The Future of the World Economy: Patriots versus Globalists

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Introduction

On the 24th September, 2019, President Donald Trump addressed the 74th Session of the United Nations (UN) General Assembly in New York and announced that "The future does not belong to globalists. The future belongs to patriots." and "The future belongs to sovereign and independent nations who protect their citizens, respect their neighbours and honour the differences that make each country special and unique". In doing so, the President renewed his attack on the very global economic and political order which the United States had played a key role in creating. He described the contest as a battle between globalists and patriots (which others might define as "populists"). One could question his terminology, but there can be no doubt about the nature of the ideological struggle to which he refers—a battle that has been raging strongly since 2016, but whose origins go back much further.

"Globalization" is the catch-all term that we use here to refer to the spread of political and economic liberalism (aka democracy and capitalism) across the world, of increasingly free international trade and migration of labour and capital across borders, as well as to the system of global governance that has been built up to oversee this developing international order. This political-economy terraforming began in the wake of World War II in 1945 (partly with a view to avoiding the pre-war economic and political disjunctions that precipitated it), and reached its zenith in the early 1990s following the dismantling of the Berlin Wall - at which point Francis Fukuyama rashly announced "the end of history".[2]

The ink was scarcely dry on Fukuyama's book before its central thesis began to fall apart, eroded by financial crises in emerging markets, the shock of the 9/11 attack, the quagmire of Afghanistan and Iraq, and the failure of the Arab Spring. The greatest shock of all was the slow-fuse onset of the Great Financial Crisis (GFC) in 2007, its explosion in late 2008 with the collapse of Lehman Brothers, and the deep recession which followed in most advanced economies. At the same time, intellectuals began to question the virtues of globalization, and the word "neo-liberal" acquired a pejorative meaning in academic discourse.[3] "Populist" politicians began to gain support, culminating spectacularly in 2016, with the Brexit referendum in the United Kingdom, and the election of Donald Trump in the United States, which took the disillusionment with globalization squarely into mainstream political debate.

This paper traces the proximate economic and distributional factors behind this intensifying distrust of globalization and examines the economic consequences of the resulting pressure for "deglobalization". It offers an analysis of these developments through the prism of Dani Rodrik's 'trilemma': a triangular perspective which predicts that rising grass roots political pressures broadly at odds with globalization, within the context of nation-states having control of their own laws and regulations, would halt progress toward global integration.[4] The paper concludes with suggestions for possible ways to rebuild support for international cooperation and renewed global integration.[5]

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[2] *The End of History and the Last Man*, Francis Fukuyama, Free Press, New York, 1992.
[3] See, for example, *Globalization and its Discontents*, Joseph Stiglitz, Norton, 2002.
[4] *One Economics, Many Recipes: Globalization, Institutions, and Economic Growth*, Dani Rodrik, Princeton University Press, 2007.
[5] Both authors of this paper have served, at various stages in their careers, with the UK Treasury in London and the International Monetary Fund in Washington DC, and have drawn on this experience in writing this paper. The views expressed in this paper are, however, their own and should not be attributed to their previous employers. Prior to joining Chatham House in 2019, Adam Bennett was (from 2012-18) affiliated with St. Antony's College, Oxford, where he was Deputy Director of the program on the Political Economy of Financial Markets. Stephen Pickford has been affiliated with Chatham House since 2010. The authors are grateful to Michela Gariboldi for expert help in preparing tables and charts and sourcing research material.

Prelude to Dissent: the Great Financial Crisis

The last 12 years have been an extraordinary period in international economic affairs. They have seen the first truly global financial crisis, the first contemporaneous recession in the major advanced economies since World War II, and an unprecedented degree of internationally coordinated policy responses, using a new set of tools to address the crisis. But it has been followed by an equally extraordinary response in political affairs, both national and international.

The GFC, the first seismic tremors of which began in 2007, erupted violently in September 2008 and provided the biggest shock to the world economy since the Great Depression in the 1930s. What started as a financial event in one small part of the mortgage market (the sub-prime sector, following the bursting of the real estate bubble) in one economy (the US), rapidly spread across financial markets generally in all advanced economies. Deep interlinkages across financial institutions, markets and countries allowed the impact to propagate quickly. The conductivity of the transmission mechanism was heightened by the securitisation of US mortgages into collateralised debt obligations (CDOs) with AAA credit ratings, defective risk management policies in financial institutions, and the favourable treatment of mortgages in the Basel framework for bank regulation. The main wholesale financial markets froze, and many financial institutions were brought to the brink of – and some of them into – bankruptcy.[6]

The initial policy responses were led by central banks, in particular the Federal Reserve and the ECB. But as the crisis spread governments and national treasuries were brought in to provide extra financial muscle. Congress approved the $700 billion TARP (Troubled Assets Relief Program), and the UK government invested £37 billion in recapitalising three major retail banks. Other major support programmes were put in place in Ireland, Spain, Germany and France (and in many other countries). These national initiatives were quickly followed by an international response, reflecting the global nature of the crisis and the international channels that had been established to deal with such events. Central bank swap lines were put in place, in particular to provide dollar liquidity. And in October 2008, three weeks after Lehman Brothers failed, the G7 agreed a plan of action[7], pledging to 'stabilise financial markets and restore the flow of credit' by:

- using all available tools to support systemically important financial institutions and prevent their failure;
- ensuring that banks and other financial institutions had broad access to liquidity and funding;
- ensuring that banks and other major financial intermediaries could raise capital from public (as well as private) sources;
- ensuring that national deposit insurance and guarantee programs were robust;
- taking action to restart the secondary markets for mortgages; and
- using macroeconomic policy tools as necessary.

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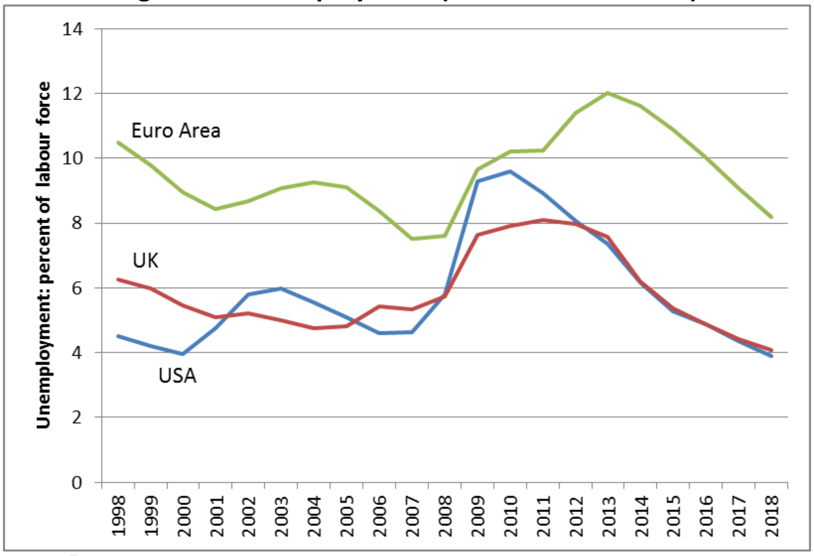
[6] In the US, all the major investment banks were badly affected. In July 2007 Bear Sterns saw its subprime hedge funds fold; in March 2008 it received emergency financing from the Federal Reserve, and was then taken over by JP Morgan Chase. In September 2008 Lehman Brothers filed for Chapter 11 bankruptcy; Goldman Sachs and Morgan Stanley only avoided the same fate by accessing the newly created TARP in October 2008; JP Morgan Chase also turned to TARP, along with a long list of other commercial banks; Merrill Lynch was taken over by Bank of America, which in turn had access to TARP; and Fannie Mae (FNMA) and Freddie Mac (FHLMC) were bailed out by the US government. In the UK a number of smaller mortgage institutions were taken over; one – Northern Rock – experienced the first run on a British bank since 1866; and in October 2008 three major retail banks (HBOS, Lloyds TSB and RBS) were part-nationalised by the government.

[7] G7 Finance Ministers and Central Bank Governors Plan of Action, 10 October 2008, Washington DC.

International collaboration was then broadened by the first G20 summit of heads of state and government in Washington in November 2008, which agreed an Action Plan for financial market reform.[8] In April 2009, a further G20 summit in London agreed a wide-ranging set of actions including: coordinated fiscal expansion measures; a pledge not to introduce new trade protection measures; an extra $1.1 trillion in funding for the IMF and development banks; and the establishment of the Financial Stability Board (FSB) to coordinate further financial market reforms.[9]

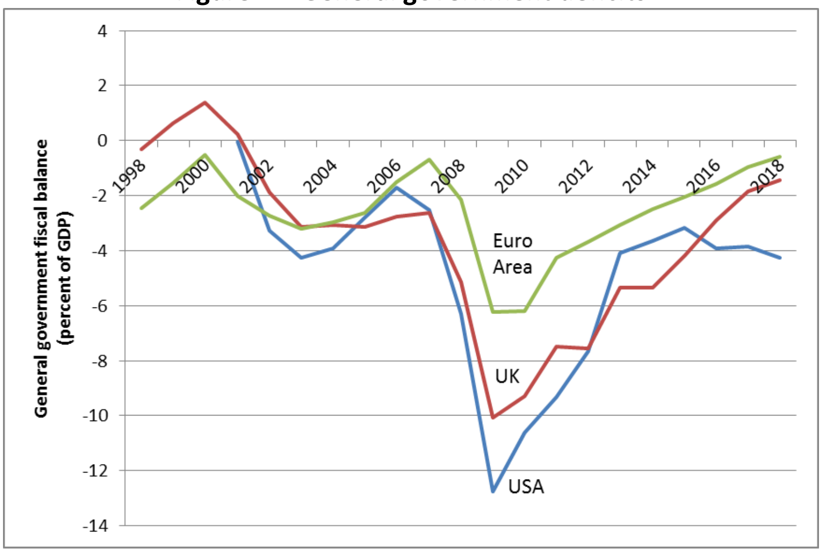
By early 2009, all the G7 countries were in full scale recession with rising unemployment (Figure 1).[10] To counter this, most of these countries loosened fiscal policy substantially: a collective action which was estimated to have provided a fiscal stimulus of around 2 percent of GDP (Figure 2). Meanwhile, central banks, after exhausting their capacity to cut interest rates (Figure 3), began to aggressively undertake quantitative easing (QE) to provide a new kind of monetary stimulus.

Figure 1 – Unemployment (% total labour force)



Source: IMF

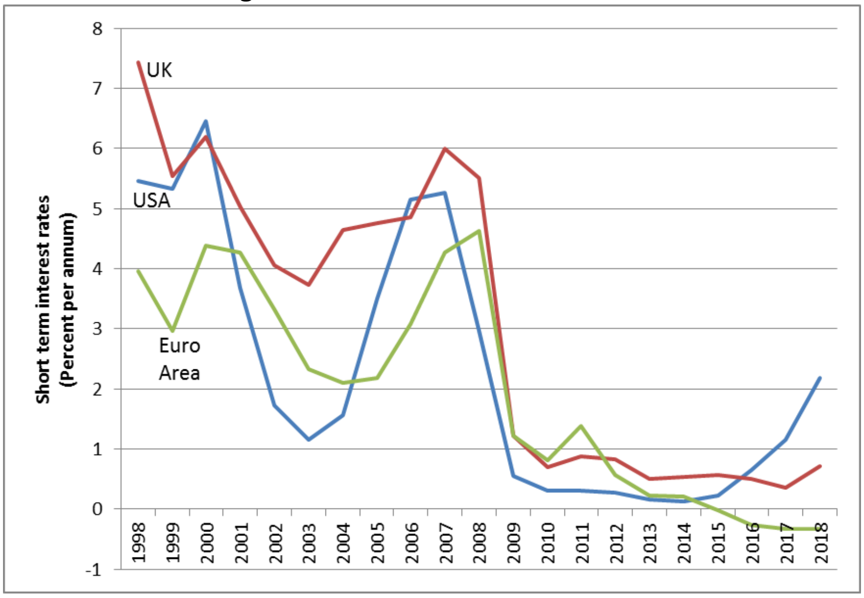
Figure 2 – General government deficits



Source: IMF

[8] http://www.g20.utoronto.ca/2008/2008declaration1115.html
[9] http://www.g20.utoronto.ca/2009/2009communique0402.html
[10] Most emerging markets were relatively unaffected (at least initially) by the financial turmoil, given their less developed financial structures and a lower level of integration into global financial markets.

Figure 3 – Short term interest rates



Source: OECD

As economic activity started to recover in late 2009, the attention of finance ministers turned to repairing the damage wrought on their fiscal balances and debt stocks by the financial sector bail-outs and stimulus measures. The G20 summit in Toronto in late 2009 marked the start of a long period of austerity in fiscal policy.

