Conference Notes

International Policy Rules and National Inequalities: Implication for Global Economic Governance

February 8, 2015

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Introduction: Jose Antonio Ocampo, Eric Helleiner and Joseph E Stiglitz.

Main questions the research will try to answer: To what extent the rules that govern formally or informally the global economy are basic determinants of the rising inequality trends we see in most countries of the world? Are there any conflicting interests between global governance and international rules and domestic governments? How and when are global economic governance rules complementary or not with national policies aimed at the reduction of domestic inequalities?

3 sessions

1. Capital account, trade and national resources
2. Taxes and investment agreements and international property rights
3. Discussion on domestic distributive issues

Some Initial considerations: J. Stiglitz

- The issue of inequality has moved to the top of the agenda. Most of the countries around the world have faced increasing income inequality.
- This is a good opportunity to put inequality in the global and national government agenda. For example, inequality is a main topic on the political discussions and agendas in the USA and in other developed countries around the world.
- The issue is identifying the domestic policy instruments that may help reduce inequality. In a globalized context with international interdependence, international rules have possible negative effects on inequality, affecting not only the trend, but also eliminating the possibility of the use of some instruments.
- For example, trade agreements are no longer about trade. Some say they are even about restricting some kinds of trade. Is this inequality enhancing? Who benefits?
    - The best way of seeing trade agreements is that people at the top use them to get in international agreements what they have not been able to get through domestic legislation.
- It is not only the rules and regulations on global governance, but also the way they are being enforced and implemented. This includes the role of judicial systems, and the dispute resolutions mechanisms. Are these fair? Is there a single rule of law? Are the legal frameworks and the processes reducing inequality?
    - The US often talks about the rule of law, as if there was only "one" rule of law. But there is even disagreements on the meaning of this rule of law. Obama addressed this issue in the State of the Union. Who is going to write the trade rules for the 21st century?

- We need to understand how the rules of the game affect different societies. We know there have been some adverse distributive implications for some countries. These inequalities are even worse when we take into account that the affected countries do not have a voice in defining these rules of global governance.
- What are the multiple channels by which international rules affects domestic inequality? An important channel, and the most commonly studied, is the macroeconomic stability channel, through financial crises and volatility. But there are many more to be discovered.
- More research has to be made on other channels, for example on micro agreements, health and child protection polices, intellectual property rights are among others.
- There are also new debates on how trade affects inequality and so trade is now back in the agenda. Developing countries have increasingly been using exchange rate mechanisms as part of industrial policies. There are some disparities and inequality in the application of these rules. Trade agreements with the US, for example, eliminate the use of currency mechanisms, but the US itself uses this mechanism.
    - The debate in the USA about anti-currency manipulation in trade agreements is interesting, but it is difficult to define what currency manipulation is. Furthermore, there is new econometric evidence showing that trade is a source of inequality in the USA. Places in USA where there have been more import competing goods have lower wages and lower employment rates. Job destruction is much faster than job creation. What can be done about this?
- It is also, not just about income inequality or wealth inequality but inequality of wellbeing. Including health and other aspects.
- Details matter a great deal. We have to be very attentive to these details, for example between 7-12 years exclusivity on biologics.
- Finally, there are also some success stories of countries that have been able to successfully reduce inequality even within the rules of the game such as Brazil. What can other countries learn from them? How can we learn from these examples and learn about policies to be used or implemented in a way to reduce inequality and protect people against risks. For example, if it has been shown that through the macroeconomic channel, higher volatility affects the poor people more, then, there is a need to design policies to protect their income.

<u>Comments and Discussion</u>

Eric: How do you make the distinction with historical inequality?

Kevin Gallagher: The political economy of trade agreements is very important, specially the politics around how the rules are set. There is a causal link, since the way you structure the economy also changes the politics.

Trade agreements are now trying to change the rules by which rules get made. For example, the USA is arguing with Europe that they have to go through the process for common procedures.

It is not only what is in the agenda, but also what is not in the agenda. The issues of tax heavens have completely gone off the table.

Rob Vos: On the success stories there is also an example in India. Agricultural policies, on public purchases to buy food, are having important positive effects, so, another question is how international policies can complement (and enhance the results) of these domestic policies.

Humberto Campodonico: Negotiations on international rules are most of the times secret. After FDA signs, you have 1 year to make changes. But after being signed there is not much policy space. In order to sign FDA and TPPS the international agreements go into national legislation. Intellectual property rights are not being part of the negotiations of trade agreements (some example being Colombia, and Peru). There are power imbalances.

Ocampo: Intellectual property rights in agriculture are an important issue. Traditional small holders in Latin America reproduce their own seeds. But the law of international property rights prohibits this reproduction.

Carlos Correa: FDAs are also signed, because there are internal actors that want to sign agreements. It is not only about USA coercion. There is coercion from the USA, international organizations or important interest groups in domestic countries. So, what kind of policies can be implemented? Minimum conditions?

This project on international rules and inequality should be policy oriented, with useful and feasible recommendations both for international and national levels, and not only an economic analysis of the correlations and implications of international rules in inequality. It should also include a framework for global governance, as with globalization you need an international architecture.

