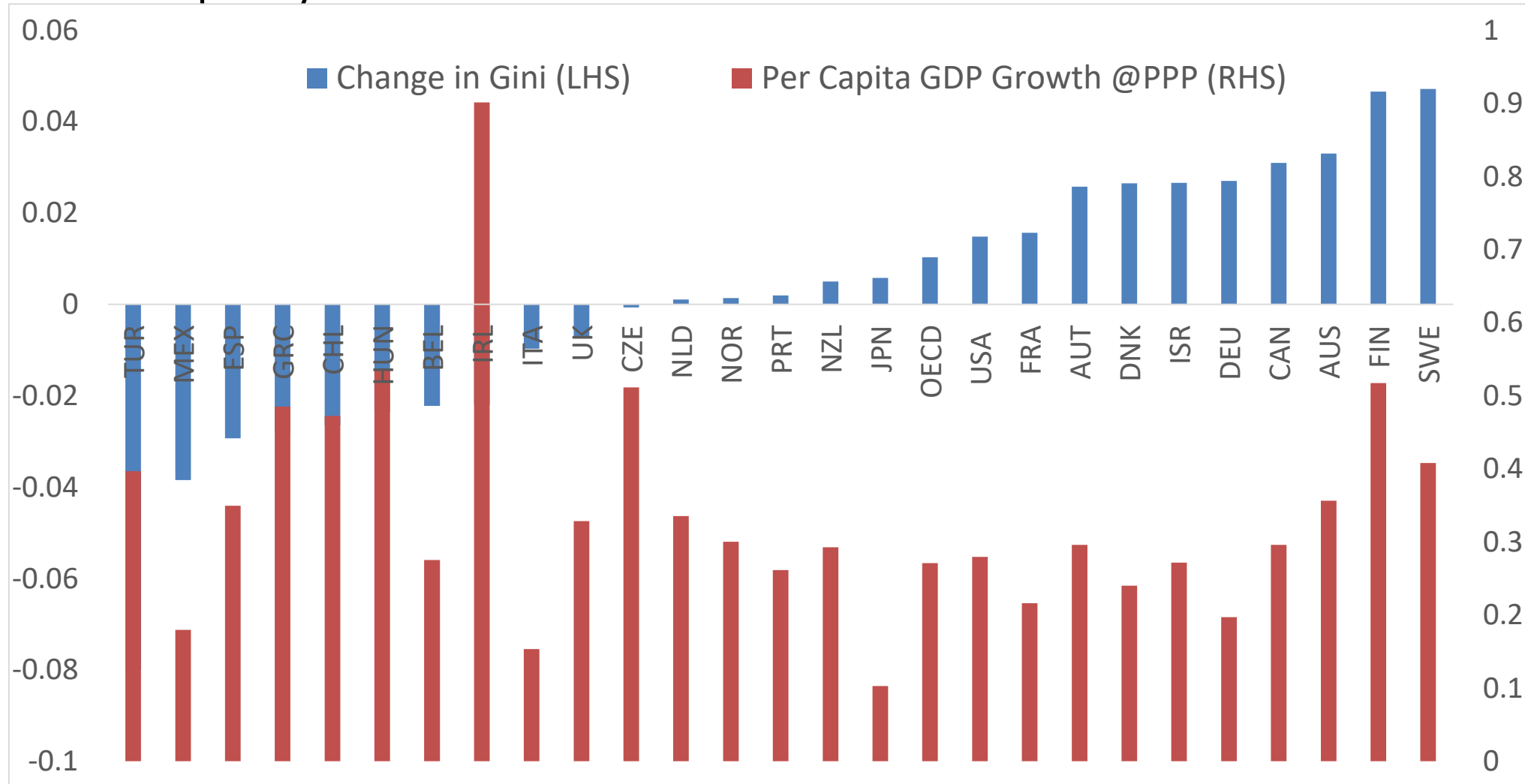
Source: RF analysis of Lakner-Milanovic World Panel Income Distribution

Notes: The red line group is Japan, Bulgaria, Czech Republic, Estonia, Germany, Hungary, Latvia, Lithuania, Poland, Romania and Slovakia. The blue line is Austria, Belgium, Canada, Cyprus, Denmark, Finland, France, Greece, Ireland, Israel, Italy, Netherlands, Portugal, Slovenia, South Korea, Spain, UK and USA. Rest of world (excluding China) includes (only) 30 countries for whom data is available.

What about within-country inequality?

# Different outcomes in different countries, despite similar exposure to trade and tech

Inequality and Growth in OECD countries mid-1990s to mid-2000s



Source: Freund 2016

# The common narrative is Heckscher-Ohlin, but the evidence is not

- Heckscher-Ohlin & Stolper-Samuelson
  - Trade raises inequality in labor scarce countries
  - Trade reduces inequality falls in labor rich countries
- Inequality rises in developed and developing countries in response to liberalization (Goldberg and Pavcnik 2007)
- Change in the relative demand for skilled workers in developed countries has occurred across firms within sectors rather than across sectors (Katz and Murphy 1992 and Berman, Bound, and Griliches 1994)

# The Role of Superstar Firms

# Large Firms Promote Modernization

- Alfred Chandler – Scale, R&D, and management.
- Allocative efficiency – Firm heterogeneity and resources flow to most productive uses.
- Individual firms matter
- Communications and logistics technology enhance effect