Against this backdrop, the political reactions have also been far-reaching.[11] The economic situation and policies adopted in most advanced economies have provided fertile ground for resentment and populist politics. This has had dramatic impacts on domestic politics in many countries. The precise form of political change has varied, but some common threads have been evident.

First, in many countries there has been a backlash against what were perceived as the specific groups responsible for the economic problems. The financial sector was criticised for causing the crisis directly, initially through sub-prime lending[12] and then the securitisation of mortgages through derivatives. It also was held responsible for leading to the conservative fiscal policies that were put in place by many governments, to offset the costs of bailing out banks and other financial institutions. Bankers' pay and bonus levels also came in for sharp criticism. The 'Occupy' movement provided one major outlet for these criticisms.

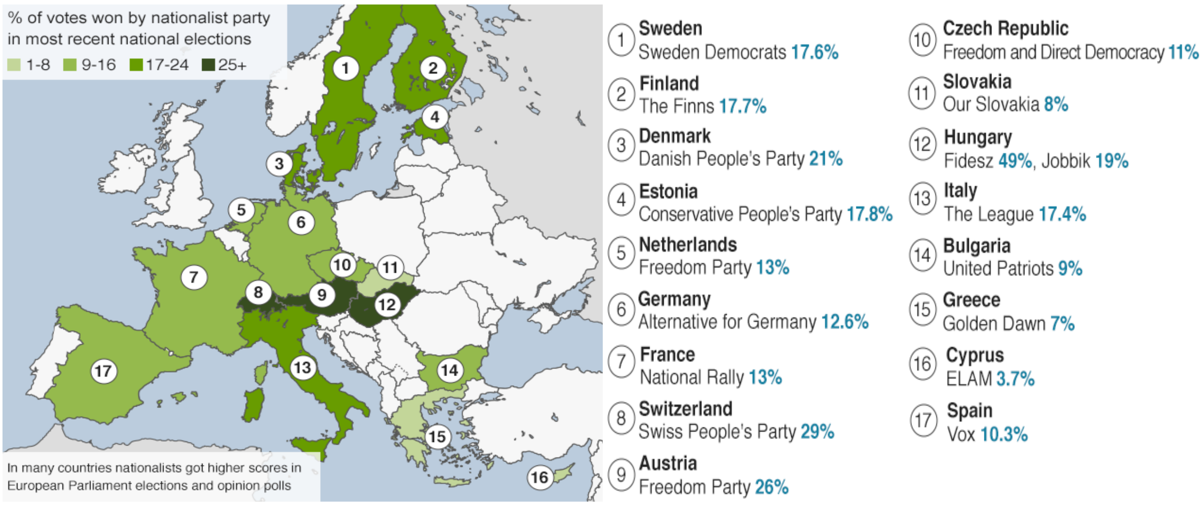
There has also been a backlash in many countries against 'elites' and 'experts'. Those in authority were held responsible for not predicting that the crisis would happen, for not taking action to prevent it, and for allowing bankers to escape relatively unscathed while fiscal austerity affected all sectors of society.

[11] The experience has also provoked a number of plans to "reform" the global economy to avoid a repeat of the crisis. See, for example, *Capitalism 4.0: The Birth of a New Economy*, Anatole Kaletsky, Bloomsbury, 2010; and *The Future of Capitalism: Facing the New Anxieties*, Paul Collier, Allen Lane, 2018, and *Capitalism Alone: the Future of the System that Rules the World*, Branko Milanovic, Belknap Press, 2019.

[12] The movie 'The Big Short' provided a coruscating criticism. The GFC as a whole has undergone extensive academic analysis and spawned a plethora of books and papers. See, for example, *How a Decade of Financial Crises Changed the World*, Adam Tooze, Allen Lane, 2018.

Second, the recession which followed on from the financial crisis has led to a more generalised attack internationally on globalisation, open trade, and immigration. This has been exacerbated in Europe by the sharp increase in migration from Africa and Syria, and in the US by migrants from Central America. Although the precise form of this has been country-specific, the common themes have been about loss of jobs, eroding living standards, and loss of national identity. Just as in the great depression in the 1930s, 'foreigners' have come in for a share of the blame. This has resulted in the rise of populist and nationalist parties in Europe.[13] Although their support seems to have waned somewhat recently, many of these parties made spectacular electoral gains in both national and EU elections (Figure 4).

Figure 4 – Opinion polls, election results



Source: BBC, April 2019.

Two aspects in particular have dominated the populist agenda in recent years:

- the UK's referendum result in June 2016 to leave the EU -- Brexit
- the 2016 election in the US of an administration that sought to restrict immigration, renegotiate trade deals, and draw back from international agreements that were seen as disadvantaging the US – 'Make America Great Again'.

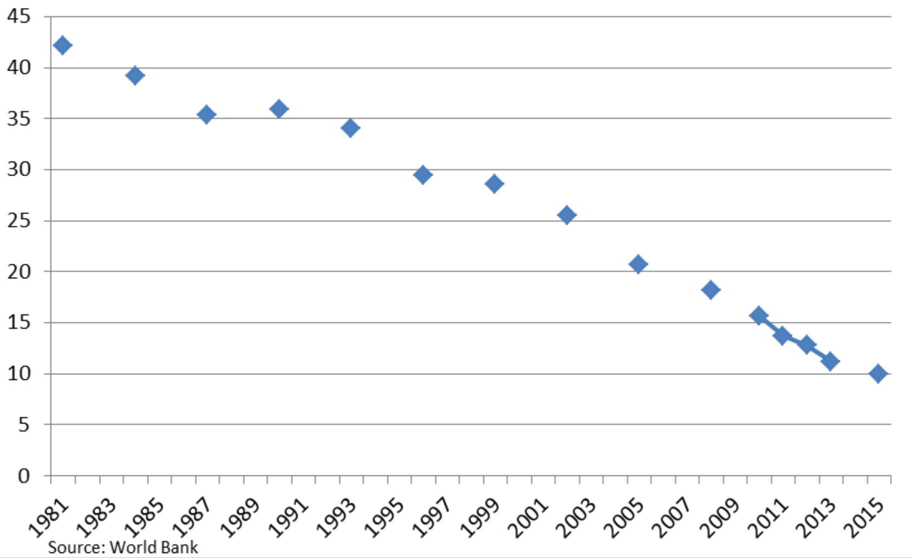
Both of these political events are extreme forms of the anti-establishment and pro-nationalist forces that have gained ground since the financial crisis. And both represent a weakening of support for the post-war trend towards greater global integration and of adherence to internationally agreed rules and norms.

[13] Examples of such allegedly "populist" parties (on both the left and the right of the spectrum) include *Golden Dawn* and *Syriza* in Greece, *Podemos* in Spain, *Front National* in France, the *Alternative für Deutschland* (AfD) in Germany, *Forum for Democracy* in the Netherlands, *Freedom Party* in Austria, *Law and Justice Party* in Poland (which has recently acquired a populist flavour), and *UKIP* in the UK, for example. Many of these parties are new. For an analysis of the rise of populism, see *National Populism: The Revolt Against Liberal Democracy*, Roger Eatwell and Matthew Goodwin, Pelican, 2018, and (with a focus on Central and Eastern Europe) *The Light that Failed*, Ivan Krastev and Stephen Holmes, Allen Lane, 2019.

Prelude to Dissent: falling poverty but rising inequality

The biggest winners from globalization have been (i) surplus capital previously confined to the industrial world and (ii) surplus and under-employed labour in developing countries.[14] Until the early 1980s, most countries in the developed world retained controls on the movement of capital, put in place after World War II to help countries deal with the "dollar shortage" as they rebuilt their infrastructure and industry. Such international capital mobility as existed was initially mainly via official flows (e.g., Marshal Aid, World Bank and bilateral loans, etc.), followed in the 1960s by commercial bank flows. The early 1980s, however, saw the wholesale dismantling of capital controls, with the result that private capital could—and did—flow abroad in prodigious quantities to the most profitable locations[15]. Having been stuck in countries with expensive and heavily unionized labour, capital originating in developed countries could now seek far higher returns in emerging markets—where labour was cheap. This coincided with a new push by the developing world into exploiting the benefits of trade -- most notably China which effectively abandoned (economic) communism in favour of capitalism.[16] The result in these countries was a huge movement of underemployed subsistence labour from the countryside into cities and export-oriented factories, attracted by higher wages. This led to a dramatic fall in absolute poverty levels across the globe (Figure 5). In 1981, 42 percent of the world's population lived on under $1.90 a day (at 2011 prices). In 2015, this had fallen to only 10 percent. This transformation has been especially striking in China, where absolute poverty is expected to have been all but eliminated by 2020.[17]

Figure 5 -- Percent of World Population Living Below the Poverty Line of $1.90 a day (at constant 2011 prices)



[14] Prior to globalization, this surplus labour, unable to tap into the capital of the industrial world, was required to generate the savings needed for investment internally (i.e., to starve)—often with terrible results such as in the misconceived Great Leap Forward in China from 1958-62.

[15] This dismantling of controls formed part of a wave of deregulation that began in the 1980s, spearheaded by new right-of-centre governments in Britain and America. At the same time, income tax rates, especially on capital, were cut. In 1979, the top rate of income tax on unearned income (i.e., from capital) in the UK was 98 percent. By 1988, it was down to 40 percent, in line with the new (lower) income tax on earnings. This in turn increased the incentive to invest and accumulate capital.

[16] These reforms were initiated by Chinese premier Deng Xiaoping, who took power in 1978 and built on the rapprochement with the West started by President Nixon's meeting with Chairman Mao Zedong in 1973.

[17] This global trend is not universal. Countries whose populist governments have driven them into autarky, such as Venezuela or Zimbabwe, have seen poverty levels rising, as have countries mired in civil war, like Syria.

In 1984, President Ronald Reagan, as part of his re-election campaign, announced "It is morning again in America". It certainly was for capitalists. Free to invest wherever they pleased, the return on their capital was set to rocket. Having risen strongly in the 1950s, when the USA was factory of the world, the return on capital had flat-lined since 1960 (Figure 6). But from 1984 until 2008—the onset of the GFC—the S&P 500 index was (including reinvested dividends) to rise tenfold even after allowing for consumer price inflation (i.e., when valued in real terms).[18] While this made a lot of Americans richer, it did so in a very uneven manner. In 1956, Cole Porter wrote a song entitled "Who Wants to be a Millionaire?". This was the measure of the pinnacle of wealth at that time. By the mid-1980s, this metric had become way out of date—the age of the billionaire had arrived. In 1987 there were estimated to be a mere 41 billionaires in the United States. By 2017, thirty years later, the estimated number of billionaires had risen to 585.[19] Even more startling was the estimated number of newly coined billionaires living in China—at 475 only just behind America and in a country still ruled by the Communist Party of China (CPC).[20]

Figure 6 – Inflation adjusted S&P 500

Source: Simple Stock Investing.