1. First session: Capital Account, Trade and Natural Resources

1.1. Capital account liberalization and inequality: Kevin Gallagher and Rachel Thrasher

According to a recent IMF paper, there is a direct relationship between capital account liberalization and Gini. The Gini increased rapidly after the liberalization of capital accounts and the years following but at a lower rate.

Why? Capital is more complementary to skilled workers and so liberalization increases the relative demand for those workers. As a result, skill premium increases leading to higher inequality.

Inequality and capital flow crises: lead to income and employment shocks, inflation, currency depreciation, and fiscal consolidation. All of these have impacts on the low and middle class that need to be further evaluated.

Capital account regulations and global economic governance: there is incoherence. There are inconsistences on the view of capital account and many international agreements. For example, the IMF promotes capital account liberalization on a gradual way, but this is incoherent with the G20 rules. In any case they also say these rules should not substitute domestic policies.

- Capital account should be regulated at both ends. They should not only regulate cash flow, but inflows and outflows.

- Capital controls of outflows have been seen in only one case: Malaysia. Now there are more controls because of a severe debt restructuring $\Rightarrow$ measures that are now being criticized by the society and sued by private or other actors were promoted by the IMF
- Government securities are considered as investments? What is the role? Expropriation?
- IMF is now recommending governments to put in place capital account controls. Capital flow management measures.
- In the G20 there has also been discussion about these issues. On the one side, they recommend capital flow management measures. But, on the other side, they announced FX, swaps, and forwards are exempted from the derivatives reforms.
- Need to define the role and coherence between financial management and financial stability. Why are there only disclosures for closing capital accounts? Why only exceptions for outflows? (Lewis model accumulation of capital) industrial policies to give credit for these sectors.

<u>Comments and Discussion</u>

Stiglitz:

- Piketty equated wealth and capital. That is one of the mistakes he made.
- It is important to distinguish two things: One type of inequality arises when it benefits people at the top but does not affect people at the bottom. Other types are the ones that negatively impact people at the bottom. Both are qualitatively different and should result in different policies.

There are differences on the rules and flexibility in the application among regions, which create inequality. If you are rich you can go to Mauritius but if you are poor you have to stick with domestic rules. There are also inequalities arising from differences in treatment among foreign firms or domestics firms.

Maria Victoria Murillo: If the bottom part of the distribution is hurt, there is potential space for political reaction and redistribution. On the contrary, why do we care about inequality driven by an increase in incomes at the top? This is not clear.

Ocampo: International issues on financial regulation. Domestic regulations affect everyone (small or big firms) while access to international capital markets is usually restricted to very big companies. Large firms can avoid the domestic financial system.

1.2. Trade: Suresh Naidu and Blige Erten

Suresh

In the classic view of economics, trade liberalization, will reward the abundant endowments, which is the factor used more intensively in the production function, and will hurt scarce factors. This will in fact help low skilled workers in developing countries relative to capital owners and so we expect to see a decrease in inequality. Why aren't we seeing this?

We all know this is pareto efficient as long as we can compensate the losers… but what does this mean? How can we compensate the losers?

Trade today is not only a movement of factors, but also movements of entire industries and jobs. In the global supply chain, low skilled activities and jobs are being transferred to developing countries. So inequality can rise in both countries

There is evidence that wages are going down for the unskilled in labor abundant factors. Why? What is happening? A model with financial frictions? (Benarjee and Newman 2004)? Or quality upgrading competition (Verhoogen, 2008)

Trilema: technology change is radically replacing unskilled jobs. You can only have either middle class jobs, equal distribution of wealth or abundant labor-saving technology.

Models of heterogeneous firms: with liberalization only the more productive firms can compete in external market and export.

Where do we put intellectual property rights? Is this a trade issue or a capital issue? We should think of it as a form of capital.

Blige

Mexican crises induced higher quality plants to export more. Those plants already paid high wages and this lead to even higher quality.

Trade integration should lead to lower inequality if you have perfect labor and capital mobility. But this is not what we are seeing. Why?

Paper by Banerjee and Newman incorporates financial frictions. They show that financial frictions cause inequality in presence of trade because they restrict financial mobility.

Conclusion of paper: Liberalization of trade and tariffs increase employment but reduction in tariffs negatively affects the employment of the less educated workers

Comments and Discussion

- Kovak: when you have trade, the regions more exposed to trade are likely to contract and will cause a higher labor market effect. Low mobility among regions.
- There are always transition costs and mobility costs, there is not perfect mobility, and so there are always some losers.
- There are frictions and no complete mobility on factors. Import on competing goods has done more poorly.
- Effects of trade by race on gender: Becker argues that when you have foreign competition this reduces race and gender based discrimination. More competition leads to hiring these populations and this will lead to higher equality. Juhn et al show that some of the technological upgrading caused by trade can also reduce gender inequality.
- How countries comply with some international rules while still facing domestic political instability? How can this be compensated?
- South Africa is withdrawing from international trade agreements, saying it conflicts with their constitution

- Bargaining power is important? IMF and other international organizations have lowered the standards to ensure compliance, but then if these are lower than domestic norms, there may be and an adverse effect.