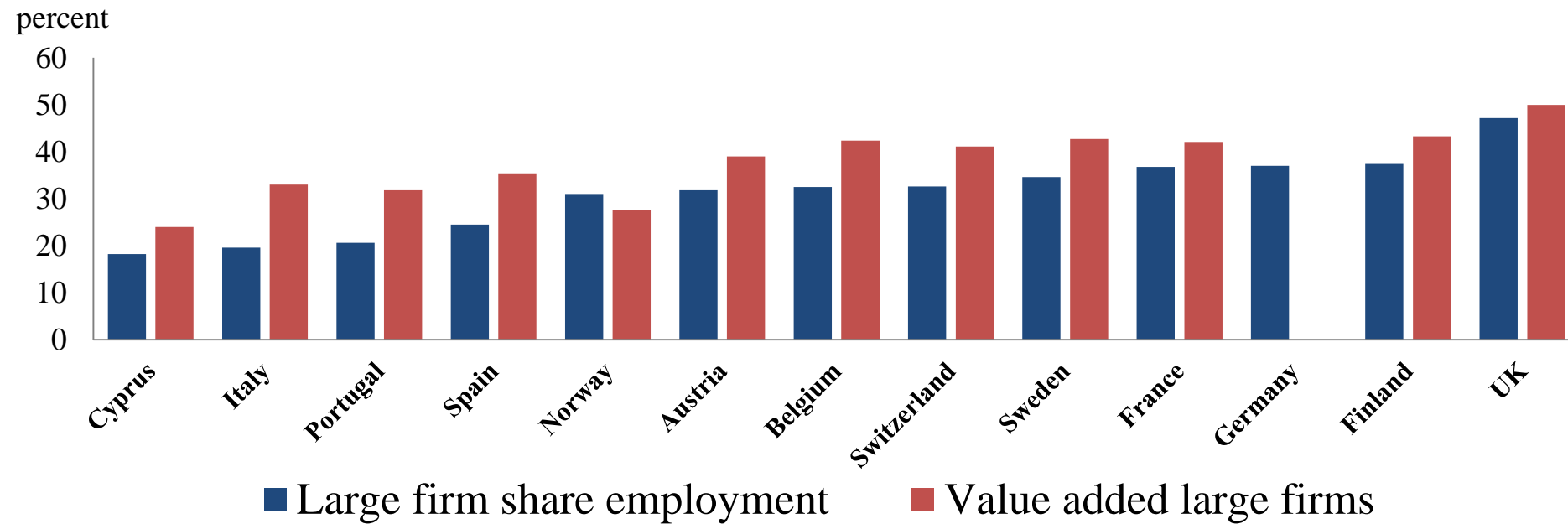




# Allocative Efficiency

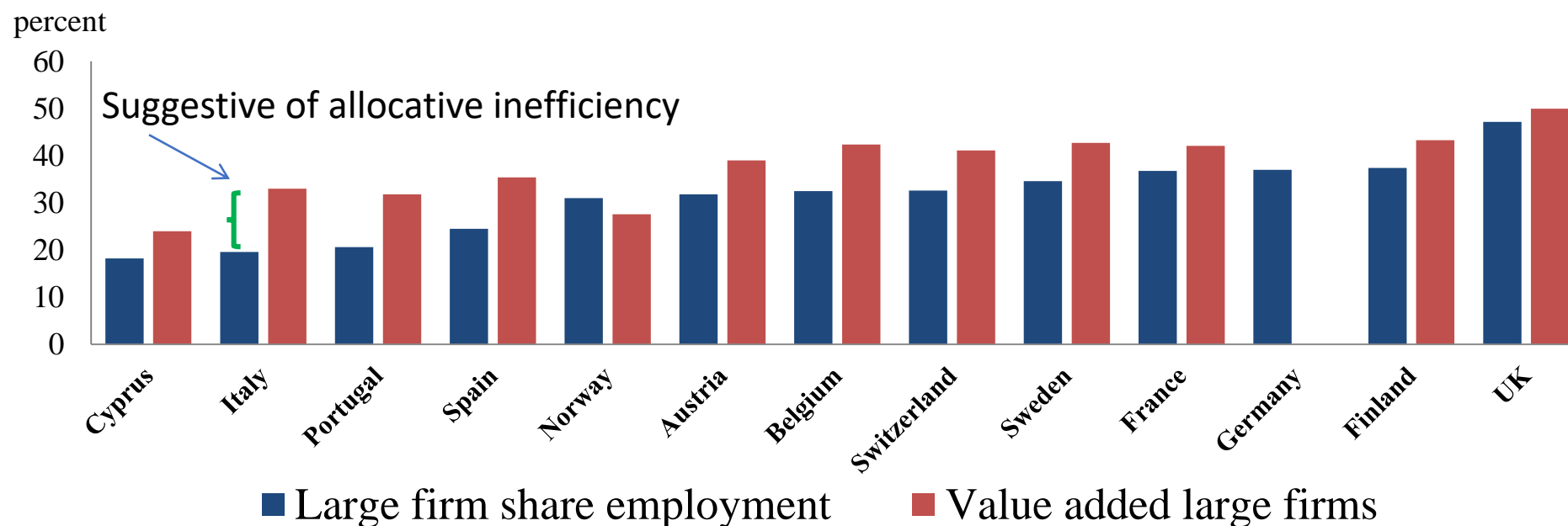
- Trade affects productivity through reallocation across firms
  - As market access abroad expands, most efficient firms export more and grow
  - As openness to imports expands, least efficient firms exit
- As countries trade and grow, superstar firms are created
- Increasing trade raises incomes, especially in poor countries, with inefficient allocation of resources
- Increasing trade also creates a class of superrich

## Rich European countries have more employment in large firms



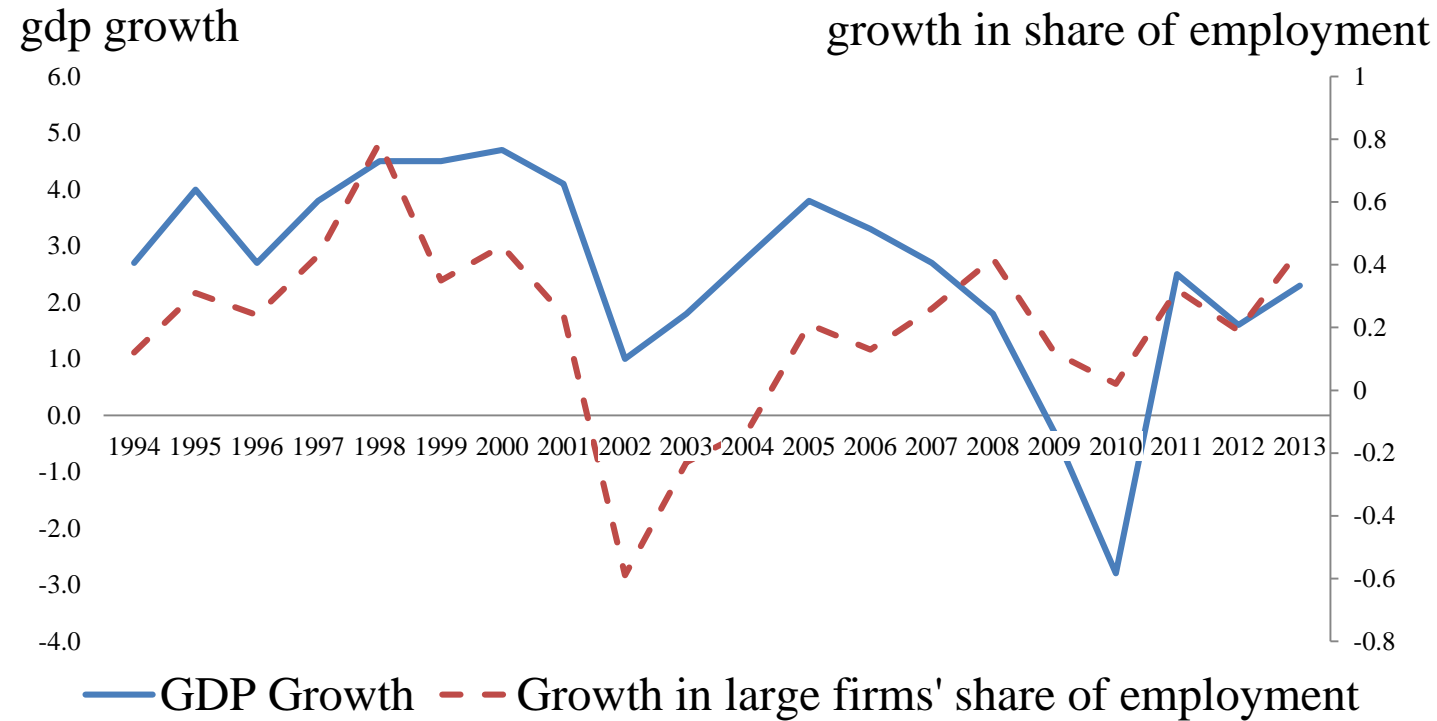
Source: Eurostat 2010.

## Rich European countries value added and employment shares are closer



Bartelsman, Haltiwanger and Scarpetta (2013) measure covariance b/w productivity and size in US industry: US is more efficient than in the United Kingdom, Germany and France. In addition, the covariance between size and productivity was near zero (or negative) at transition in Eastern Europe and has since increased, i.e. allocative efficiency has improved sharply.

# Growth in the US is driven by large firms



Source: US Bureau of Labor Statistics

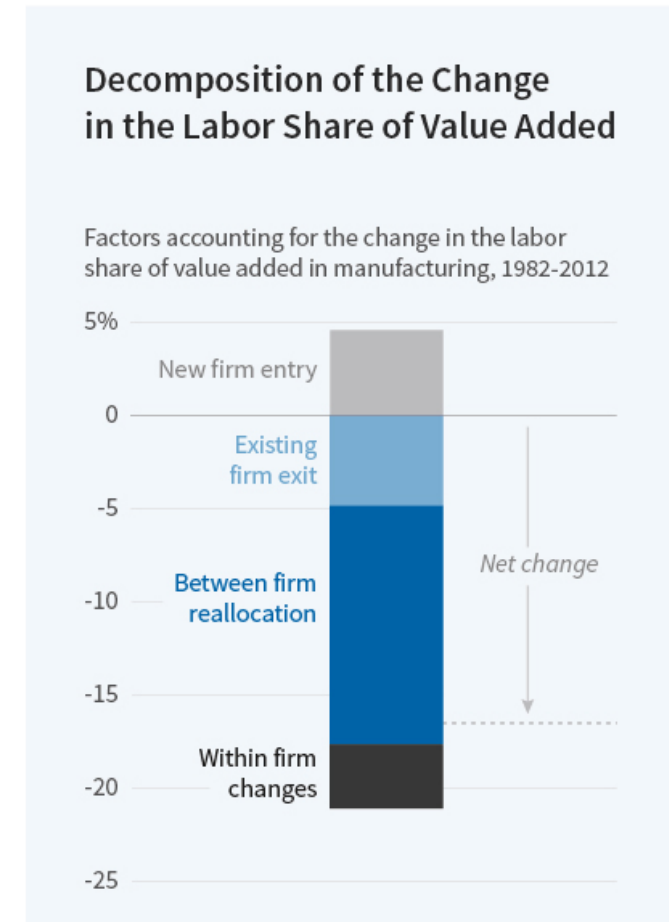
Share of large firms increased from 49 to 53 percent over period.

# The Fall of the Labor Share and the Rise of Superstar Firms

Autor, Dorn, Patterson, Katz, and Van Reenen (2017)

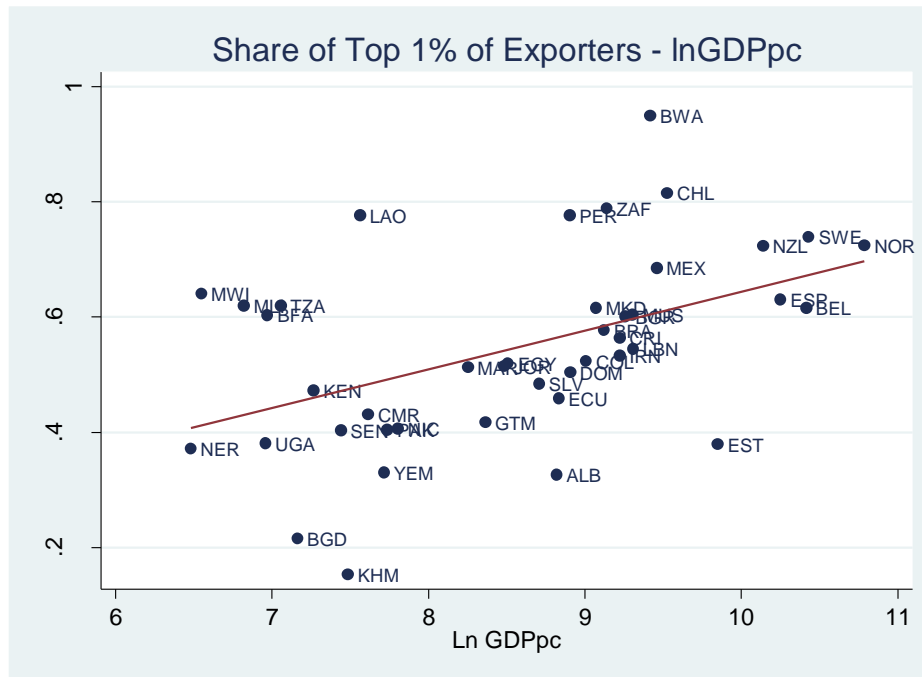
- The ratio of wages to national income has declined in the last three decades in most developed nations
- Superstar firms with low labor shares are capturing an ever greater share of the market
- Industries with increasing concentration have fast TFP growth and patent growth.