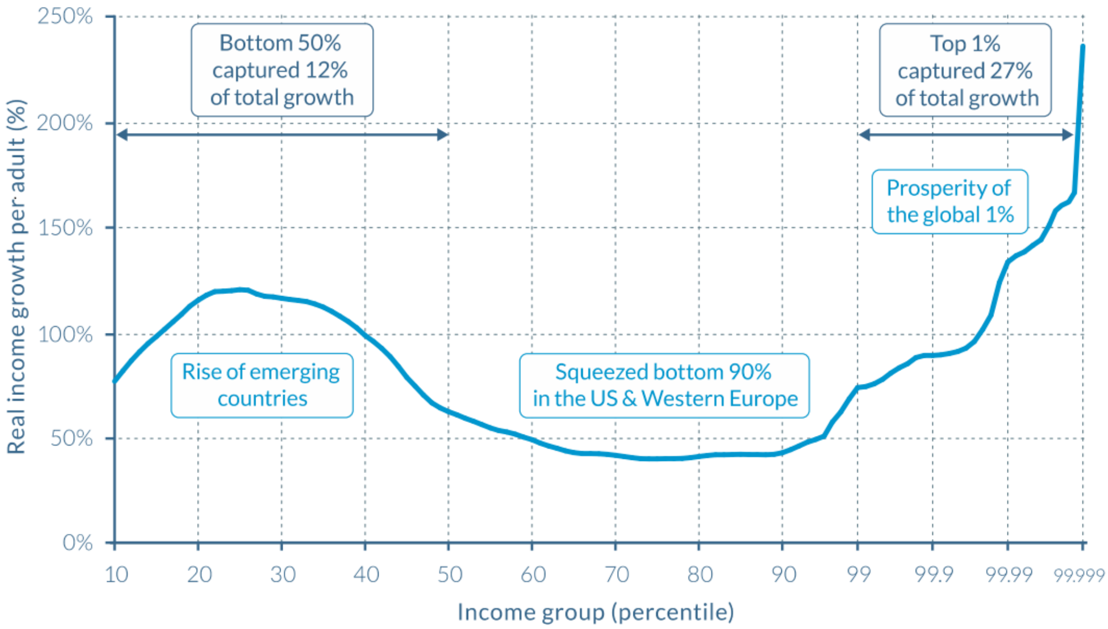
If absolute poverty has been reduced, what about labour income generally? Here the story is more complicated. In China, for example, there is a new prosperous middle class, enjoying a standard of living that their parents and grandparents could only have dreamed of. But they are still only a fraction of the total population. Although absolute poverty has been all but eliminated, GDP per capita in China (2018) is still only around $10,000—well below $45-65,000 in the USA, Europe and Japan. In the developed world, meanwhile, the "professions" and well educated workers in the higher income service sectors have done well, but the old middle classes and manual labour working in factories have not. With the old industrial base upon which their livelihoods depended hollowed

[18] The S&P losses incurred during the GFC have since been fully recouped.
[19] UBS/PwC Billionaires Report 2018.
[20] China recently celebrated 70 years of rule by the CPC, with banners displaying images of Mao Zedong—a man who is reported to have once declared that "The weeds of socialism are better than the crops of capitalism". Not any more, according to the Chinese billionaires.

out by foreign competition from the 1960s through the 1980s, their real wages (but not their aspirations) have largely stagnated. These workers are the true (relative) losers of globalization.[21]

In 2013, Thomas Piketty acquired overnight fame with a book which drew the world's attention to the huge increase in inequality that has accompanied globalization.[22] While the World Bank, and other academics, had already for some time been monitoring and analysing inequality, this book propelled the issue into public debate.[23] Piketty is now a co-author of the World Inequality Lab's annual Inequality Report. The latest report from 2018 includes a chart that elegantly encapsulates the points made above (Figure 7), showing real income growth for various income groups between 1980 and 2016.[24] The biggest gainers have been the top 1 percent—the millionaires and billionaires. The next biggest gainers have been the poorest groups in developing countries—the new middle classes and those lifted out of poverty. The weakest groups are the "squeezed bottom 90 percent in the US and Western Europe". These are the people who now provide fertile ground for populist parties to forge dissent against globalization.

Figure 7 – The elephant curve of global inequality and growth, 1980-2016



Source: WID.world, (2017).

It should not be concluded from this section that globalization is necessarily the sole (or even the main) cause of rising inequality. A key structural problem arises when flawed institutions and regulations (essentially poor governance) allow key actors to acquire the resources needed to allow them to influence the political process in their favour, thereby creating a vicious circle.[25] Either way, rising inequality is contributing to popular disenchantment with globalization.

[21] The dilemma for China is that the trade war with the USA has come at a bad time, leaving the aspirations of many Chinese to join the new middle classes unfulfilled. China will need to look for a new growth model, less dependent on exports—perhaps following the Indian model.
[22] *Le Capital au XXIe siècle*, Éditions du Seuil, Paris, August 2013
[23] In December 2013, President Obama declared income inequality to be "the defining challenge of our time".
[24] "The Elephant Curve" of unequal income growth was first devised by Branko Milanovic in his book *Global Inequality: a New Approach for the Age of Globalization*, Belknap Press, 2016.
[25] See *Why Nations Fail: the Origins of Power, Prosperity and Poverty*, Daron Acemoglu and James Robinson, Random House, 2012. Acemoglu and Robinson argue that the solution is not to halt globalization or apply punitive taxation, but instead to "increase social mobility by providing an opportunity for the bottom to become rich, not forcing the rich to become poor."

Deglobalization: the Gathering Storm

The most tangible consequence of the growing dissent of the last ten years has been a retreat from the long-term trend towards a fully integrated global economy based on adherence to internationally agreed rules and norms. The foundation stones of the global economic and financial architecture that have supported these goals were laid in the last years of World War II, when the Allied powers sought to avoid a return to the isolationism and protectionism, and lack of international cooperation that had characterized the 1920s and 1930s. Following the Bretton Woods conference in 1944 and the UN Charter in 1945, the IMF, World Bank and the United Nations were all established and quickly operational. The General Agreement on Trade and Tariffs (GATT) soon followed in 1948 (and morphed into the World Trade Organization in 1995). The European Union (EU) – albeit a regional European initiative – born out of the ashes of World War II in the form of the Treaty of Paris in 1951 (which set up the European Coal and Steel Community) and the Treaty of Rome in 1957 (establishing the European Economic Community, or EEC) was motivated by similar aims and ambitions.

As the global economy evolved, these institutions also changed, but always respecting the principle of international cooperation. They have survived, adapted to, and (largely successfully) managed the numerous international shocks and stresses over the years since their inception[26]. But the integrity and influence of these institutions and agreements has never been as much in question as it is today, with the election of President Trump in the USA and the Brexit referendum in the UK. It is ironic that the two nations which spearheaded the initiatives for international cooperation in 1944 and 1945 -- the USA and the UK -- are now in the forefront of efforts to reverse the global international order.[27]

(i) Trade tensions

Spurred on by a favourable WTO ruling in 2017 concerning the ongoing dispute between Boeing and Airbus about unfair subsidies, Trump is now imposing substantial tariffs on the EU. He has also attacked Germany's trade surplus, and mused about withdrawing from NATO on the grounds that other member countries aren't paying their share. Not since the end of World War II have relations between the USA and Europe been quite so bad. Meanwhile, the President also threatened to withdraw from NAFTA, describing it as the "worst trade deal ever", thereby forcing concessions from Canada and Mexico. Most significantly of all, he has embarked on a trade war with China. In all of these disputes, his slogan has been "America First" – protectionism designed to appeal to his electoral base, especially in America's hollowed out rust belt.[28] [29]

[26] Including *inter alia* the Cold War (1945-1991), the Korean war (1950-53), the ongoing Middle East Conflict (starting in 1967), the Oil Shock (1973), the collapse of the Bretton Woods system of fixed exchange rates (1973), the collapse of the Soviet Union (1991), and last but not least the GFC (2008).

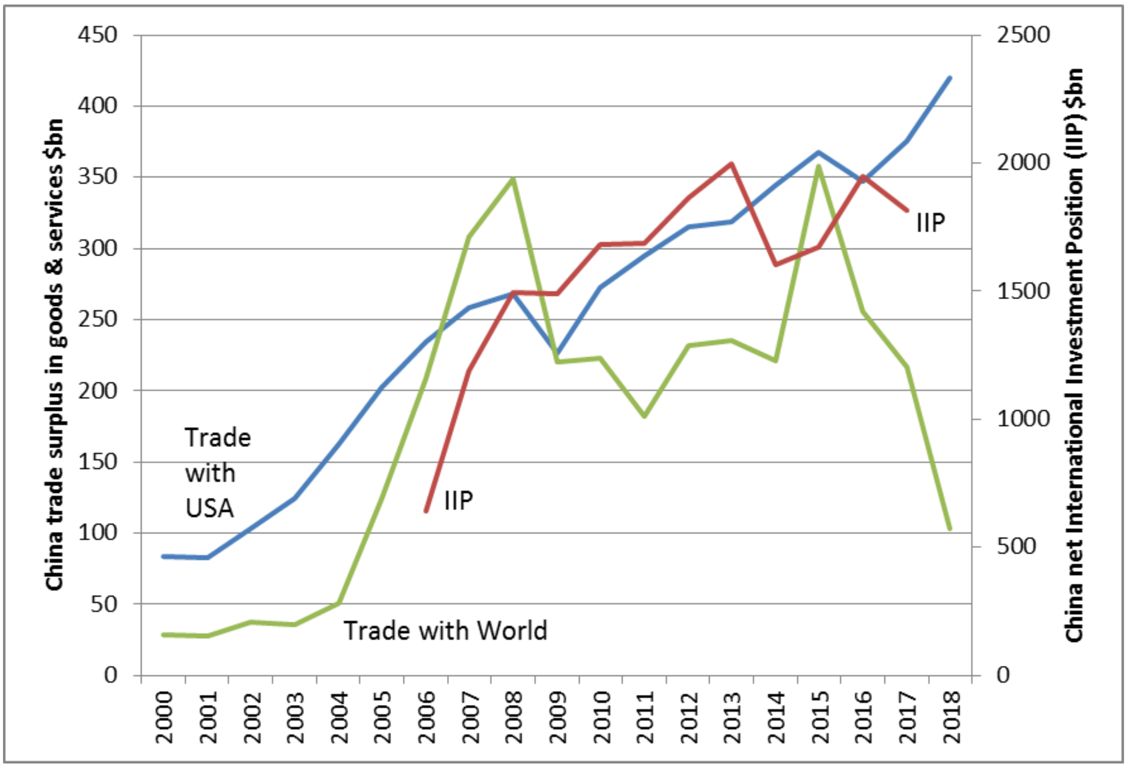
[27] Not content with shaking the international order in the economic sphere, President Trump has also worked to unravel various other international agreements, including the Iran nuclear deal framework, and has signalled his intention to withdraw from the Paris Climate Accord. The Iran nuclear deal framework was agreed between Iran and the P5+1 (Permanent Members of the UN Security Council plus Germany) and the EU in 2015, with a view to controlling Iran's nuclear weapon capacity. The Paris Climate Accord was agreed in 2016 by consensus among all members of the United Nations.

[28] "America First" echoes the *America First Committee* (of which Charles Lindburgh was a prominent member) formed on September 4, 1940 on the outbreak of World War II in support of US isolationism and which was dissolved on December 10, 1941 after the Japanese attack on Pearl Harbour.

[29] The term "Rust Belt" refers to an economic region in the northeast United States, roughly covering the states of Michigan, Wisconsin, Indiana, Illinois, Ohio, and Pennsylvania, a region known as the manufacturing heartland of the nation.

Trade tensions between the USA and China have had a long gestation period - including via the build-up of "global imbalances".[30] Successive US governments have claimed that China was deliberately undervaluing its currency against the dollar in order to gain an unfair competitive advantage. The growing trade surpluses that China ran versus the USA (and globally) in the first decade of this century, combined with the cheapness of the goods it exported, were suggestive of some sort of artificial trade imbalance. The problem for US policymakers was that the very cheapness of imported Chinese goods helped keep inflation low in the USA.[31] The lion's share of China's trade surplus was with the USA (Figure 8). Moreover, while its global surplus has been shrinking since 2016, China's bilateral surplus with the USA has actually increased further.[32]

Figure 8 – China Trade Surplus with USA and World, and China net International Investment Position (US billions), 2000-2018



Source: United States Census Bureau, World Bank, and IMF

[30] China's contribution to "global imbalances" has itself been ascribed a role in generating the GFC. Ben Bernanke, Chairman of the US Federal reserve System (2006-14), asserted in March 2009 that "In my view … it is impossible to understand this crisis without reference to the global imbalances in trade and capital flows that began in the latter half of the 1990s." In October 2009 Maurice Obstfeld and Kenneth Rogoff argued that "countries with current account surpluses faced minimal pressures to adjust. China's ability to sterilize the immense reserve purchases it placed in U.S. markets allowed it to maintain an undervalued currency and defer rebalancing its own economy. Complementary policy distortions therefore kept China artificially far from its lower autarky interest rate and the U.S. artificially far from its higher autarky interest rate. Had seemingly low-cost postponement options not been available, the subsequent crisis might well have been mitigated, if not contained." from *Global Imbalances and the Financial Crisis: Products of Common Causes*, paper prepared for the Federal Reserve Bank of San Francisco Asia Economic Policy Conference, 2009.

[31] This effect thereby arguably misled the Federal Reserve into holding interest rates lower than they should have been (the Obstfeld/Rogoff point in fn. 30) and thereby stoking the property boom that led to the GFC.

[32] Mao Zedong wrote in 1917 about US/China trade "The two Republics East [China] and West [USA] will draw close in friendship and cheerfully act as reciprocal economic and trade partners" and this was to be "the great endeavour of a thousand years", see *Mao's Road to Power: Revolutionary Writings 1912-1949: The Pre-Marxist period, vol. 1, 1912-1920*, New York, (1992), page 104. Mao's later conversion to Marxism ensured that this "endeavour" was somewhat delayed. It was unfortunate for the Americans that it turned out rather one-sided.

