

23rd Global Economy Lecture: Caroline Freund on “Trade, inequality, and populism”

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On October 1, 2018, the Oesterreichische Nationalbank (OeNB) hosted the 23rd Global Economy Lecture², delivered by *Caroline Freund*, Director of Macroeconomics, Trade and Investment at the World Bank. Caroline Freund’s research focuses on the effects of trade intensification, at both the intra-country and global level. In her lecture, she discussed the relationship between trade and inequality, and analyzed the origins of the recent backlash against globalization.

After a period of stagnation during the 1980s, global trade (measured as a share of global GDP) grew twice as fast as income from the mid-1990s to the mid-2000s. It was during the latter period that the global supply chain network was established. However, the recent financial crisis put international trade relations to the test. After a temporary trade contraction, we are now facing another period of trade stagnation, which in several respects resembles its 1980s precursor, characterized by slow progress toward concluding trade agreements as well as by protectionist tendencies.

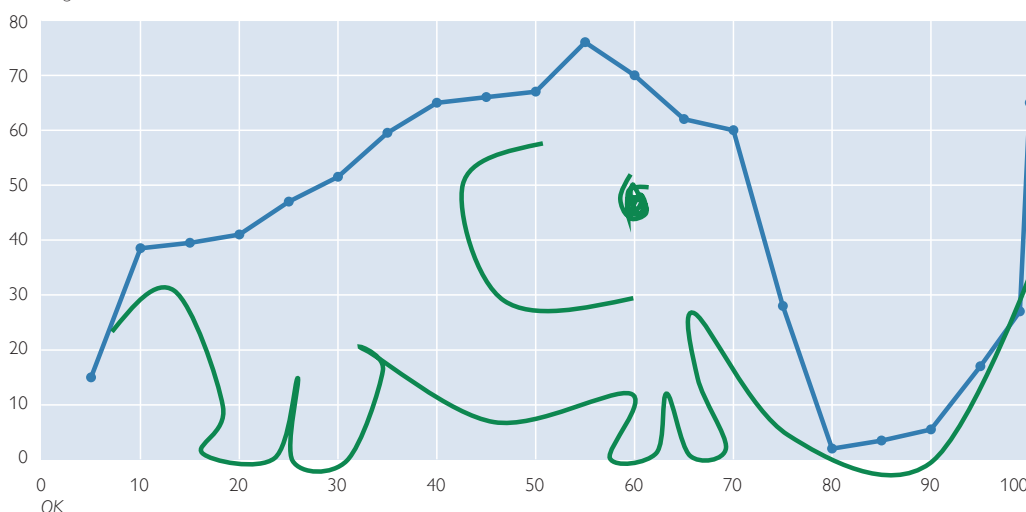
According to one common narrative about trade and inequality, globalization has enabled poor countries to export more labor-intensive goods, a development which has then destroyed lower-skilled jobs in rich countries. In line with the Heckscher-Ohlin model, trade should reduce inequality in labor-rich countries, but raise it in labor-scarce countries. The provocative conclusion is that development in poor countries has come at the expense of low-skilled workers in industrial economies, thus also fueling the backlash against globalization.

The “elephant curve,” which ranks people across the world from the poorest to the richest, seems to support this common narrative: trade makes poor people

Chart 1

Growth incidence curve, 1988–2008

Income growth rate, %



Source: Graph by Lakner and Milanovic; elephant added by Freund.

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² The Global Economy Lecture is an annual event organized jointly by the OeNB and The Vienna Institute for International Economic Studies (wiiw).

better off (top of the elephant's back) and creates a class of super-rich (tip of the elephant's trunk), while the middle class in industrial countries is paying the bill (middle of the trunk). The reality, however, is much more nuanced.

Trade has contributed significantly to a drop in global inequality. Trade openness, in combination with complementary accompanying business regulations, has provided a growth boost to the economies of poor countries as resources shift to productive uses. As a result, the share of the world population living in extreme poverty, defined as living on less than USD 1.90 a day, has dropped markedly from 42% in 1981 to 10% in 2015.

The conclusion that less-skilled workers in industrial countries are net losers from trade integration may be misleading. The trough of the elephant curve actually reflects very low growth in Japan during this period, as well as negative growth in transition economies as a result of the Eastern Bloc's disintegration. In fact, the "hollowing-out of the middle" effect of the elephant curve is significantly less pronounced if Japan and the Soviet satellite states are left out.

The presence of superstar firms is actually indicative of allocative efficiency, as large firms tend to be more productive and innovative. In this sense, superstar firms are beneficial to growth and development. At the same time, however, they create extreme wealth, thus contributing to inequality.

The empirical evidence on how trade has affected within-country inequality is ambiguous. Recent evidence shows that inequality has increased in some countries as trade has helped create a class of super-rich. This reflects changes within rather than across sectors, as best performers embark successfully upon trade integration. However, trade also lowers prices, thus helping the poor, and as a result contributes to more equal distribution in other countries.

Caroline Freund concluded by emphasizing that property rights, the liberalization of business regulations, and openness to trade and foreign direct investment (FDI) play a key role in maximizing the benefits of trade integration. Taxing less productive sources of wealth may help spread these benefits to those who may otherwise lose out as a result of globalization. According to Freund, the backlash against globalization can be traced back to more than just trade effects, for instance the post-financial crisis slowdown. Interestingly enough, support of foreign trade among Americans is at an all-time high.

For more in-depth coverage of the topic, see Caroline Freund. 2016. *Rich People Poor Countries: The Rise of Emerging-Market Tycoons and their Mega Firms*. Washington, DC: Peterson Institute for International Economics.