## Technological Dynamism and the Fall in Labor's Share

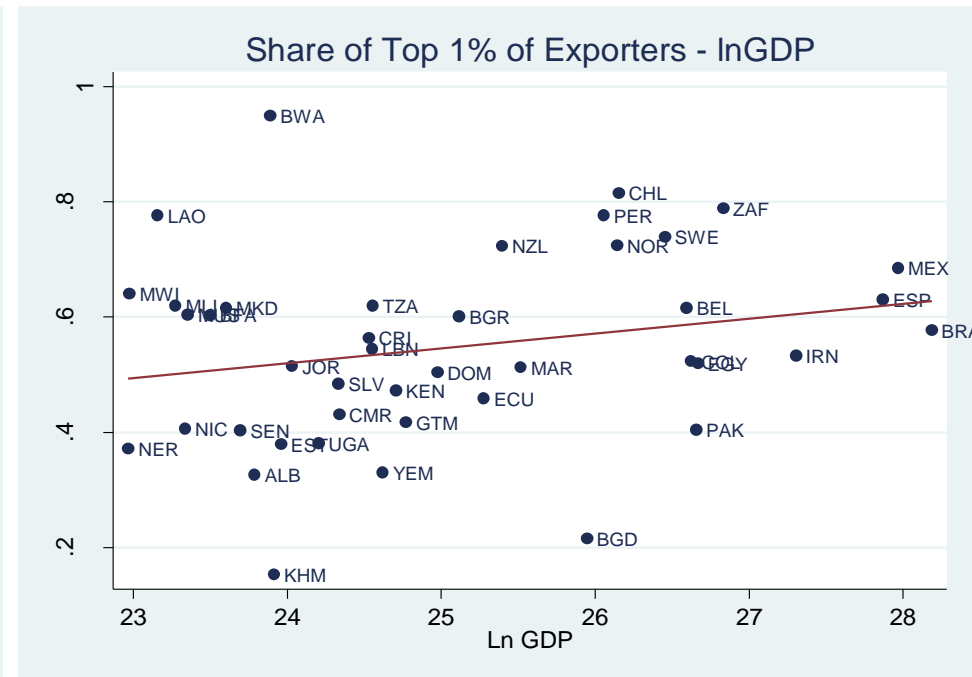


# Exporter concentration is increasing in level of development

Share and per capita GDP at PPP

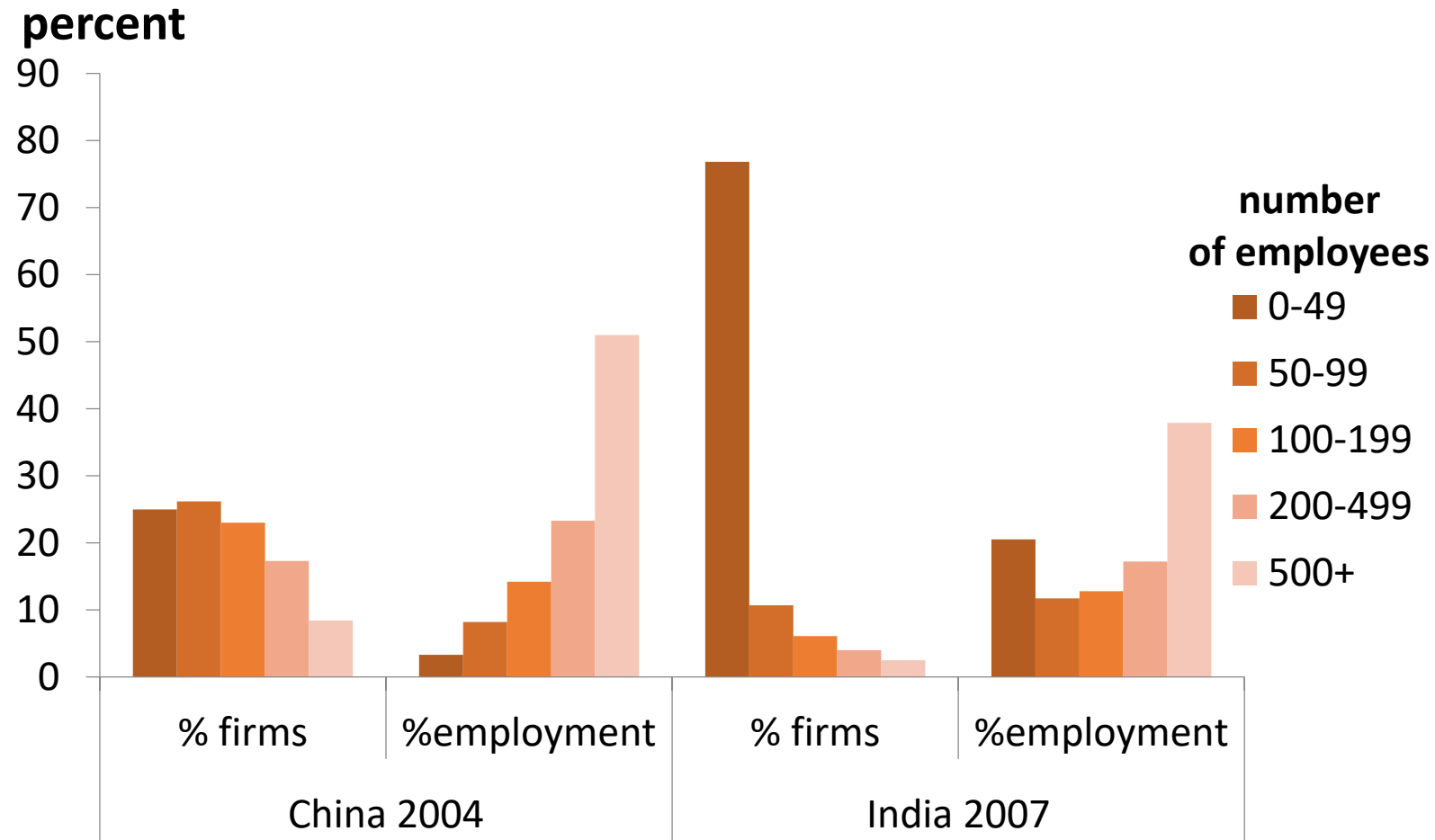


Share and per capita GDP at PPP  
Controlling for sector FE



Source: Fernandes, Freund and Pierola (2017)