It was only when China began to use its massive accumulated foreign savings, or net international investment position (IIP), to aggressively assert its newly ambitious geopolitical objectives – including sovereignty over Taiwan and the South China Sea, and securing access to natural resources – that US policymakers began to worry. At first, they turned to the IMF, which was mandated in its Articles of Agreement to police and pass judgment on unfair exchange rate practices. However, IMF staff – sensitive to the need not to be seen as simply supporting the US hegemon - sought to avoid being caught in a power struggle between two of its largest shareholders.[33] In an effort to get round this dilemma, the IMF's Executive Board approved in 2007 an updated "Surveillance Decision", which required it to intensify its oversight over exchange rate policy, and especially over what it termed "fundamentally misaligned exchange rates".[34] The problem was that it was very hard to define objectively when an exchange rate was fundamentally misaligned. The 2007 Surveillance Decision was effectively abandoned within a year of its approval, and the USA was back to square one.[35] [36]

The onset of the GFC in 2008, combined with evidence that China's real effective exchange rate (driven by a combination of a more appreciated Renmimbi and relatively higher domestic inflation) was beginning to appreciate (Figure 9) while its global trade surplus appeared to go into reverse (Figure 8), diverted the attention of US policymakers away from the Chinese problem towards the more urgent task of stabilizing the global financial system. In doing so, they collaborated with other countries around the world in what was to prove to be one of the last great international concords, through the forum of the G20.[37] Including China and other major emerging markets was seen as an important component in the global response to the GFC, and was one of the reasons why G7 countries signed up to the declaration at the Pittsburgh summit that the G20 was 'the premier forum for our international economic cooperation'. In the global effort at the G20 London summit in 2009 to raise funds for the IMF to aid crisis-affected countries, ensuring that China contributed to the tripling in size of the IMF's NAB (New Arrangements to Borrow) was an important element, both financially and presentationally.

[33] Cracks in the global order were already evident in the proliferation of regional Development Banks during the 1960s, and talk of an Asian Monetary Fund in the wake of the Asian financial crisis in 1997, which were interpreted as efforts to escape the US model underpinning the Bretton Woods institutions in Washington. Notwithstanding a more equitable re-weighting of shares in the IMF and World Bank in 2010, these centrifugal trends continued with the creation of the ESM (a European Initiative) in 2012, the BRICs bank (an Indian initiative) in 2014, and the AIIB (a Chinese initiative) in 2016. Two other bodies designed to provide mutual financial support in balance of payments crisis independently of the United States are the Chiang Mai initiative (for Asian countries) and the Contingent Reserve Arrangement set up by the BRICS countries.

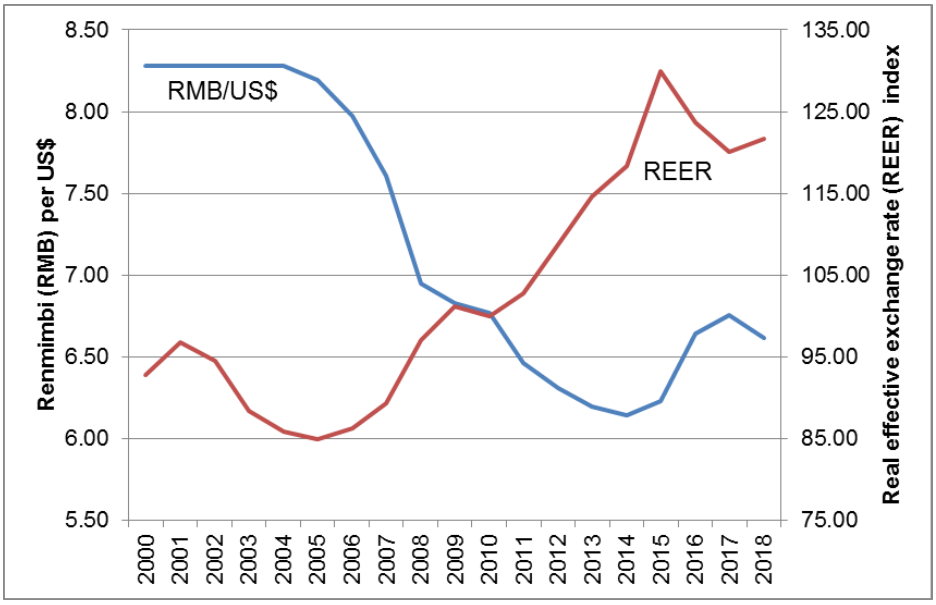
[34] The 2007 Decision on Bilateral Surveillance over Members' Policies updated and revised the 1977 Decision on Surveillance over Exchange Rate Policies, which was itself devised to adapt the IMF's polices to the new world of floating exchange rates following the demise of Bretton Woods system of fixed rates in 1973. The latter became inevitable after the US abandoned its commitment to exchange gold for dollars in 1971.

[35] For the IMF to use this new power to immediately single out China as an abuser put the staff straight back onto the horns of the dilemma they had tried to avoid. The staff decided to point the finger at the Maldives first, so that it would not appear that the new Surveillance Decision was actually an instrument designed to attack China. But to accuse a country with a population of less than 400,000 of orchestrating a predatory exchange rate regime as the precursor to naming China was, of course, palpably absurd. The 2007 Surveillance Decision was formally repealed in the context of the 2012 Decision on Bilateral and Multilateral Surveillance.

[36] The other (related) complaint that the Americans have concerns intellectual property, which US authorities allege is being stolen by China. Intellectual property theft was also a complaint that the British brought against the USA – then a developing country – in the early 19th Century, when American entrepreneurs, supported by the US government, went to considerable lengths to steal British manufacturing technology.

[37] Although the G20 was originally established in 1999, it rose to prominence in 2008 and eclipsed the G7 with a series of summits of heads of state to address the GFC.

Figure 9 – Renminbi/Dollar exchange rate, average period



Source: IMF, International Financial Statistics.

However, the global recovery from the GFC combined with the election of Trump turned the spotlight back onto the US' bilateral trade imbalance with China. Possibly reflecting the bite of US tariffs, China's exchange rate to the dollar began to weaken again in August 2019, prompting President Trump to identify China as a "currency manipulator", explicitly asserting what US policymakers had hoped the IMF would do for them in 2007.

(ii) Sovereignty issues

In Britain, tensions with Europe have a long history, starting with the first referendum on remaining in what was then the EEC in 1975 (called by Harold Wilson leading a Labour government), following the UK joining the EEC in 1973 (a decision taken by Edward Heath's Conservative government).[38] Britain has always had a semi-detached relationship with Europe, half-in half-out and with one eye on its Empire pre-war and then post-war on the "special relationship" with the USA and on its former English-speaking dominions.[39] [40] For the most part, however, the complaint about Europe was less about trade (in which the UK had enthusiastically participated) or the trade barriers surrounding of the customs union, but rather about "sovereignty" – the balance of power between the UK Parliament and the European Commission and Parliament in Brussels. Such complaints became more vocal each time the EU strengthened its political vision of "ever closer union", first with the Maastricht Treaty in 1992 and then the Lisbon Treaty in 2007.

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[38] One of the economic arguments against joining the EEC in 1973 was made by Enoch Powell, Conservative MP, in his book *The Common Market: The Case Against*, Elliot Right Way Books, 1971. In this book he argued, inter alia, that free trade was preferable to a customs union. The sovereignty argument in favour of leaving in 1975 was championed by Anthony Wedgwood Benn, Labour MP, in the Spectator, 18 January, 1975. Then, as now, the Brexit debate spanned traditional party lines. European migration was not, at that time, on the radar.

[39] See *Britain's Europe: a Thousand Years of Conflict and Cooperation*, by Brendan Simms, Allen Lane, 2016, for a history of Britain's relationship with Europe. Despite its imperial ambitions overseas, Britain could never take its other eye off ensuring that there was a balance of power in Europe, essential to Britain's security.

[40] In this respect, the UK is in a similar position to Russia which has also historically had a half-in half-out relationship with Europe (if not with the EU where Russia has always been fully out), with one eye on its Siberian Empire and its Pacific dimension. Europe's current problems with Russia may reflect a lost opportunity to draw Russia into a closer arrangement with the EU in 1991 following the dissolution of the Soviet Union and initial readiness by the successor states to accept the Western economic and governance models.

Margaret Thatcher, soon after she was deposed as Prime Minister, was one of the first to renew calls for a referendum on EU membership centred on the issue of sovereignty, during the debate in the House of Commons on the Maastricht Treaty in 1991.[41] Soon afterwards, James Goldsmith launched the Referendum Party in 1994.[42] UKIP (UK Independence Party) was founded at about the same time, but was of minor significance until the Referendum Party was dissolved on Goldsmith's death in 1997. In 2006, Nigel Farage assumed the leadership of UKIP, and under him the party's popularity rose significantly, gaining 23 percent of the vote in UK local elections in 2013.[43]

The Leave campaign during the 2016 referendum concentrated primarily on calls to "take back control", and was supported by growing worries about inward migration (albeit reinforced with discredited estimates of the financial savings of leaving the EU). As in 1975, the main economic argument in favour of leaving the EU was not protectionist, but rather the opposite – arguing that leaving the EU customs union would allow a much more liberal trading relationship with the rest of the world (as well as escaping the supposed burden of European economic, financial and social regulations). But there is little doubt that the Leave campaign was populist in nature – appealing to the people who felt they did not benefit from being members of the EU or from globalization more generally.[44] And this populism drew strongly on fear of migration.[45]

(iii) Migration pressures

In May 2004, the EU was enlarged to incorporate ten new member states – the majority from Central and Eastern Europe – in what was the largest expansion in the history of European integration. The UK was one of only three existing member states, alongside Sweden and Ireland, to open its labour market to these new EU citizens immediately. They were under no obligation to do so. The majority of the other existing member states opted to impose temporary restrictions, with Germany and Austria applying the maximum permitted seven year delay. Perhaps reflecting the much larger immigration flows from these new members into the UK than had been expected, the British government chose to apply the longer seven year delay to the next EU wave of expansion in 2007 which included Bulgaria and Romania. By 2016, on the eve of the Brexit referendum, immigration into the UK from the rest of the EU (and not just from the new member states) was strong (Table 1).[46] Wage levels were relatively higher in the UK, but also at that time the British economy –recovered from the GFC – was booming and unemployment was low while the rest of Europe was still struggling to emerge from the Eurozone crisis and unemployment was still high.

[41] See *Margaret Thatcher: Herself Alone*, Charles Moore, Allen Lane, 2019, page 769. Once again, the issue crossed party lines, as Thatcher found herself in agreement with Tony Benn, who also pushed for an EU referendum in the same debate, and on the same question of sovereignty.

[42] James Goldsmith (1933-97) was an Anglo-French tycoon active in British politics and knighted by Harold Wilson in the infamous "Lavender List" in 1976. Ironically, he launched the UK Referendum Party shortly after having been elected as a member of the European Parliament for a French constituency. Goldsmith was critical of the trend toward globalization and free trade and advocated Mercantilism and controls on migration.

[43] Nigel Farage (1964-) was elected a member of the European Parliament for South East England in 1999, and he remains a member. After the 2016 referendum, Farage left UKIP (considering it no longer necessary) but in 2019 set up the rival Brexit Party. This party has largely displaced UKIP in the opinion polls.

[44] In an exit poll of over 12,000 voters undertaken by Lord Ashcroft immediately after the referendum, 49 percent of leave voters cited sovereignty as their motivation, 33 percent cited immigration, and only 6 percent voted to leave because they thought the UK would have better trading arrangements as a result.

[45] For an informed discussion of the Brexit saga, see *A Short History of Brexit: From Brentry to Backstop*, Kevin O'Rourke, Pelican, 2018. Being Irish himself, O'Rourke is well placed to explain the single most contentious issue in Brexit—how to reconcile Brexit with the 1998 Good Friday Agreement. This seemingly insoluble conundrum received almost no attention during the referendum.

[46] But there were substantial net immigration flows into Britain from outside Europe as well, especially from the Indian subcontinent.

After the EU referendum, migration to the UK slackened off, while recovery in the Eurozone prompted a rise in migration to its members, more than offsetting the fall in flows to the UK.

