Overcoming zero-sum games to sustain growth and globalisation

Antonio de Lecea argues that Europe's stance on globalisation is capable of reconciling higher growth with a fairer distribution of income and opportunities.
Some in the West argue that the emerging countries have prospered from globalisation at the expense of low- and middle-income classes in advanced countries by abusing open trade. Others in the East counter that the problem is the unfair distribution in Western countries of the benefits derived from global integration.

This column argues that Europe’s stance on globalisation – a combination of enforcement of a level playing field at home and abroad and a welfare state that mitigates polarisation and empowers middle classes – is capable of overcoming these zero-sum stories by reconciling higher growth with a fairer distribution of income and opportunities and a multidimensional concept of sustainability and well-being.

In the US, globalisation is often blamed for allowing countries to thrive at the expense of the jobs and income of Western middle classes. Milanovic’s (2016) ‘elephant’ graph of the global distribution of gains in real income per capita (Figure 1) can be understood in this way. It shows that between 1988 and 2008 the income of Asian middle classes increased by 60% or even 75%, while income of Western middle classes remained virtually flat.

The same chart lends itself to a very different interpretation – as a West-West zero-sum game. In this vein, China’s President Xi or Prime Minister Li underline that globalisation brings benefits to both the East and West, and is wrongfully blamed for domestic issues like the unequal distribution of the gains between the 1% and the rest.

Both narratives capture some relevant features but miss important ones, and their policy conclusions do not solve the underlying problems. Below, I review these in more detail and discuss the associated policy conclusions. I then propose an alternative East-West grand bargain that builds on current EU policies.
Figure 1a. East-West zero-sum game

Who has gained from globalization
The global 1% and the Asian middle class

Real income gains in percentage, 1988 to 2008

Poorer  GLOBAL POPULATION BY INCOME DISTRIBUTION ON PERCENTILE  Wealthier
Figure 1b. West-West zero-sum game

Who has gained from globalization
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Real income gains in percentage, 1988 to 2008

Pooper ← GLOBAL POPULATION BY INCOME DISTRIBUTION ON PERCENTILE → Wealthier
1. Unfair growth and job displacement from West to East
Some delocalisation of jobs and activities from the West is due to the natural play of comparative advantage, and brings benefits to all in the West in the form of lower consumption prices and a wider range of products.

But protectionist policies and practices in the East exacerbate this displacement. The OECD ranks China the second-most restrictive country in terms of FDI, while Russia, China, Brazil, and India continue to be the main users of trade protectionist measures (European Commission 2017).

Growth and globalisation can become a proper positive-sum game through a grand bargain between the East and West
Maintaining measures that discriminate against foreign companies is difficult to justify with the infant industry argument when there are now as many Chinese as European firms amongst the 200 largest global companies. Protectionist practices are instead the result of deliberate industrial policies, and of regulatory capture by well-connected firms, that benefit from substantial economic rents. In spite of official reform announcements, significant distortions remain and new ones have resulted from loose domestic regulation and discriminatory enforcement.

2. The distribution of gains within the West is increasingly polarised
Eastern voices are rightly pointing out that the East and West both benefit from globalisation. Moreover, several indicators support the perception that market outcomes are increasingly unfair and insufficiently offset by fiscal policies.

Labour productivity and compensation of private sector workers before taxes grew broadly in tandem in the US until the 1970s but have increasingly diverged after that, particularly since the 2000s (Bivens et al. 2014).

Labour shares in GDP have also persistently declined, notably after crises, and the ratio of top salaries in major US corporations to low-skill wages rose sharply since to reach nearly 300 in 2013 (after being stable at 25-30 until the late 1980s). Education is necessary for economic and social advancement but is no longer the silver bullet, as signalled by declining real salaries of recent graduates in the US since 2000 (Davis and Mishel 2014).