# Large Firms & Manufacturing Employment



Source: van Ark et al. 2010

# Research confirms importance of large firms

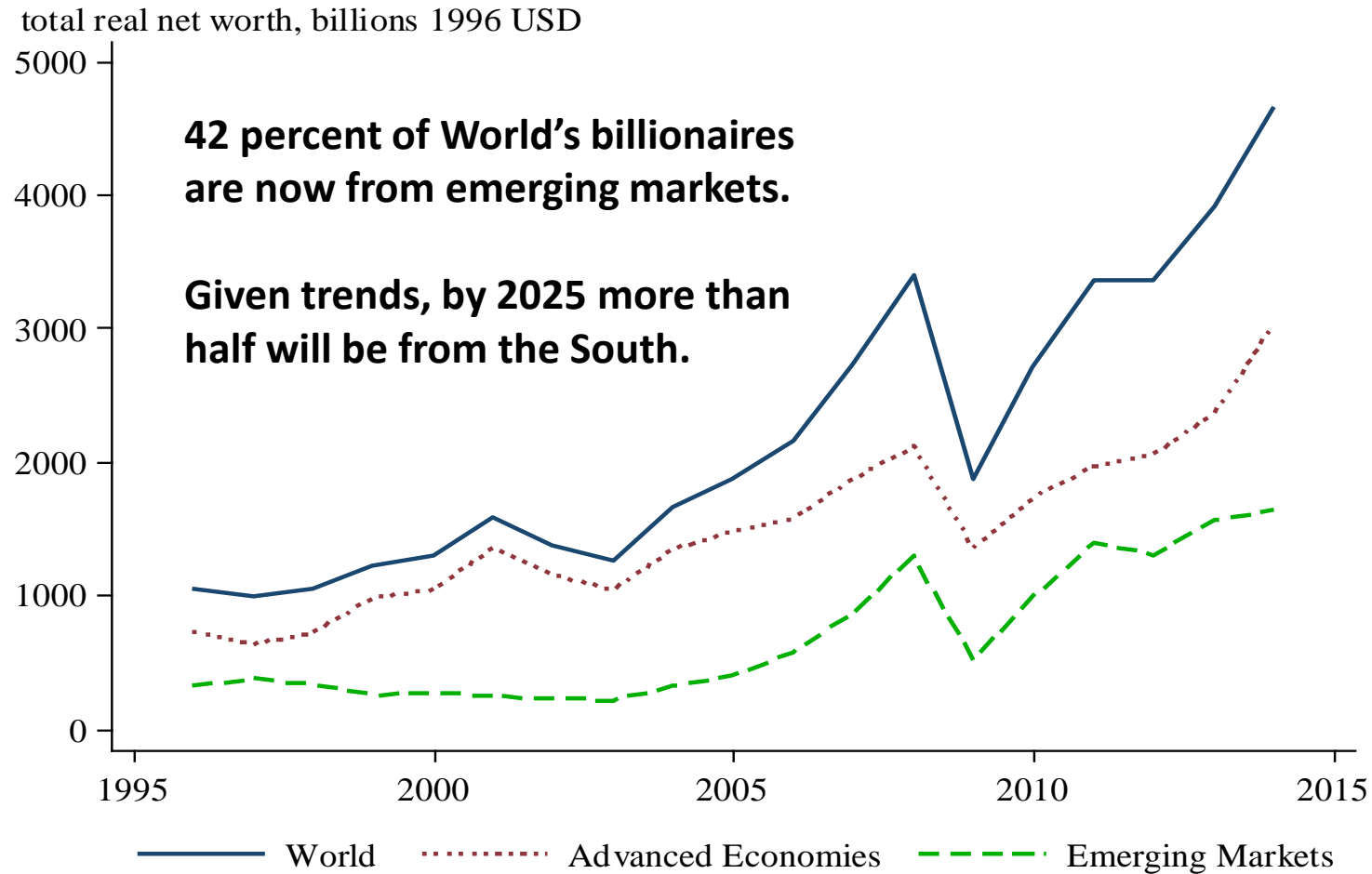
- Cross country research: Average firm size increases with development: 10 percent increase in per capita income associated with a 2.6 percent increase in average firm size. (Bento and Restuccia 2014).
- The myth of the missing middle--Large firms have higher average productivity and that the fraction of missing firms is increasing in firm size (Hsieh and Olken 2014).
- Developing countries export less because they are missing the largest superproductive firms—the firm-size distribution is truncated at the top. Fernandes, Freund, and Pierola (2015).



Superstar firms are good for growth, but create extreme wealth

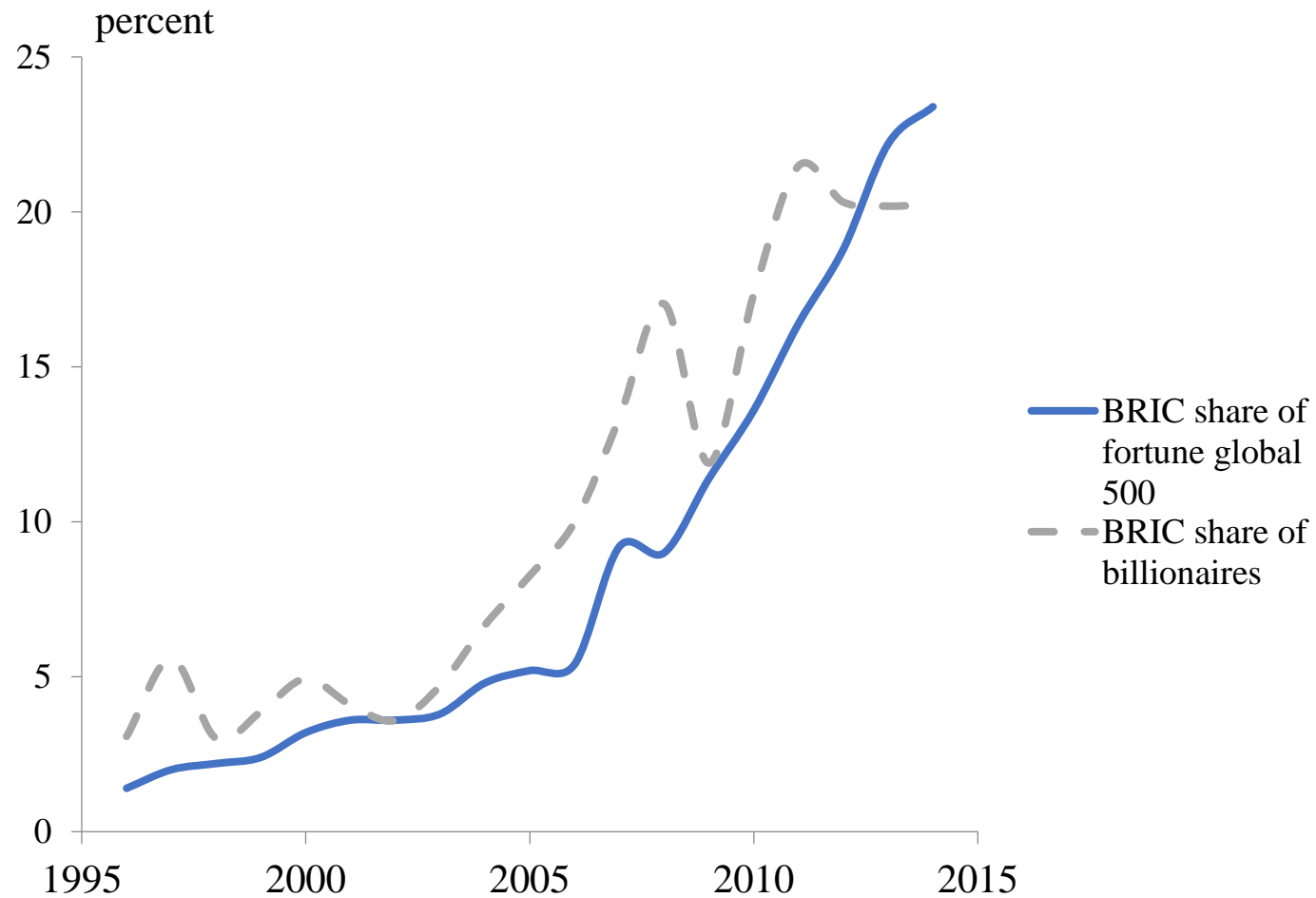
The force of trade is present in North & South

# Growth in Extreme Wealth



Sources: Forbes World's Billionaires and World Bank WDI.