Table 1 Migration		Percent change				Stock as percent of local population	
		2005/2000	2010/2005	2015/2010	2019/2015	2000	2019
European Union	Total	21.2	17.7	7.0	13.2	7.2	11.7
	Refugees	-0.1	-0.0	0.5	0.4	0.4	0.6
Ireland	Total	68.0	24.0	3.9	9.8	9.3	17.1
	Refugees	-34.8	49.4	-21.5	10.1	0.4	0.3
Sweden	Total	12.2	23.0	21.0	19.6	11.3	20.0
	Refugees	-46.1	11.7	222.5	-10.4	1.9	2.9
United Kingdom	Total	25.3	20.1	18.1	13.6	8.0	14.1
	Refugees	62.8	-21.4	-34.1	3.3	0.3	0.2
Germany	Total	4.6	4.4	4.2	28.5	11.0	15.7
	Refugees	-22.7	-15.1	24.0	90.0	1.1	1.7
United States	Total	12.8	12.5	9.0	5.2	12.4	15.4
	Refugees	-38.6	-50.7	106.5	66.2	0.3	0.3
Source: UN Population Division							
Note that European migrants includes migrants from within Europe (other states) as well as from outside Europe							

On top of intra-EU migration, the so-called "Arab Spring" movement of 2011, intended to bring peace and democracy, resulted instead in chaos and bloodshed and led to a huge influx into the EU of refugee migrants from North Africa and the Middle East. These flows were felt primarily by Italy and Spain, but under pressure from these countries other member states (especially Germany) agreed to share the burden. Although the UK was not one of them, the Leave campaign in the 2016 referendum made much of the potential of limitless migration into the UK from the EU, including from Turkey (which was not even an EU member, nor likely to be in the near future).

The case for and against unlimited migration has been argued in numerous fora.[47] There is little doubt that the UK economy has now come to depend increasingly on economic migrants. However, migration has now become an EU-wide issue which has fed the rise of populist parties across Europe, although unfettered Freedom of Movement remains one of the sacrosanct Four Principles of the EU.[48]

Migration was also an issue that President Trump focussed on in appealing to his core vote, tapping into the fears of US citizens of a Latin American invasion[49], and campaigned to build a "big, beautiful" border wall between the USA and Mexico. Again, the would-be migrants from Latin America comprise a mixture of economic migrants from Mexico and refugees trying to escape low-income and semi-failed states (mainly in Central America) beset with corruption, violence and crime.

[47] For example, for opposing views see *Exceptional People: How Migration Shaped Our World and Will define Our Future*, by Ian Goldin, Geoffrey Cameron, and Meera Balarajan, Princeton University Press, 2011, and *Exodus: How Migration is Changing Our World*, by Paul Collier, Oxford University Press, 2013.

[48] The 'four freedoms' of the European Union are the freedom of movement of people, goods, services and capital over borders.

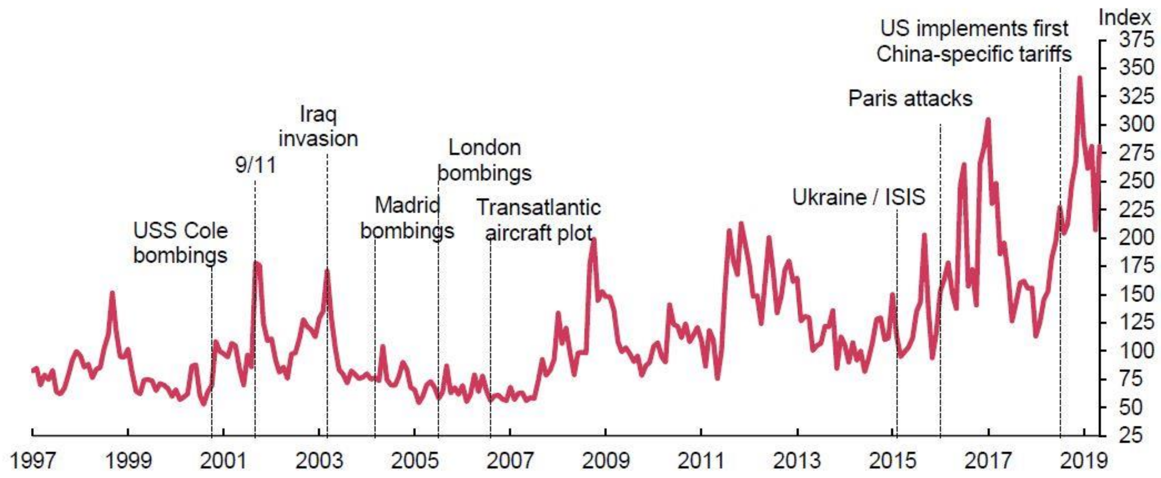
[49] The irony for the USA is that if it is to prevail in its hegemonic 21st Century battle with China, it will in the end need to match China not just in wealth, industry and geographic reach, but also in population. It can only hope to do so by means of immigration. China's population, like Japan's, is expected to decline during the 21st century and – on some demographic projections – nearly halve, on account of its low birth rate. The possibility that the populations of China and the USA (boosted by migration) could converge by 2100 is therefore not wholly unrealistic.

Deglobalization: economic effects and "entrenched uncertainty"

The rapid deconstruction of the established order and principles of cooperation over the last few years, and the uncertainties about future policies that this has generated, have begun to weigh heavily on economic confidence. The most obvious examples of this policy uncertainty are Brexit (where three years after the referendum it is still unclear how or whether Brexit will happen), and trade tensions, especially between the US and China (where new measures can be announced overnight in a presidential tweet).

But it is by no means confined to these two examples. The wider trend towards more autocratic leaders in other parts of the world, including in Russia, Turkey and Brazil, appears to make policy direction more uncertain. U-turns are in danger of becoming the norm rather than the exception. The increase in policy uncertainty in recent years, and especially coinciding with events such as the announcement of tariffs and Brexit, is illustrated by an index by the website-based research group Economic Policy Uncertainty (Figure 10).[50]

Figure 10 – Global economic uncertainty

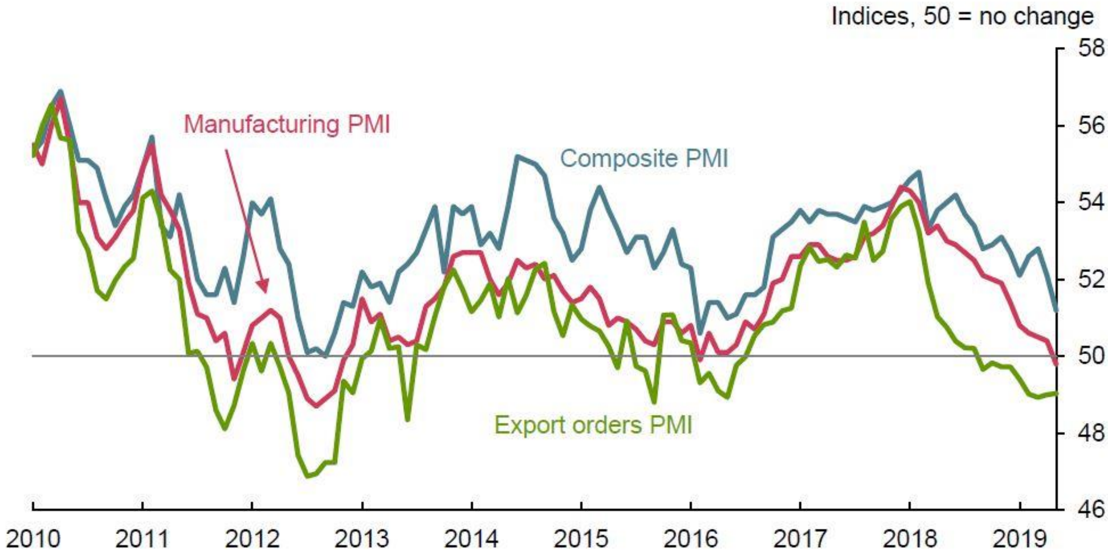


Source: Baker, S, Bloom, N and Davis, S (2015), "Measuring economic policy uncertainty", NBER Working Paper No. 21633.

Economic theory (and common sense) strongly suggests that uncertainty can potentially have significant effects on investment decisions, companies' willingness to hire workers, and consumers' willingness to spend (especially on durables such as cars). It can also have indirect effects on activity through higher cost of finance. Although consumer sentiment appears to have held up relatively well up to now, recent rises in uncertainty do seem to have affected companies' behaviour significantly. Global business confidence has fallen sharply in the last year, as have PMI measures (Figure 11).

[50] Baker, Bloom and Davis, https://www.policyuncertainty.com/

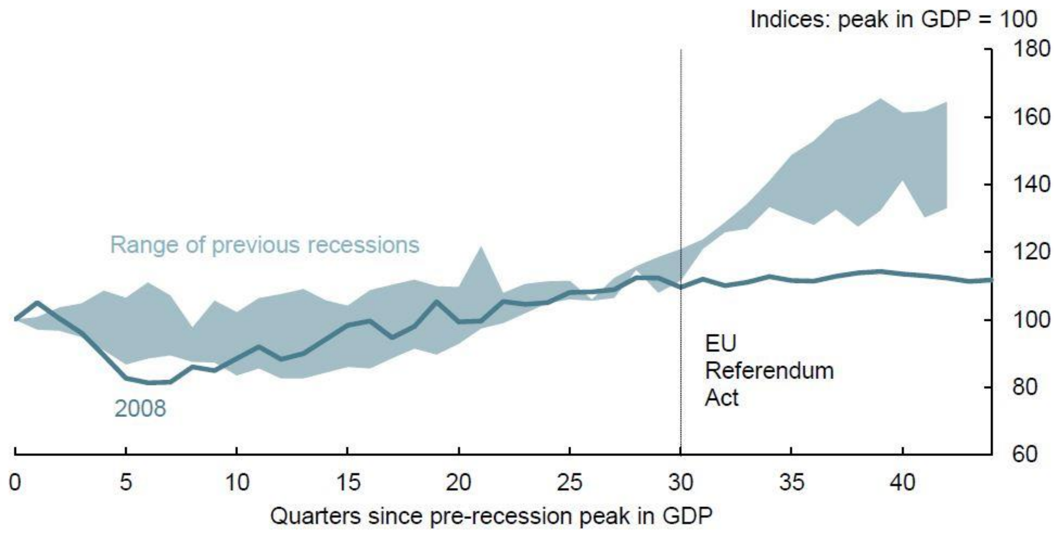
Figure 11 – Purchasing Managers Index (PMI) for the G7



Sources: Conference Board, CPB, European Commission, ECB, Markit Economics, OECD, and Bank of England calculations. Speech by Governor Carney

The Bank of England has tried to quantify the likely economic effects of these shocks.[51] On trade tensions, it estimates that the direct effects are relatively small, lowering global GDP by about 0.2 percent. But if the tariff war was to escalate, the effects could rise further, perhaps to a peak effect of 0.8 percent of global GDP. The Bank has also looked at the effect of Brexit uncertainty on investment in the UK. UK business investment has been broadly flat for the last three years, following the EU referendum (Figure 12). By contrast, past business cycles would suggest that during this period, when the economy should have been recovering from the previous recession, business investment would normally have been booming. The Bank concludes that on average there has been 'a 12 percent hit to UK business investment caused by Brexit uncertainty'.

Figure 12 -- UK business investment underperforms compared with previous recoveries



Sources: ONS and Bank of England calculations. Speech by Governor Carney
Notes: Recessions are defined as at least two consecutive quarters of negative GDP growth. Previous recessions include those beginning in 1973, 1975, 1980 and 1990.

[51] See *Sea Change* Speech by Mr Mark Carney, Governor of the Bank of England, at the Local Government Association Annual Conference and Exhibition 2019, Bournemouth, 2 July 2019.

The overall impact is that global growth has slowed over the last couple of years. The IMF WEO forecast in October 2019 that world growth would have fallen back by 0.8 percent between 2017 and 2019. The IMF's new Managing Director has warned of the risk of a 'synchronised slowdown'.

The picture is not uniformly bleak. For example, unemployment is at near-50 year lows in both the US and UK, and stock markets have been booming. To some extent policy loosening has offset the headwinds, with the US tax cuts of 2017 still having an effect, and monetary policy now expected to be looser, at least in the US, UK and Euro Area. President Trump's claim that the US economy is the 'best ever' therefore has some support. But the consensus among commentators is that further weakening is likely.

Whether these economic effects will persist depends in part on whether these policy uncertainties are resolved, and in what way.[52] The result of the escalating tariff war between the USA and China is that US tariffs on Chinese imports could be hiked to 25% (rising to 30%) on $50 bn of imports, to 10% (rising to 25% and 30%) on another $200 bn of imports, and to 10% (rising to 15%) on a further $325 bn of imports.[53] Chinese tariffs on US imports (which the WTO has validated as a legitimate response) would increase to 25% on $50 bn of imports, to 5% (rising to 10%) on an additional $60 bn of imports, and to 5% (rising to 10%) on a further $75 bn of imports. US tariffs on Chinese imports, and Chinese tariffs on US imports, would both average around 25% by December 2019. As noted above, the net negative impact of this tariff war on global GDP is estimated by the IMF to peak at 0.8% in 2019, bringing global growth down to 3% - the lowest since 2008/9 at the height of the GFC.