3. Rent extraction and rent seeking are at the heart of polarisation
The gap between productivity and wages, and wage polarisation, are often attributed to technological change and to the growing importance of other intangible inputs. The divergence between high and low wages is partly due to the rewards to scarce talent that is capable of dealing with the increased complexity and technological content of
But significant rent extraction and rent seeking, particularly in specific industries and expert professions, is another explanation (Stiglitz 2013, Furman and Orszag 2015, Bessen 2016, Deaton 2018). Several indicators point in this direction. Industry concentration has increased, and mark-ups have risen from 18% to 67% between 1980 and 2014 in the US (De Loecker et al. 2017), while antitrust enforcement became looser and technological barriers to entry increased (Grullón et al. 2016). Some rents to knowledge-intensive industries may be justified by the need to provide incentives to innovation.

But beyond these cases, there is often a vicious circle of barriers to entry and market power, capture of the regulatory process, and lax competition enforcement. The bargaining power of rent-extracting firms vis-à-vis labour and governments increases with deregulation. It also expands across borders via loose trade and investment agreements.

Baker (2015) estimates that rents from patent and copyright protection, the financial sector, and top executives, doctors, and other highly educated professionals account for between 6% and 8.3% of US GDP, as illustrated in Figure 2.

The regressive impact of rent extraction in these few sectors is of the same order of magnitude as the overall effect of progressive redistribution through the fiscal system. Fiscal redistribution from the top 10% to the remaining 90% accounted for 8% of GDP in 2014, as shown in Table 1.
Figure 2. Economic rents in selected activities (% of GDP)

The way forward: policies to prevent and correct market power abuse do matter

The East-West zero-sum narrative concludes that global integration must be curbed, or at least that bilateral flows must remain balanced, and recent policies in the US are consistent with this line. At the opposite end, the West-West approach pleads for globalisation to continue, hardly changed. President Xi’s message to the 2017 APEC Summit to “let more countries ride the fast train of Chinese development” illustrates this approach.

Neither of these options is effective or sustainable. Protectionism and disengagement from global agreements will not address the US savings-consumption imbalance and the US stands to end up worse off if the unilateral trade measures escalate into a trade war. Rolling back social, financial stability, and environmental regulation will amplify domestic polarisation. It will also reduce the redistributive capacity of fiscal policies, widening the scope for rents. The lot of those left behind by globalisation is unlikely to improve.

Table 1. Fiscal redistribution, adult individuals, 2014 (% of GDP)

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<th>Pre-tax income</th>
<th>Post-tax income</th>
<th>Redistribution</th>
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<tbody>
<tr>
<td>Top 10%</td>
<td>49.1</td>
<td>41.1</td>
<td>-8.0</td>
</tr>
<tr>
<td>Middle (50-90%)</td>
<td>40.2</td>
<td>41.8</td>
<td>1.6</td>
</tr>
<tr>
<td>Low (0-50%)</td>
<td>10.7</td>
<td>17.1</td>
<td>6.4</td>
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Source: Piketty et al. (2016)
The West-West zero-sum narrative is not a politically sustainable option either. Speeding up globalisation without correcting for unfair, protectionist policies also accelerates the excessive dislocation of jobs and activity. It will aggravate the resentment among Western low and middle classes and the likelihood of backlashes.

The G20 members agreed a more sustainable strategy towards strong, balanced, and inclusive growth. They have taken actions to increase growth and improve compensation, including structural reforms and investment initiatives, as well as measures to enhance inclusion. At their latest summit meeting, G20 leaders nevertheless acknowledged that overall results fall short of the objectives set and called for further action as suggested by the OECD and World Bank (OECD-WBG 2017).

The reforms and initiatives contained in the G20 strategy are necessary but not sufficient. Without corrections to limit rent extraction, additional growth will continue to accrue to a limited few. Fiscal systems will at best offset the bias introduced by market imperfections.

The G20 strategy can be complemented with further emphasis in reducing market distortions and economic rents both domestically and internationally. A combination of growth enhancing, pre-distributive, and redistributive policies may thus bring higher sustainable, inclusive growth. Reduced economic rents would diminish the need for fiscal redistribution, and could make it more effective.