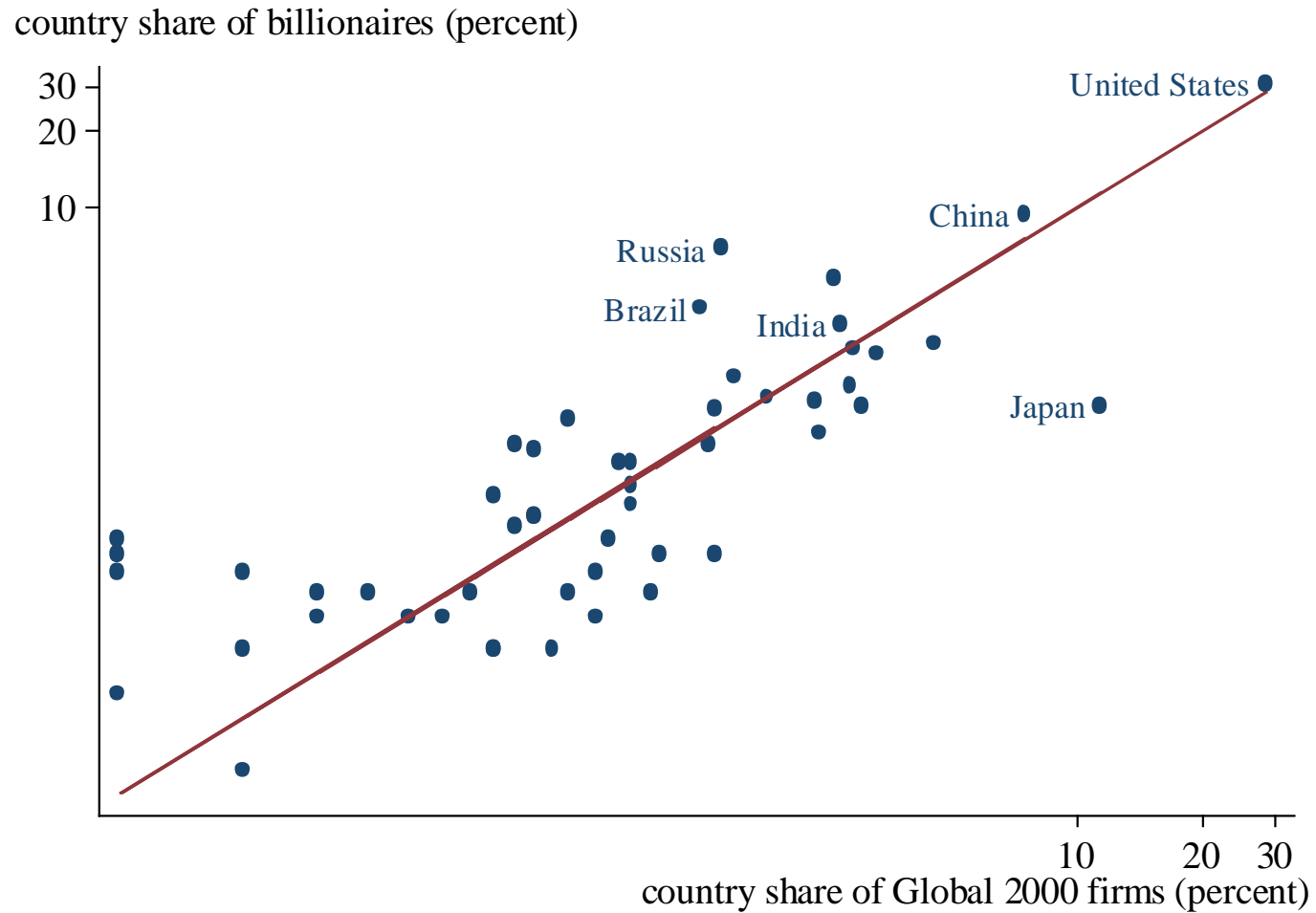
# Extreme Wealth & Mega Firms



BRIC countries include Brazil, Russia, China and India

Sources: Forbes World's Billionaires and Fortune 500.

# Wealth and Large Firms Go Together



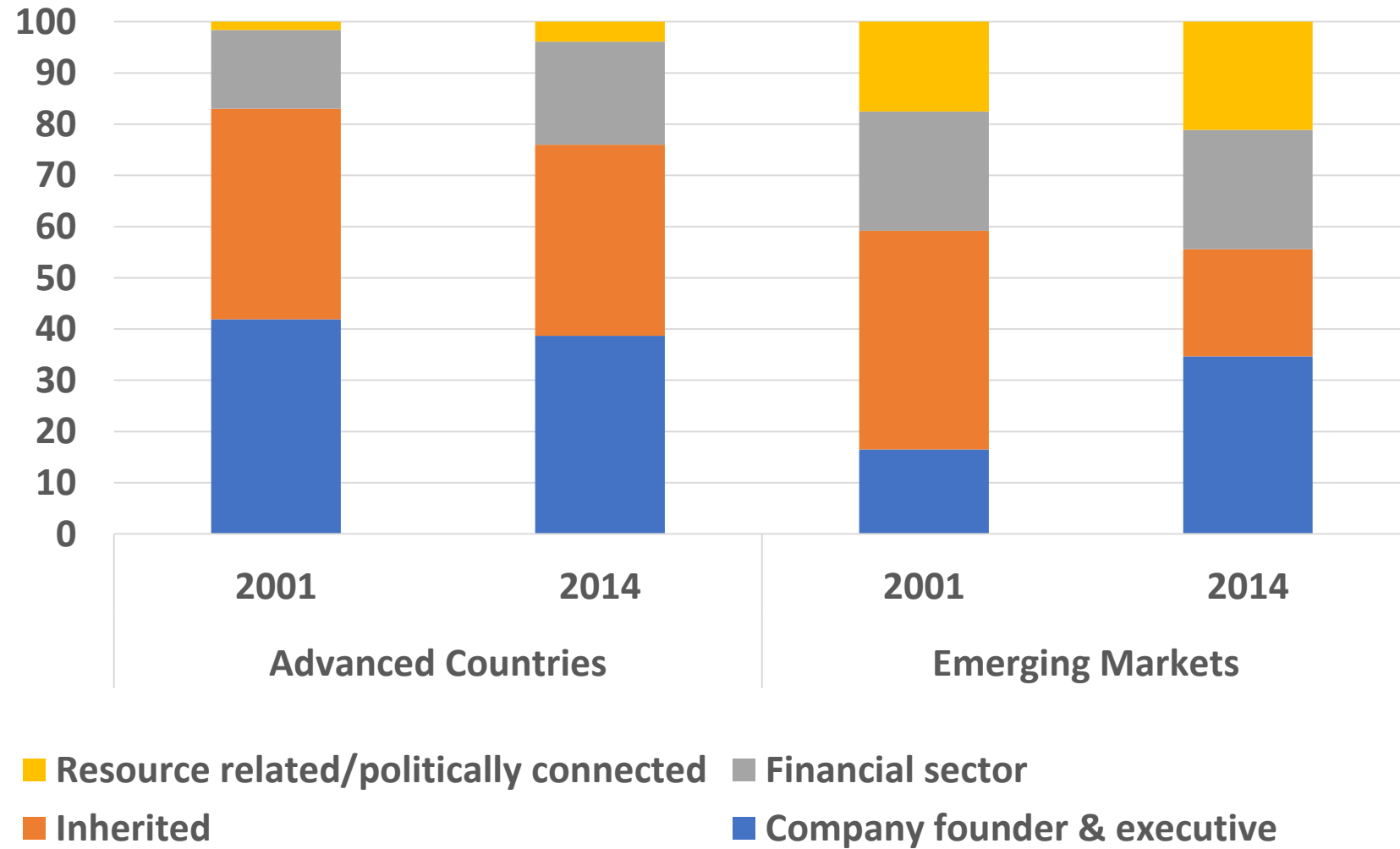
Sources: Forbes World's Billionaires and Global 2000.

Where does extreme wealth come from?

# Who are the Superrich?

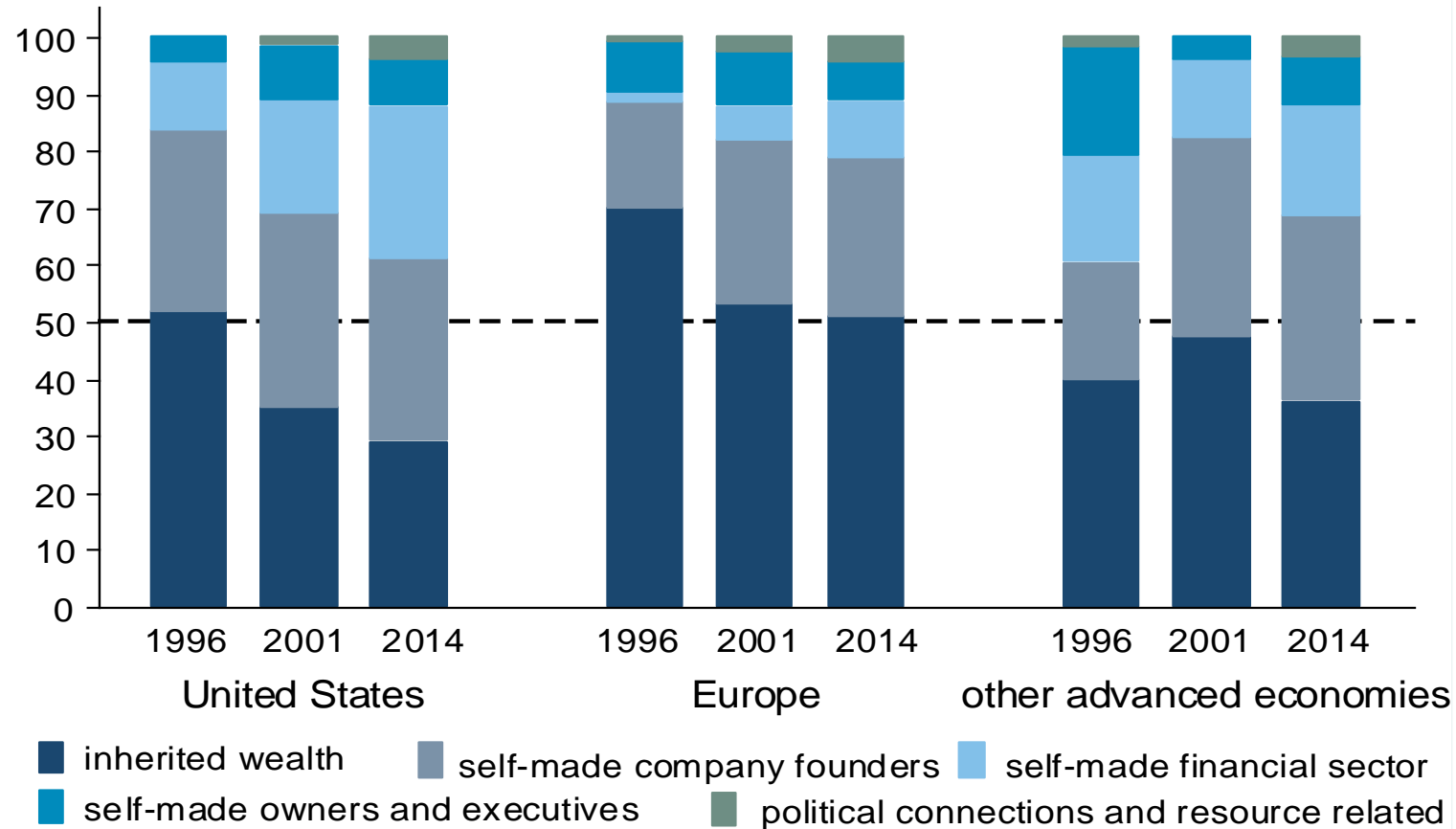
- Inheritors
- Self-made
  - Company founders
  - Executives
  - Politically connected/resource based
  - Finance/real estate