As for the UK/EU relationship, Prime Minister Theresa May negotiated a withdrawal agreement that addressed the Irish border issue (the need to avoid customs checks by virtue of the Good Friday Agreement) by keeping the UK as a whole in both the EU Customs union and single market while the UK and the EU explored their future relationship (the "backstop"). This arrangement which prevented the UK from agreeing bilateral trade deals with the rest of the world was labelled BRINO (Brexit In Name Only) and could not pass Britain's House of Commons. Her successor, Boris Johnson, renegotiated the withdrawal agreement to allow the UK to leave the customs union and single market by establishing a customs border through the Irish Sea, leaving Northern Ireland in the EU de facto, if not de jure. Northern Irish MPs could not accept this arrangement, so the result was to call a General Election for December 12, 2019, to try to break the impasse. The EU meanwhile agreed to extend the application of Article 50 to January 31, 2020.

The non-binding political declaration accompanying the withdrawal agreement envisages a future free trade agreement with the EU, but for goods only. Most analyses of the economic effects of such an arrangement, by comparison to the status quo, suggest that it would result in a net loss of GDP for the UK over the medium to long term. According to the think tank *UK in a Changing Europe*, income per capita in the UK could be at least 2.5 percent lower, while income per capita could also be lower in EU, but by less than 0.5 percent (higher in Ireland).[54] The government's own analysis suggests that UK GDP could be 3.4 to 6.4 percent lower, depending on migration arrangements.[55] The IMF has suggested that GDP in the EU 27 could be 0.8 percent lower.[56] It is unlikely that the loss of GDP resulting from the UK's detachment from the EU would be fully made up by trade deals elsewhere.

[52] The debate in the UK over Brexit has become polarised, and analyses and predictions are believed or disbelieved on the basis of whether they support one side of the argument or the other. But most economists are agreed that if the UK were to crash out of the EU without a deal, this would have the big negative impact.
[53] Estimates from the IMF's October 2019 WEO.
[54] *UK in a Changing Europe,* October 2019.
[55] HM Government, *EU Exit Economic Analysis*, November 2018.
[56] IMF, July 2018.

Even if Brexit is resolved in a way which is not too disruptive for Britain and Europe, if the US-China trade tensions calm down, and if no other policy or geopolitical upheavals emerge, it is very likely that the uncertainties of the last three years will have a persistent and long-lasting effect on economic performance. Mark Carney, the Governor of the Bank of England, has referred to this phenomenon as 'entrenched uncertainty'. Part of the reason for this pessimism is that 'trade tensions could be far more pervasive, persistent and damaging than previously expected '; and 'the longer current tensions persist, the greater the risk that protectionism becomes the norm'.[57]

The economic effect of the current high levels of uncertainty could also be more prolonged, in particular through its effect on investment. Business investment produces long-lasting returns, not only financial but also economic. As with all supply-side improvements, the impact on potential growth, productivity and employment are felt over many years. A shock to the level of investment and the capital stock on the scale estimated by the Bank would, therefore, have serious negative effects over many years.

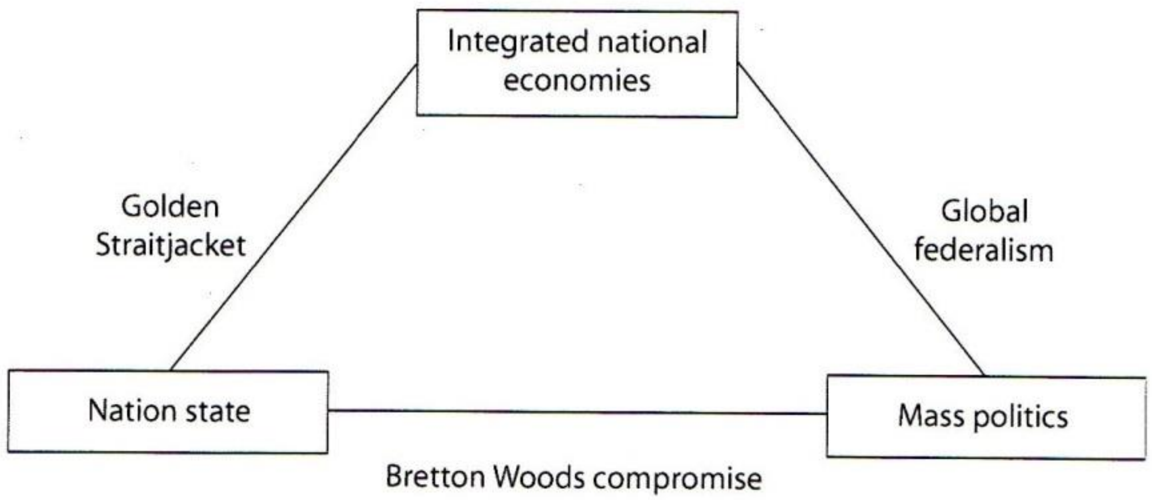
[57] Mark Carney, *Sea Change* speech (op cit).

Making sense of it all: the political economy Trilemma

The present juncture—the conundrum of the benefits from trade and international cooperation combined with the popular political backlash against this (i.e., toward "deglobalization")—can perhaps be best illustrated with reference to Rodrik's Trilemma. The development economist Dani Rodrik formulated the concept of a 'political trilemma' for the world economy, borrowing from the more familiar text-book open-economy trilemma.[58] While originally designed for analysing development growth strategies, the concept of the political trilemma provides some parallels for the political economy trends observed in advanced economies since the GFC.

Under Rodrik's formulation (Figure 13), countries can follow at most two of the following three options: (i) integration into the global economy; (ii) independent sovereign nation-states able to set and enforce their own laws and regulations; and (iii) political systems which are responsive to grass roots and mobilized pressures. For example, full integration with the global economy can be achieved under a system of "Global Federalism" (e.g., with a global representative government) that can respond to grass roots pressure globally. This implies that national governments would have very limited powers to set their own independent laws (perhaps up to the level of US States within the US Federal system of government). Alternatively, global integration can be achieved if nation states—free to set their own laws—do so in conformity with the goal of open international trade and capital flows. If they do so, however, they will necessarily be less responsive to (local) mass politics which may have different objectives. This he calls the "Golden Straightjacket".[59]

Figure 13 – The Political Economy Trilemma



Source. Rodrik (2007), page 200

[58] Rodrik (2007) op cit. The open-economy trilemma that he borrows from states that governments cannot pursue all three policies – monetary autonomy, fixed exchange rates, and capital mobility – at the same time.
[59] Rodrik credits this descriptive title to Thomas Friedman in his book *The Lexus and the Olive Tree: Understanding Globalization*, New York, 1999.

The world is obviously not characterized by the first option (global federalism). Instead, what we had—until ten years ago—was a steady trend (starting in the early 1980s) toward the Golden Straightjacket. More recently, however, we have seen a combination of: (i) resistance on the part of nation states to the drift from the Golden Straightjacket toward Global Federalism, represented most vividly by the UK's objection to the EU's "ever closer union", its refusal to join the Euro, and lately by the Brexit referendum result to leave the EU and "take back control"; and (ii) pressure from mass politics against unresponsive nation states, represented by the rise of populist parties across the Western world, inter alia resisting measures aimed at global integration. On this analysis these trends are pulling us toward what Rodrik terms the "Bretton Woods Compromise".

The "Bretton Woods Compromise" takes us back the world that existed before the 1980s. In his words "The essence of the [former] Bretton Woods-GATT regime was that countries were free to dance to their own tune as long as they removed a number of border restrictions on trade and generally did not discriminate among their trade partners". This was a world that permitted capital restrictions, and allowed tariffs (but discouraged quantitative restrictions). Rodrik credits this earlier regime with enabling the EU to develop according to its goals (including protecting agriculture), Japan to catch up with the rest of the industrial world, China (once it espoused capitalist economics) to follow suit, all deploying tools and restrictions that would now (under WTO rules) mostly be banned.[60] From tariffs imposed during this era, the USA continues to this day to protect its politically sensitive textiles industry.

Should the world go back to the Bretton Woods Compromise? Some regression—at least over the short to medium term—may be inevitable. Even if it succeeds in restoring political stability, it may also be economically costly, the further it takes the world away from a globalized economic system.

[60] Although Rodrik's book was written in 2007, before the GFC, it did contain a particularly prescient observation "One alternative possibility is that an ongoing series of financial crises will leave national electorates sufficiently shell-shocked that they willingly, if unhappily, don the Golden Straitjacket for the long run. Another possibility is that governments will resort to protectionism to deal with the distributive and governance difficulties posed by economic integration."

Globalization: the case for reset and reform

Since the dawn of time, humans have traded with each other. There were enormous benefits from doing so which justified the great risks that traders were willing to take in order to buy, ship, and sell goods across the globe. These benefits enabled traders (and the bankers and insurers who financed them) to become some of the richest people on earth, and certainly (until the era of industrialization) richer than the people who made the goods which they traded.

In 1817, David Ricardo (in London) elegantly explained why this was so, with the classical principle of Comparative Advantage.[61] This principle (which continues to confound opponents of free trade) shows there is an incentive for two countries to trade even when one country's workers are more efficient at producing every single good than workers in the other country. What mattered was whether the two countries had a difference in their *relative* domestic efficiency in producing one good over another. He explained these relative differences (in labour productivity) as being due to different technologies. In 1933 Bertil Ohlin and Eli Heckscher built on Ricardo's theory by predicting patterns of commerce and production based on differing factor endowments (i.e., Capital and Labour) rather than differing “technologies”.[62] The model predicts that countries will export products that use their abundant and cheap factors of production, and import products that use the factors they are scarce in. These two theories continue to underpin (in one way or another) almost all intellectual debate about international trade. Yet neither theory can fully explain actual developments nor the continued popular resistance to free trade in the face of such apparently obvious benefits.

The Heckscher-Ohlin model depends on there being full factor mobility within countries, but none between countries. As these theoretical conditions are relaxed – and conform closer to reality – the model’s predictions regarding trade begin to unwind. Indeed, full factor mobility is required of only one factor, e.g. capital, to negate the results entirely. Both labour and capital mobility have waxed and waned over the centuries, being relatively high in the 19th Century and relatively low in the 20th Century until the 1980s, and then high again thereafter. Nevertheless throughout these periods the incentives to trade have remained. Labour mobility from developing countries has, however, been high enough to create one of the biggest problems of globalization—undercutting wages in the developed world. Mobile capital from rich countries has meanwhile been criticized as a means of exploiting cheap labour in developing countries, exporting goods back to rich countries where people are put out of work, and yet failing to pass on the benefits in terms of higher wages in the poorer countries. These claims are controversial and not always robust when confronted with data, but they have led to pressure for protection by those workers affected in the developed world, as well to calls to slow or stop inward migration.

The case for protectionism in developing countries, meanwhile, is usually made in the form of the “infant industry argument” – that before a developing country can benefit from free trade, it must first build up an industrial base protected from foreign imports until it has secured the necessary economies of scale to enable it to compete internationally. This argument was originally deployed by Alexander Hamilton, the first US Treasury Secretary, in his *Report on Manufactures* in 1790. It is ironic that, from 1816 through 1945, the USA—one of the greatest champions (at least until President Trump) of free trade—had some of the highest tariffs in the world. The other side of the coin for development economists is the mantra of “Export Led Growth”.[63] This model seeks to avoid

[61] *On the Principles of Political Economy and Taxation*, David Ricardo, London, David Murray, 1817.
[62] *Interregional and International Trade*, Bertil Ohlin, Cambridge (USA), Harvard University Press, 1933.
[63] For an elucidation of this theory see, for example, *Economic Growth and the Balance-of-Payments Constraint,* McCombie, J.S.L., and A.P. Thirlwall, New York, St. Martin's, 1994

the balance of payments problems that often plague growth models based on stimulating domestic demand. It is based on the observation that many developing countries have successfully transformed themselves into developed economies by following this two-step model of protection followed by (at least partial) free trade, such as Japan, Korea, and now China. Not all countries fit this model, however, with India being the principal anomaly—being seemingly able to generate rapid growth rates without being overly dependent on exports.

Both the infant industry argument and the export led growth model can be, and have been, abused. The former has been used to justify protection of many industries that will never be able to compete internationally, mainly for the purpose of protecting rent-seeking domestic vested interests. Similarly, the export led growth model has been used to artificially accelerate exports with (opaque) subsidies, so as to destroy or weaken the relevant industry in competitor nations (a sort of reverse of the infant industry tactic). Both of these phenomena have led to appeals by aggrieved nations to the WTO for adjudication. Notwithstanding these various qualifications and problems, the vast majority of theoretical and development economists today continue to argue for the merits of free trade.