**Europe can lead an East-West grand bargain**

A comparison between Europe and the US confirms that the adverse redistributive effects from globalisation are not inevitable, and that adequate policies can at least mitigate them (Alvaredo et al. 2018). Wealth, income, and profits are less concentrated in the EU than in the US, even though inequality has also increased. This better perfor-
mance results from policy frameworks that combine growth-enhancing, high standards and enforcement of regulation and competition with redistributive policies (European Commission 2017b).

The EU supports innovation, productivity, and growth. Budget guarantees and European Investment Bank loans leverage physical and intangible investments, research and innovation programmes, and education and training. The forthcoming EU midterm budgetary framework may further upgrade European financial support.

Some EU member states have taken successful measures to build skills and improve employability – such as Germany’s dual vocational training, the Scandinavian flexicurity model, and Estonia’s e-school system – and the EU has a European Globalisation Adjustment Fund which helps displaced workers to find new jobs or start their own businesses.

Policies to further remove internal borders open up business opportunities and reduce the capacity to appropriate economic rents. Furthermore, the EU state aid and antitrust regulations have put limits on the market power abuse of both European and international firms. These policies have the double benefit of reducing rents and removing the perception of unbalanced or unfair distribution of costs and benefits, thus reducing the resistance to structural reforms and innovation. EU countries have also been more ready to use taxes and benefits to improve fairness in the income distribution that results from market outcomes. Europe’s welfare states have thus mitigated the side effects of technology and globalisation to a more considerable extent than in the US.

Similarly, along the international dimension, the EU is showing the way to keeping markets open and reaching broader, more transparent, and fairer trade agreements. Having completed the agreement with Canada, and initialled one with Japan, the EU is negotiating with all NAFTA and TPP countries except one, and also with Mercosur.
At the same time, it has increased transparency and engaged stakeholders in negotiations of international trade agreements to reduce the scope for capture by special interests, and hence distortions and cross-border rents.

It has reviewed its WTO-compliant defensive instruments against trade agreements violations. It has proposed an international tribunal on investor-to-state disputes to reconcile openness with high living standards and societal choices. It is cooperating with competition and regulatory authorities in other jurisdictions to align anti-competitive financial stability and tax policies internationally. And it is also a leader in strengthening global governance in climate and financial stability.

**Conclusions**
Growth and globalisation can become a proper positive-sum game through a grand bargain between the East and West where:

- the West pursues the growth-enhancing policies and deals with the unequal distribution of income and opportunities;
- the East continues its reforms to correct its imbalances, addresses domestic rents that hinder growth, and tackles the distortions to competition that put Western companies at a disadvantage; and
- the East and West both accelerate the convergence towards adequate financial stability, fiscal capacity, consumer protection, and social and environmental standards that underpin fair competition and strike a balance between common ultimate welfare goals and diverse paths resulting from societal choices.

The EU is well positioned to engage with emerging and other advanced countries to address the sources of discontent and drive this grand bargain. The G20 is the natural forum to bring it forward. If it becomes more difficult to reach consensus there, the EU and like-minded countries can complement multilateral negotiations with decisive
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Author’s note: the views in this column are exclusively those of the author and should not be attributed to the European Commission. This research started while the author was 2016-2017 European Union Visiting Senior Fellow at the National University of Singapore Lee Kuan Yew School of Public Policy.

Endnotes
1. G20 members have encouraged hiring by making labour legislation more predictable (Brazil), improved gender balance in labour participation (Germany), facilitated youth placements (European Union, UK, South Africa), improved skills and employability (Canada, China, France, Italy, Turkey) and broadened active employment policies (Spain). Some countries have expanded the safety nets through more employment security (Germany), enhanced employment insurance (Canada), equal pay (Japan), pension benefits (Argentina), minimum wages (South Africa), minimum income schemes (Italy, Saudi Arabia), or supply of affordable housing (UK).

References

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