# Sources of Wealth



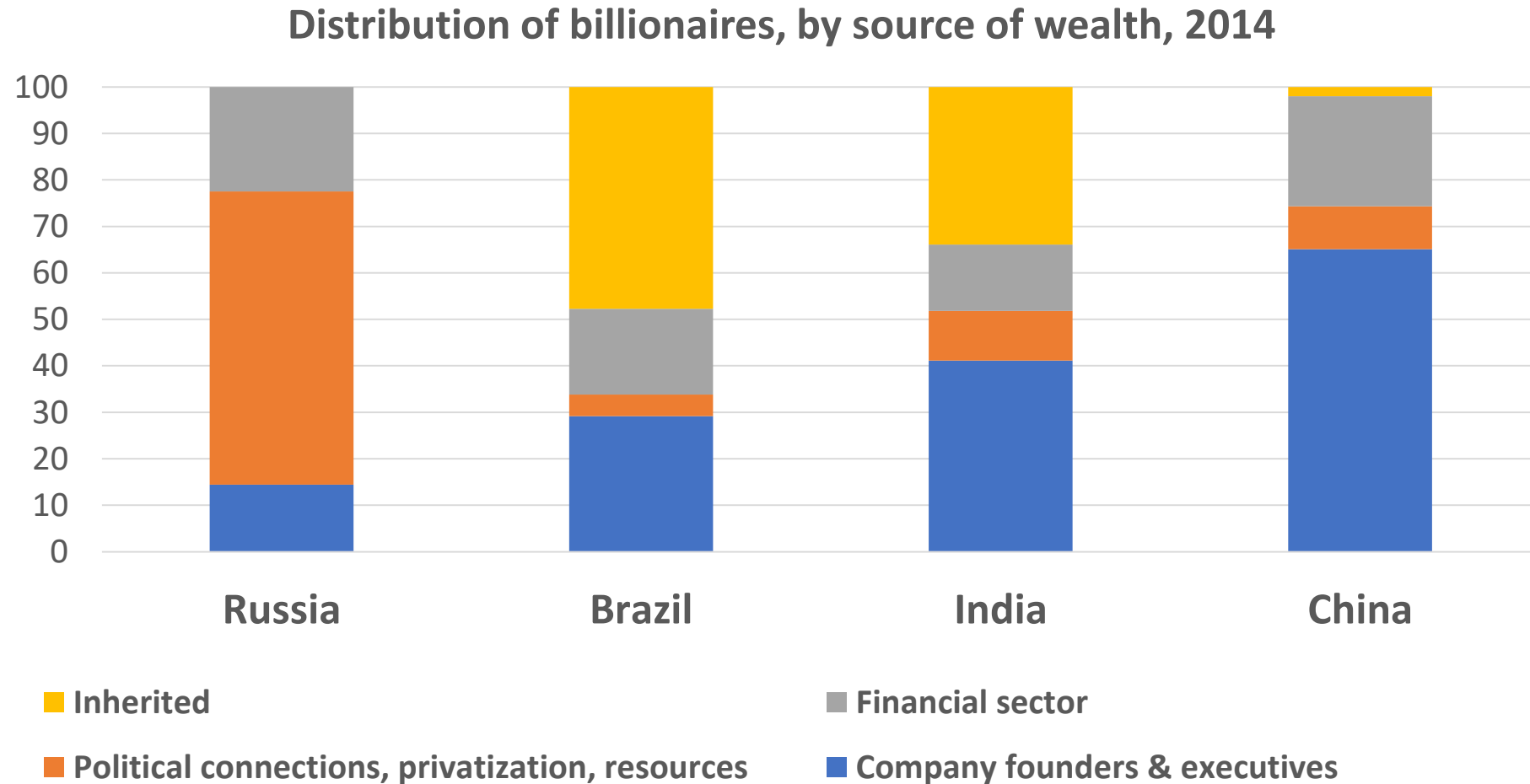
# Wealth in Advanced Countries

share of billionaires



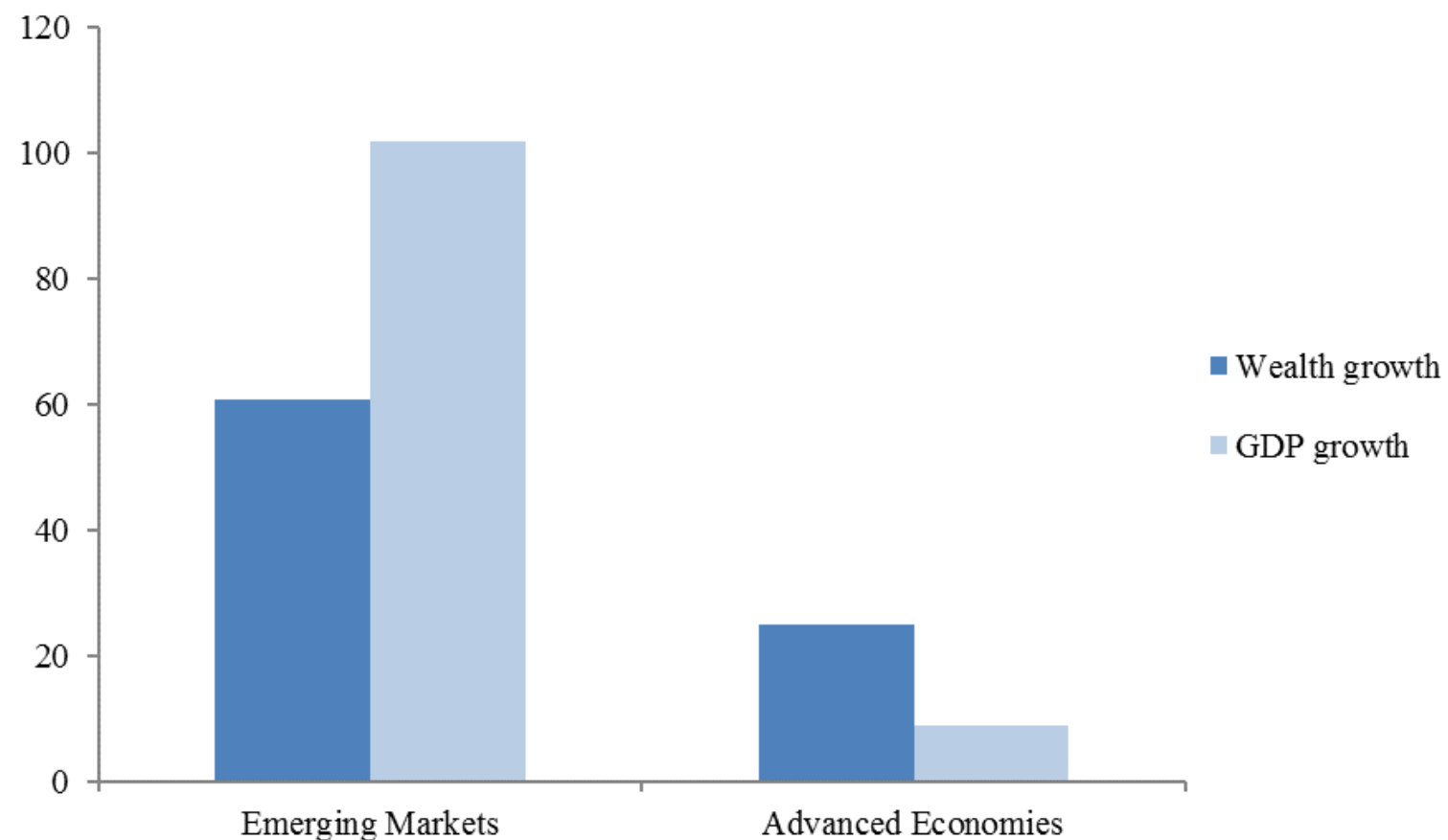


# BRIC Source of Wealth



# Wealth is growing faster than income in the North, but not in the South

Growth in wealth of the 5 richest and GDP growth 2006-2012



Source: Author's calculations using data from Forbes World's Billionaires and World Bank WDI.