Reforms to trading system oversight

As the above suggests, free trade is all very well, but there will be instances of complaint and genuine grievance. For this the WTO, borne out of GATT, and built on the presumption of a gradual dismantlement of tariffs over the medium to long-term, has developed as a successful forum for the settlement of disputes. Indeed, by virtue of WTO membership, a nation with a complaint is obliged to seek adjudication by the WTO rather than take unilateral action. The WTO's dispute settlement system is one of the most active international adjudicative mechanisms in the world today. President Trump has complained that the WTO's dispute settlement system was biased against the US (despite the evidence showing that the US wins the vast majority of disputes it brings against other countries, while other countries typically lose most of the cases brought against the USA). Nevertheless, most commentators agree that the WTO is failing. It is not providing a forum for multilateral trade agreements, and has not done so since the collapse of the Doha round.[64] And it is increasingly proving unable to police the existing set of rules.

The failure of its dispute settlement function is primarily due to the US blocking new appointments to the appellate body.[65] But at heart there are deeper problems: its failure to adapt to the new trade realities of global value chains, the dominance of services, and the role of state-owned enterprises in trade; and its inability to make progress on new trade deals because of its principles of decision-making by consensus and the 'single undertaking' (whereby nothing is agreed until everything is agreed). Even without the current US administration's attempts to bypass and undermine the WTO, these are serious problems. It is therefore not surprising that countries have increasingly been resorting to bilateral and plurilateral trade agreements (for example EU-Japan and the 'comprehensive and progressive TPP').

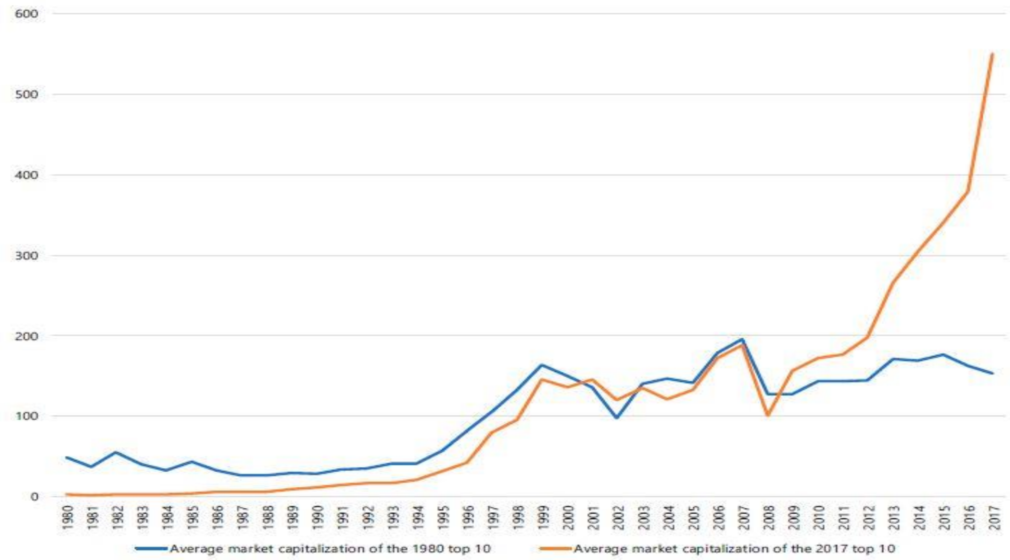
[64] The "Doha Development Round" of multilateral trade talks - aimed at reducing tariffs around the world – began in November 2001, but stalled in 2008 without agreement. Little progress has been made since then.
[65] The WTO's dispute settlement process is seen as one of its most effective parts. But its appellate body, which makes rulings on the interpretation of WTO rules which are binding on members, is facing a crisis. There are normally seven appeals judges, and requires a minimum of three judges to make rulings. The US (which has a veto) has been blocking new appointments to the appellate body for nearly two years, and as the terms of office of judges have expired new members have not been appointed. There are now only three judges in office, and two of them see their terms expire in December. At that point the appellate body will cease being able to function, unless the US reverses its stance. See *The Dispute Settlement Crisis in the World Trade Organization: Causes and Cures*, Tetyana Payosova, Gary Clyde Hufbauer, and Jeffrey J. Schott, Peterson Institute for International Economic, Policy Brief 18-5, March 2018.

Many proposals have been put forward to reform the WTO. But to succeed they require two major changes. Firstly, there needs broad agreement on how the WTO can make progress on adapting to the new realities (including contentious issues such as whether China's dependence on state-owned enterprises precludes it gaining market economy status, and whether emerging markets should still have developing country status – as ten of the G20 members currently do). And secondly there needs to be fundamental reform of the WTO's decision-making processes, which currently prevent any meaningful progress on big issues. A reinvigorated WTO will be essential to strengthen the 'rules of the game' for international trade and to prevent the global trading system from fragmenting further. But neither of these changes is likely to happen unless and until its major members (especially the US) are prepared to work together to make the WTO more effective and relevant.

Tackling the tech giants

There is one dimension of free trade which has, however, renewed a problem in the 21st century not seen since the end of the 19th Century. Up until recently, free trade had primarily concerned trade in goods. Even in the European Union, of the Four Freedoms, freedom of services (of particular interest to the UK) remains an unfulfilled goal. Yet some service providers have now grown into global juggernauts even greater than the more established industrial giants like General Motors, Boeing, or Exxon. These are the companies like Amazon, Apple, Facebook, Google (now owned by Alphabet), Microsoft, and Netflix that are sometimes known as the "trillion dollar companies" or referred to as the 'FAANGs' (Figure 14).[66] Like the old railroad, steel, and oil magnates (the "robber barons") of the 19th century, these new global service providers have acquired – by a combination of being first into the market and economies of scale – a dominant global market share in their particular sector. In other words, they are world monopolies.[67] Their founders have meanwhile accumulated unimaginable wealth.

Figure 14 – The World's Ten Largest Companies in 1980 and 2017



Source: Corporate Taxation in the Global Economy, IMF Policy Paper, January 2019.
Note: Average market capitalization of the largest 10 companies in 1980 and 2017. The largest in 1980: Exxon Mobil, General Electric, Coca-Cola, HP, IBM, Walt Disney, Eastman Kodak, Ford, Intel, and du Pont. The largest in 2017: Apple, Alphabet, Microsoft, Amazon, Facebook, Tencent, Berkshire Hathaway, Alibaba, Johnson & Johnson, and JPMorgan Chase.

[66] Apple is the only FAANG to have yet achieved (in 2018) a market capitalization of over one trillion US dollars.
[67] For a discussion of the power of monopolies in the modern economy, see *The Myth of Capitalism: Monopolies and the Death of Competition*, Jonathan Tepper, Wiley, 2019. The 19th Century "robber baron" monopolies were broken up by the introduction of anti-trust legislation in the United States, starting with the Sherman Antitrust Act in 1890.

These global companies have also emerged as almost unaccountable to anyone – even to governments.[68] The inability, among other things, to satisfactorily bring these new trillion dollar companies into the national corporate tax net of the countries in which they operate and where they generate (but do not book) their profits, and the scandals with which they have been associated (such as the unauthorized harvesting of data and its improper use), point to an urgent need to agree an international order—including a revised common international corporate tax code—to curb the power of these organizations.

Companies, especially those operating multinationally, have become expert at minimising their global tax bills. The attention of tax authorities has been focussed on a number of high-profile cases, including the new tech giants discussed above, such as Apple, Amazon and Google. The European Commission has, for example, taken the government of Ireland to the European Court of Justice (ECJ) in order to force the country to recover from Apple some €13bn in what the Commission considers illegal state aids. The IMF estimated that corporate income tax rates in advanced economies have collectively declined from 50 percent in 1980 to 25 percent in 2016; and global revenue losses from tax avoidance through profit shifting could be as large as $650bn.[69] The current international tax treaty system still reflects the principles and structures developed in the 1920s by the League of Nations, under pressure from US and UK multinationals anxious to avoid double taxation. But these principles were developed in a world economy in which international trade was largely in goods and international communication was slow. They are ill-suited to the modern globalized—and digitalized—economy of the 21st Century.

One route to avoid paying tax has been by booking profits in low-tax jurisdictions.[70] Digitalisation has made it more difficult to determine where economic activity is physically located. A major reason why companies have been able to minimise their world-wide tax bills is because differences in national corporate tax regimes and definitions across countries inevitably create loopholes. Countries also continue to offer companies favourable tax treatment to attract the investment and jobs they bring. This has created incentives for corporations to shift profits into low-tax jurisdictions and exploit offsets and allowances such as on intra-company interest payments. This problem can only be solved by international cooperation. However, countries jealously guard their 'sovereignty' over tax policy. Even within the EU, only limited progress has been made on tax harmonisation, and tax matters are still decided by unanimity rather than qualified majority voting, which greatly reduces the chances of agreement.

In 2013 the G20 recognised the need for tax harmonisation at the St Petersburg summit, and commissioned the OECD to work on Base Erosion and Profit Shifting (BEPS), and tackling tax avoidance to protect countries' revenue bases. Based on the principle that profits should be taxed where they are generated, the BEPS programme was designed to reduce the ability of multinational companies to shift profits to low tax jurisdictions, and to cut their tax bases, for example by manipulating capital allowances. Nevertheless, despite regular commitments by G20 members to implement the 15 agreed BEPS actions, peer review mechanisms are still only now being put in place to monitor compliance. Without high-level political commitment, progress has remained slow and hampered by national interests. In particular, the US has tended to see any moves against big US

[68] In this unaccountability they share a feature not seen since the 18th Century – like that of the East India Company which the British Government struggled to control and when it eventually did so inadvertently created the British Indian Empire – testament to how huge this company had become.

[69] *Corporate Taxation in the Global Economy*, IMF Policy Paper, January 2019. This report contains an in depth analysis of the problem of global corporate tax avoidance.

[70] For example, profits can be funnelled from the country where the service is provided to lower-tax jurisdictions in the form of royalties, franchise fees, and other charges.

multinationals and their aggressive tax avoidance strategies, as an attempt to erode their competitive advantage and thereby against US interests.

On October 9, 2019, the OECD issued a Public Consultation Document on the BEPS initiative.[71] The proposal would re-allocate some profits and corresponding taxing rights to countries and jurisdictions where multinational corporations have their markets, as opposed to having a physical presence. It envisages the creation of new rules stating (1) where tax should be paid ("nexus" rules) and (2) on what portion of profits they should be taxed ("profit allocation" rules). This is an important first step toward developing a long overdue internationally agreed set of principles on the reform of international taxation, and should help avoid the proliferation of *ad hoc* measures such as sales taxes to counter avoidance.[72] The aim is to outline the new architecture by January 2020 and agreement by consensus of the OECD's membership of the end of 2020.[73]

Retuning the IFIs

Of the two international financial institutions (IFIs) with global representation, the World Bank and the IMF, the latter found itself marginalized during the run-up to the GFC by the apparent stability of the global financial system during the first seven years of the new century.[74] With no country borrowing from it, the IMF was left only with its (crisis prevention) surveillance duties, primarily through its annual Article IV Consultation process. The institution (under pressure from its major shareholders) undertook a major downsizing operation in 2007 and early 2008, reducing its payroll by some 20 percent and reconfiguring its business model toward purely providing advice (technical assistance) and surveillance.[75] No sooner had it done so, when the GFC (which blindsided the IMF just as much as the rest of the global policy making establishment) exploded onto the scene. The GFC was a very costly global disaster, but it did reestablish the IMF as the lender of last resort for countries in crisis.

The IMF's record in predicting crises is no better than any other organization. Its unique and well proven function in the global economic and financial system is rather in crisis resolution, traditionally employing its flagship instrument the Stand-by Arrangement supporting economic adjustment programs. IMF adjustment programs have often been criticized as being unimaginative, "one-size-fits-all" austerity packages, but these characterizations are often wide of the mark. The IMF acronym used to be mocked with the moniker "it's mostly fiscal" with reference to its apparent obsession with fiscal adjustment; but until the onset of the world's 'first 21st Century crisis' in 1995 – as Michel Camdessus termed Mexico's "tequila" crisis – the economic problems of the countries that came to it for help did indeed typically have a mostly fiscal origin.