# Policy Implications

- Promote entrepreneurship
  - Property rights, free entry and openness to trade and foreign investment
- Limit cronyism
  - Transparent privatization & government procurement, competition policy
- Tax more heavily less productive sources of wealth
  - Inheritance & (some) finance

Why the backlash against globalization now?

# The backlash can't be only about trade

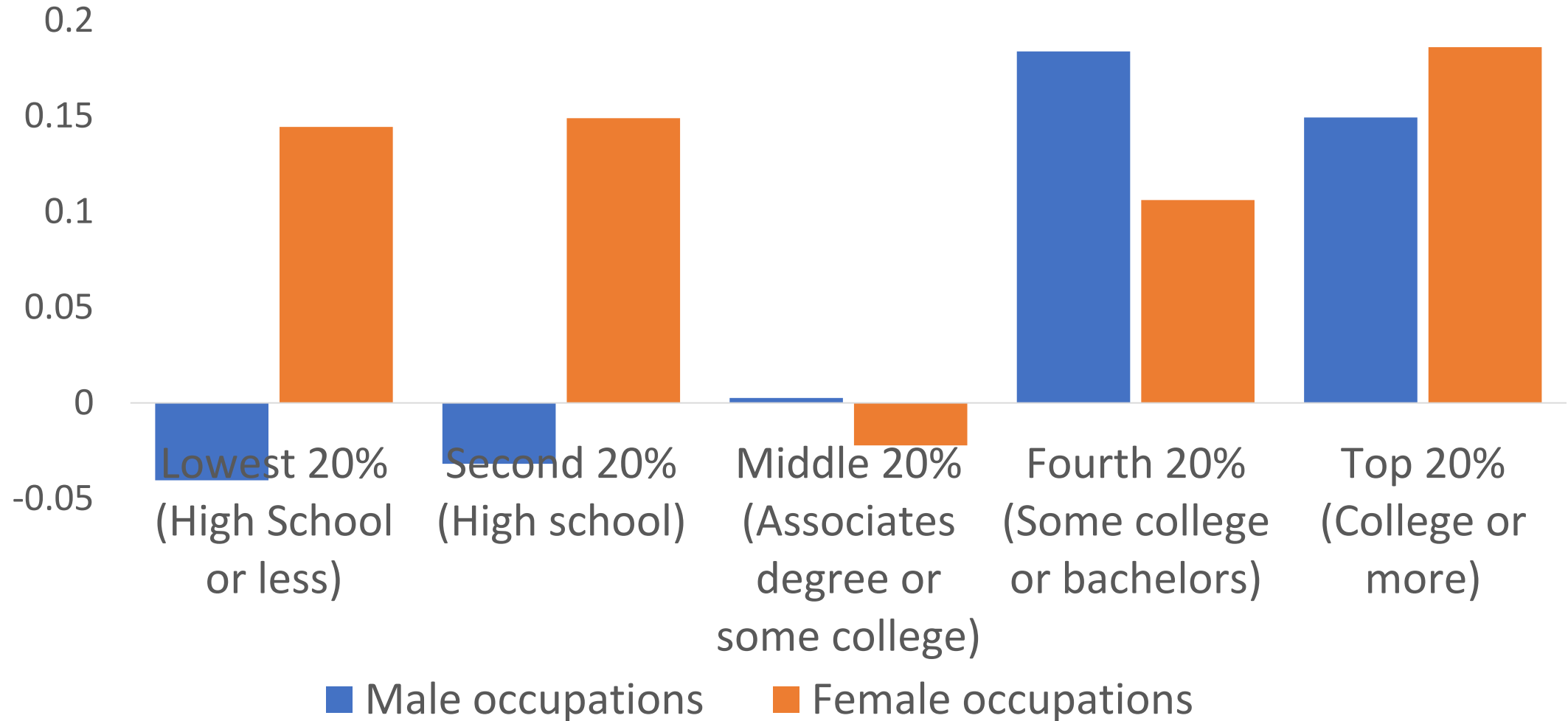
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- Inequality and jobs in advanced countries
  - Same shocks, trade and technology, but inequality not up everywhere
- Timing—trade surged from 1995-2005 and then stagnated
- Post financial crisis slowdown
- The rise of China
  - New issues—subsidies, investment, SOEs, technology

# Other pressures on inequality in Anglo countries

- Policies: Tax cuts, deregulation, de-unionization, rise of finance, lower spending on labor adjustment
- Social: Assortative mating, private schools, tutoring
- Fear around immigration and terrorism

# US occupational change: Tougher on less-educated men



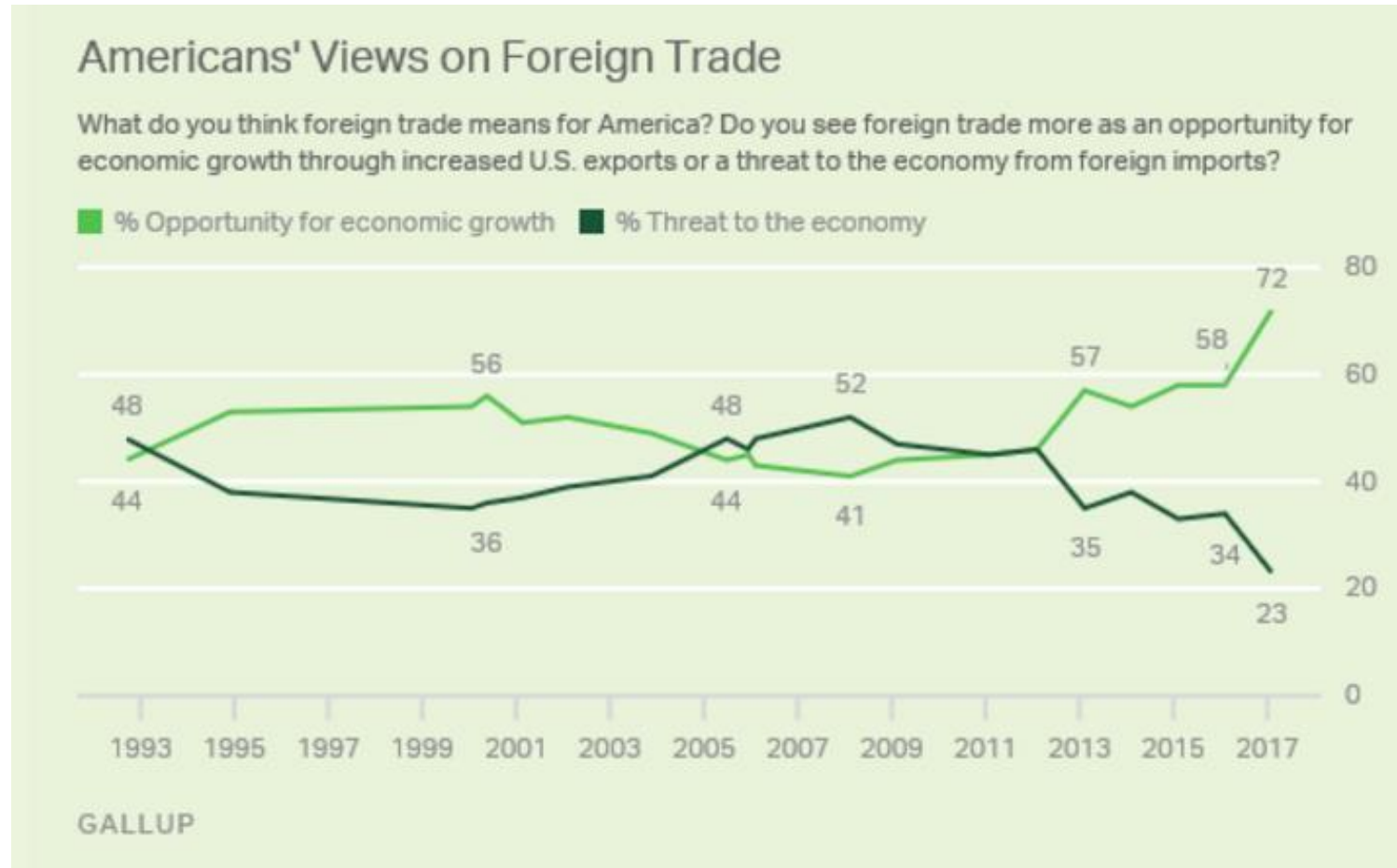
Structural change is difficult

Discontent among workers

But, do workers really blame trade?



# Views on Foreign Trade at all Time High



# Worry about terrorism and immigration up worry about economy down

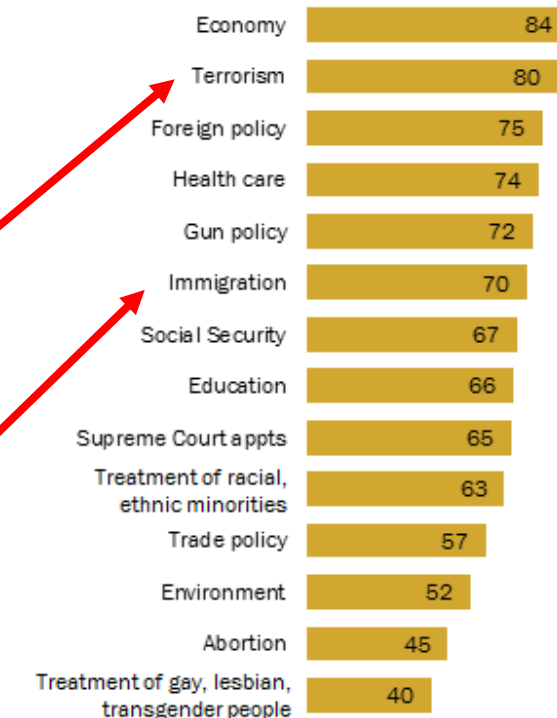
## Voters' Priorities: 2008-2012

% of voters saying each is "very important" to their vote ...	2008 %	2012 %	Change
Economy	87	87	0
Jobs*	80	83	+3
Health care	73	74	+1
Education	73	69	-4
Budget deficit**	69	68	-1
Taxes*	71	66	-5
Medicare	--	65	--
Terrorism	72	60	-12
Foreign policy	--	60	--
Energy	77	55	-22
Abortion	39	46	+7
Immigration	52	41	-11

PEW RESEARCH CENTER Sept. 12-16, 2012.  
Based on registered voters. All 2008 figures from August except\* October 2008 and \*\* May 2008.

## Economy and terrorism are top issues for voters in 2016

% of registered voters saying each is "very important" to their vote in 2016 ...



Note: Based on registered voters. Q40.  
Source: Survey conducted June 15-26, 2016.

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# Moving Forward

- Education, skills and labor adjustment policies
- A backlash against the backlash against globalization may be coming
  - Anti-Brexit rallies & pro-EU rallies, TPP 11, EU-Japan, Pacific Alliance etc.
- Media's negative bias is helpful
  - Trade bashing raged in 2016, not so much now
- Export industries are organizing & gaining voice
- International organizations, think tanks and academics offer data and evidence
- Reforming WTO to handle new issues
- All countries should continue liberalization programs, avoid resorting to restrictions, and use the WTO or dispute settlement bodies of regional trading arrangements to bring disputes

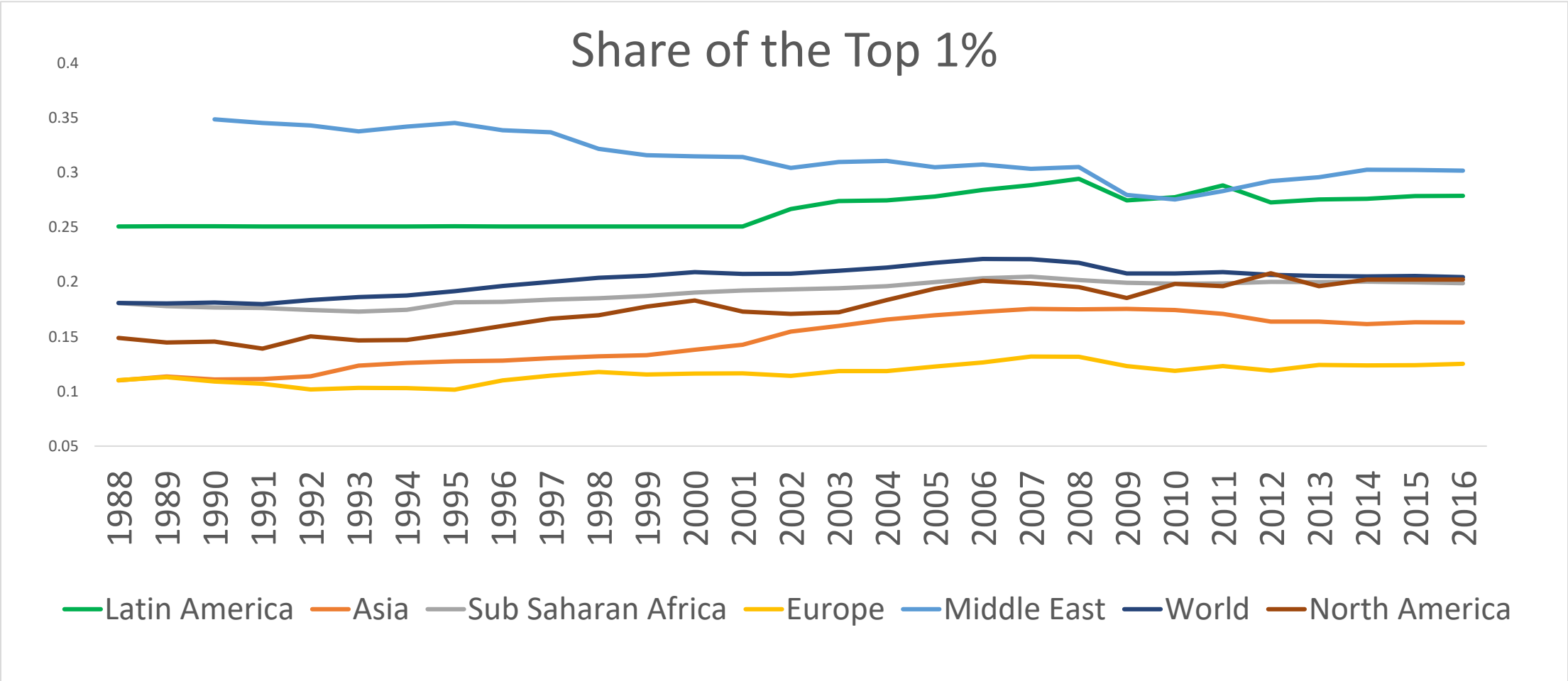
# Thank you!

Follow me on twitter

@carolinefreund

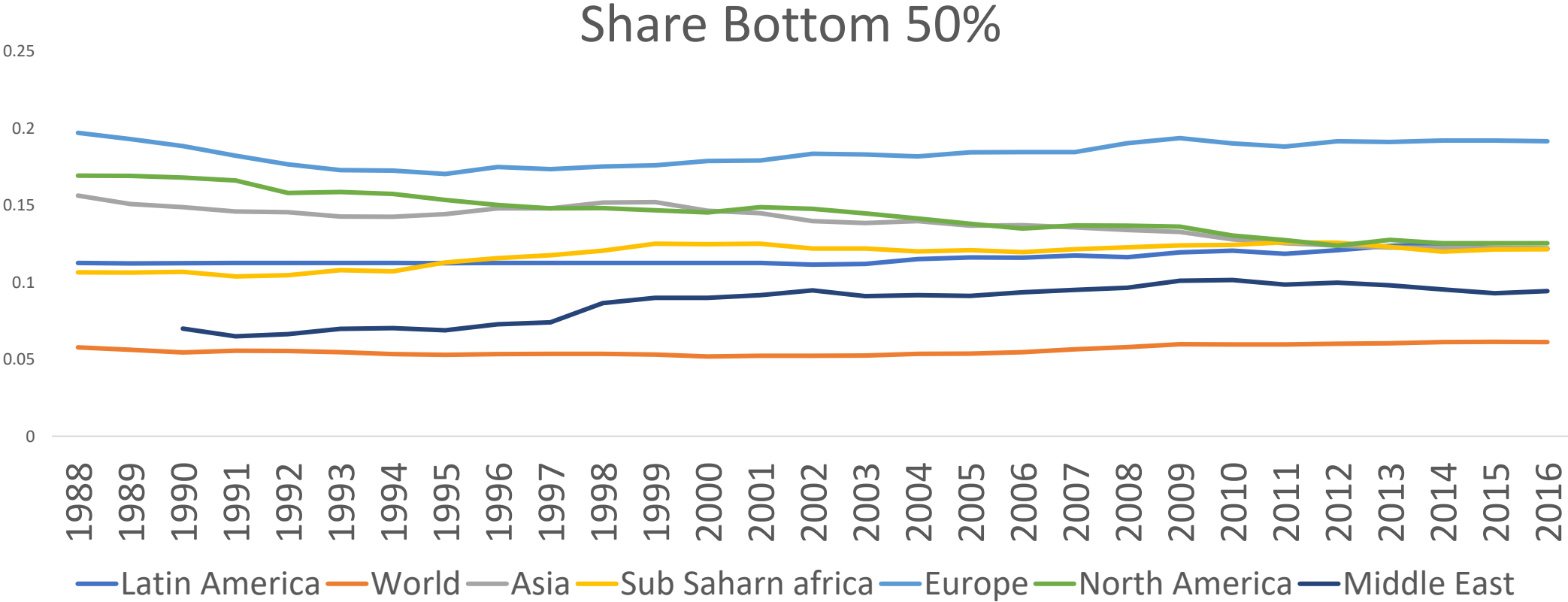
Extras...

# Diversity in the Evolution of the Top 1%



Source: World Inequality Database

# Diversity in the Evolution of the Bottom 50%



Source: World Inequality Database

# Rapidly Rising Inequality is an Anglo Problem