With financial sector stresses coming increasingly to the fore in subsequent crises, the IMF turned its attention to these issues, beefing up the department that handles banking and financial matters and instigating regular financial sector reviews (called Financial Sector Assessment Programs) as a form of crisis prevention surveillance in parallel to the regular Article IV process. Responding to criticism

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[71] "*Secretariat Proposal for a "Unified Approach*" under Pillar One, OECD, October 9, 2019.
[72] Sales tax measures have been floated by the UK, France Italy and India, as well as the EU for its membership.
[73] Beyond the specific elements on reallocating taxing rights, a second pillar of OECD work aims to resolve remaining BEPS issues, including ensuring a minimum corporate income tax on the profits of multinational corporations. This will be discussed in a public consultation foreseen to take place in December 2019.
[74] Gordon Browne (UK Chancellor of the Exchequer and later Prime Minister) famously reiterated his oft-repeated statement that there would be "no return to boom and bust" in his March 2006 budget speech to the House of Commons. These were words he was soon to regret.
[75] IMF income for paying salaries and covering its operating costs derive from the small margin earned between its lending rate and the rate it pays on equivalent funds borrowed ("purchased" to use the IMF's obscure terminology) from its creditor members. No lending means no income.

about the intrusiveness of its adjustment programs during the Asian financial crisis in 1997, the IMF scaled back its structural conditionality and abolished it entirely (in its strictest form) in 2009. While many academics continue to complain about the Fund and its part in the Washington Consensus, it is not clear what would be put in its place.[76]

One criticism which has become widespread is the dominance of the USA, and more generally of Western European countries, in IMF management, quota shares and representation on the Board of Directors. This is a governance problem which increasingly undermines the perceived legitimacy of the institution (and of its sister the World Bank) as a global institution. Since the inception of the IMF and World Bank, their heads have effectively been chosen by the US and European countries, with the result the World Bank president has always been an American, and the IMF managing director a European. This convention has been challenged by emerging markets, but the US and Europe have always had sufficient voting power and influence to ensure that their nominations have been appointed. The recent appointments of David Malpass at the Bank and Kristalina Georgieva at the Fund continue that tradition. But the convention ensures that the appointments process is an essentially political one, and one which is geographically confined—which rules out eminently qualified candidates if they are not American or European citizens.[77].

On quota shares, the charge that the IMF has been dragging its feet is less strong. There has been significant movement in quota shares over the years.[78] In 1958, prior to the 1st Review of Quotas, the US quota share was 30 percent (its original share in 1946). Now, following the 14th Review of Quotas (initiated in 2010 and effective in 2016) it is down to 17 percent (though still just large enough to uniquely give the US a veto on substantive policy or constitutional issues). The UK's 1958 quota share was 14 percent. Now it is 4 percent (equal to that of France). And China is now the third largest shareholder. While efforts to bend the IMF's quota system to favour more diversity have been reasonable, if emerging market countries continue to grow substantially more quickly than advanced industrialised countries, the redistribution of quota shares towards them will have to resume in the next Quota Review.

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[76] The term "Washington Consensus" was first coined by John Williamson in *What Washington Means by Policy Reform*, in Williamson (ed), *Latin American Readjustment: How Much has Happened?*, Washington DC, Peterson Institute for International Economics, 1989.

[77] The presumption had been that US and European countries would usually represent creditor countries in the system, rather than countries seeking assistance. This changed in 2010 with the Eurozone crisis, which created a clear conflict of interest where the then Managing Director of the IMF—a European known to have ambitions to the French Presidency—was overseeing IMF financial assistance for some members of the Eurozone (of which France was also interested participant). It could be said that this conflict of interest led the IMF to support a program (for Greece in 2010) that it knew would be unsustainable, violating an established IMF policy that would normally have ruled this out.

[78] The quota formula used to help determine quota shares has been adapted from time to time, though not extensively, to allow for anomalies. The traditional quota formula was based on a weighted average of measures of GDP, trade openness, variability of the balance of payments, and reserves. Small open economies thereby tend to get a relatively larger quota share compared to large closed ones than they would if shares were based on GDP alone. The GDP component was initially measured in market value terms, but it is now itself a weighted average of 60 percent market value, and 40 percent purchasing-power-parity, in order to give China a greater weight than it would otherwise have had. It could be argued that this ploy was itself a confirmation of China's exchange rate undervaluation (the US complaint). If China's exchange rate were more realistically valued, it wouldn't need to use purchasing power parity to boost its quota share. Conversely, it could be argued that it is a country's market value that matters for financial metrics (and therefore for membership of a global financial institution), rather than a hypothetical valuation based effectively on equating the cost of a Macdonald's hamburger in China versus the USA.

Strengthening the structure of the EU

Narrowing the focus to the regional level, the EU remains a key forum for international cooperation between European member states. Alongside the GFC, the EU had its own home-grown crisis in the form of the Eurozone crisis. The seeds of this crisis were sown in the pursuit of European Monetary Union (EMU), whose final phase -- the introduction of the Euro – was launched before the necessary preconditions for its success were in place. The evidence of most currency unions is that they rarely work unless a system is in place to make transfers to offset asymmetric shocks and to prevent the less competitive parts of the union – having lost the ability to adjust their exchange rates - from falling into relative poverty and unemployment. Thus, in the UK, the central fiscal authority redistributes revenues collected from more prosperous parts of the union (i.e., England) to less prosperous parts (Wales, Scotland and Northern Ireland). Similarly, Northern Italy subsidizes Southern Italy, and West Germany subsidizes East Germany. But there was – and remains – no such mechanism at the level of the Eurozone.

The Europeans have done much to bolster their EU and Eurozone wide institutions in the wake of the Eurozone crisis, in particular through the Banking Union. But making progress towards “Fiscal Union” remains elusive.[79] While there are currently mechanisms to redistribute at the EU level from richer to poorer regions, the amounts involved are negligible. The total EU budget is only around 1 percent of EU national income, mainly financed by direct contributions from member states. Of this budget, only around one-third is spent on explicit means of redistribution from richer to poorer areas, through the regional development fund and the cohesion fund. These funds provide support amounting to only 3 percent of Greek GDP, one of the poorest members of the Eurozone. In the UK, by comparison, fiscal transfers to Scotland, Wales and Northern Ireland are equivalent to 6, 11 and 22 percent of their GDP, respectively.[80] In the USA (during 1990-2009), the richest 20 states subsidized the poorest 20 states by the equivalent of 7 percent of the latter’s combined GDP through Federal transfers, and by over 12 percent in the four very poorest states (including Puerto Rico).[81]

As with the IMF, the EU needs to revisit the power structures within it and the means in which that power is exercised. At present, the exercise of power reflects a delicate balance between the member nation states, the European Commission, and the European Parliament. And among the member states there is an imbalance between their economic power – which is concentrated in France, Germany, and (until Brexit) the United Kingdom. Of these, Germany is the most economically powerful of all and the country with a huge trade surplus (offsetting the total deficits of all the other member states) and large fiscal surplus. Unless Germany agrees to some form of fiscal union – and so far it has been strongly opposed since it will inevitably be the principal paymaster – then these reforms will not take place, with the risk that the Eurozone might fail in the end – and with it quite possibly the whole European Union.

Europe also needs to find some way of absorbing the inevitable flow of migrants from the Middle East and North Africa. Demographically, with an aging population and low birth rate, Europeans will need to accommodate inward migration to lower the average age of its citizens, stay competitive

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[79] The case for Eurozone fiscal union was made forcefully by Emmanuel Macron at the Sorbonne University, Paris, in September 2017, following his election to the French Presidency. Although Angela Merkel was lukewarm to his ideas, they were subsequently endorsed by the outgoing ECB President Mario Draghi (Financial Times interview, September 29, 2019). The IMF has also recommended a degree of Eurozone fiscal union in order to bolster the monetary arrangement’s resilience to shocks,

[80] These transfers result from a redistributive system based on the so-called “Barnet Formula”.

[81] Calculated using data from the US Census Bureau, the Internal Revenue Service, and the Economist magazine (August 1, 2011)

and finance their pension bill. The problem is to demonstrate the economic benefit from migration, at a time when standards of living are stagnant, exacerbated by the lack of an internal fiscal stabilization mechanism.

Investing in people

Narrowing the focus down further, to the country level, Europeans are faced with the dilemma that one of its richest and largest members is poised (perhaps) to leave. Why is this happening? Aside from the ideological arguments about sovereignty, as well as the concerns about migration, one of the motivating factors behind the vote to leave was a revolt against the establishment by those sectors of society who feel that they have not benefited from European integration, or from globalization more generally.

Most members of the 'establishment' in the UK are well educated to the tertiary level. A university education brings higher salaries at home, and globalization allows graduates the mobility to enable them to get the best return from their human capital, whether it be in London, Frankfurt, New York or Tokyo. They have become citizens of the world.[82] For them the European Union – through freedom of movement – has been an enormous benefit.

For those without tertiary education, the experience of globalization, and EU membership in particular, has been rather different. These include, for example, the plumbers, shopkeepers, and other semi-skilled workers without degrees, and more generally the three-quarters of the baby boom generation which did not receive a university education, prior to the expansion of higher education from 1999 onwards.[83] The real take home pay of this lesser-educated cohort may have stagnated since the onset of the GFC, but it still remains high relative to the majority of countries in the EU, reflecting the relative strength of the UK labour market compared to the EU as a whole. These people are much less likely to be offered high paying jobs abroad. Moreover, freedom of movement within the EU has meant that their wages have been undercut by cheaper migrant workers from abroad, e.g., Poland or Romania, who *are* readily offered jobs abroad.

Most surveys of Brexit voting have found that the more highly educated the voter, the more likely they were to have voted Remain (Table 2). Findings that people from higher social grades, or younger people, tended to vote Remain (Table 3) almost certainly reflect the fact that these groups also have a higher level of education than those who voted Leave. This is the dilemma of developed countries seeking to benefit from globalization: how to protect those left behind—especially the less well educated—who cannot compete with cheaper foreign labour but do not have the skills to move up the job ladder or into new industries or sectors.

[82] In her inaugural speech to the annual Conservative Party conference on October 5, 2016, Prime Minister Theresa May referred to such "citizens of the world" as "citizens of nowhere". This was a criticism which stung because it contained an element of truth: globalization has softened nationalist allegiances amongst the elites that most enjoy its benefits.

[83] Prime Minister Blair announced in 1999 that his government would aim for a target of 50 percent of school leavers to enter tertiary education by 2010. In fact, it took somewhat longer than this—the target was only reached in the 2017-18 academic year.

Table 2 Brexit referendum exit poll:
percent voting for Remain or Leave based on education level

	Education level					
	No formal education	Primary school	Secondary school	University degree	Higher degree	Still being educated
Remain	18	28	36	57	64	81
Leave	82	72	64	43	36	19

Source: Ashcroft Polls (24 June, 2016)

Table 3 - Brexit referendum exit poll:
percent voting for Remain or Leave based on age and social grade

	Age					
	18-24	25-34	35-44	45-54	55-64	65+
Remain	73	62	52	44	43	40
Leave	27	38	48	56	57	60
	Social grade					
	AB	C1	C2	DE		
Remain	57	49	36	36		
Leave	43	51	64	64		

Source: Ashcroft Polls (24 June, 2016)

So what is the answer to this problem? The answer (in the UK at least) may well be to expand higher education yet further, from a target of 50 percent of school leavers to say, 70 percent. It may also be the answer in the USA. But this may not be a universal formula, for example in some European countries, such as Greece, which have a chronic problem of graduate unemployment. Each country must therefore look to its own particular circumstances to find ways to protect those “left behind”, to help them make the most of globalization in their own way. Unless this can be done, there is a real danger that globalization—which has raised global income and wealth significantly but unequally—will unravel and the world could turn back to an inward-looking and protectionist place as was seen in the 1930s.

Conclusion

This paper has explored the origins of popular discontent with “globalization”. it argues that the rise of “populism” owes much to the after-effects of the Great Financial Crisis, especially in Europe. The world has also seen a major increase in the inequality of the distribution of wealth and income, especially within countries (especially in the USA, China and India, but also evident elsewhere). Globalization has led to spectacular gains for those at the very bottom and top of the income scale, but in developed countries this has led to the stagnation of the incomes of those in the middle. These are the “left-behind” who currently are most opposed to globalization.

The paper employs the political-economy trilemma developed by Dani Rodrik to illustrate the tensions between national governments trying to meet the goals of globalization in the context of resistance from local “mass politics”. For the moment, the latter are winning, aided by populist parties able to tap into the anger of those “left-behind” by globalization. This is pushing many countries back to a situation where national governments will be forced to retreat from the global agenda in order to meet the concerns of their domestic electorate. The paper concludes with suggestions for ways to help counter these pressures, and better align the interests of mass politics with the rewards of globalization. The world’s global institutions and representative bodies, meanwhile, need to enhance their legitimacy as global forums to strengthen their ability to better manage the world’s financial system, make trade fairer, and avoid a race to the bottom on corporate taxation.