1.3. Natural Resources: Humberto Campodónico and Lise Johnson

Humberto Compodónico: Natural resources governance and inequality

- There is a natural resources course; either Dutch disease, or corruption. The common view is to exploit them and wait for benefits to trickle down; this is if we continue with “business as usual.”
- The large investments in extractive industries have provoked an increase in social and environmental conflict in many countries that are rich in natural resources. In turn, in many cases these countries have also been compounded by the lack of governance.
- Since 2011 and 2012, the IMF has substantially modified its position on the approach to natural resources.
- The IMF is looking for a change. It is now admitted that the "normal" macroeconomic framework can be changed in the case of NRRC that has to meet urgent needs of its population.
- The World Bank, in its book "From Rents to Riches,” states that the analysis of natural resources must be addressed with a focus on political economy as its economic and political importance is so great that it cannot be confined to a static or sectorial analysis.
- There are two topics of concern: (i) how to distribute rents with-in the countries, centralized vs decentralized mechanisms and (ii) what is the money going to be use for?
- Several studies have focused on the analysis of the governance of NRRC, obtaining the conclusion that there is no natural resources curse but that the problems are caused mainly because of weak governance. It is also noted that there is no institution that brings together these countries.
- From a regional point of view, Africa has advanced more. The African Mining Regional Vision, a framework of policies for all African countries proposes a shift away from a model of exploitation of extractive resources, based on a high dependence on international export markets.
- There is nothing like the African Vision in Latin America, where all countries are growing based on extraction of natural resources.
- In the recent ECLAC Report, "Pacts for Equality: Toward a Sustainable Future," the establishment of social pacts is proposed, from a conceptual and organizational framework to address governance in the countries of the region and move towards Structural Change with Equality.
- It is required to have an institutional and regulatory framework to avoid distortions due to the high international prices of natural resources.

Lise Johnson

- Dispute mechanisms have to play a higher role. How are certain government policies being designed to protect domestic budgets? Or are some being overwritten by private sector? Unequal procedure rights? Unequal arbitration?
- Incoherence between (unequal remedies) human rights advocates and international agreements on investments and liberalization. Governments have less power to reduce inequality and make regulations.
- There are arbitrary violations of treaties and different taxation measures. One case is Ecuador, where some government's attempts to reduce negative effects of redistribution are resulting in law sues and problems with private firms.
- There must be a stronger role of international courts; in any case, Human Rights should always prevail when there is conflict, even above other international treaties.

Comments and Discussion

Vicky Murillo: In Peru inequality declined without social policies, but this is not the same to say that there was a trickle-down effect.

- Why are there negative effects from the decentralization of these resources coming from rents? Is it centralization better (case of Colombia)? How do we know? It is not only corruption, but that the money is not being spent, and also how it is being implemented?
- What about the macroeconomic effects of stabilization policies?

George Gray: The story of inequality reduction in Latin America is mainly a supply side story. The expansion of secondary education, lower skilled premium, and lower wage inequality in the labor market (even in the informal sector); and also an increase in social pensions. But there must be another side of the story, the story of the top one percent.

- Latin America is not progressive in post fiscal income. The effects of social transfers are being, in some cases more than, eliminated by taxes

José Antonio: There has also been a demographic effect. There has been a reduction in the labor force, which has grown by less than half. So people are better educated but there is also fewer people (it is both effects).

J. Stiglitz: It is not only national resources curse, but also about the interaction.

Why Countries abundant in natural resources have higher inequality? If the mayor source of revenue is labor, taxing natural resources would in theory, not have a negative supply effect on labor. If this is true, we would, presumably have more equality in these countries. But then why are we not seeing this? Why the income they get not being equally distributed and what are the channels?

Some possible channels: The first channel is higher income: yes, the boom from prices increased construction, infrastructure and employment, but then the problem is that this is not sustainable. There are some positive effects in the beginning, but when prices go down you see negative effects.

Another channel is the political channel. There is some bad political behavior and rent-seeking attitudes that cause inequality. Why is the rent seeking so unequally distributed is still a question?

How can changing the rules affect this and other channels that affect the unequal distribution of natural resources revenues? More transparency? Higher regulations and processes?

What are the changes in policies?

The effects of the set of rules of the environmental agreements and climate change agreements in inequality have not been studied.

2. Second session: Tax competition, investment agreements and property rights

2.1. Tax competition and investment agreements: Manuel Montes

Industrial agreements, tax competition, and domestic inequality: How changes in global policies have modified the responsibility of the state in dealing with inequality. What are the direct economic impacts of the rules? How do the global rules affect domestic inequality?

The impact of foreign investment: Tax competition:

a. The most important impact is on the tax revenues. Fewer revenues and what they represent on redistributive policies
b. Tax competition to attract foreign investment has adverse effects on domestic inequalities and results in contrary policies
c. Tax burdens and regressive taxation
d. There are unequal effects. The winners are highly mobile factors

Tax competition is an attack to the tax base of any country, and reduces the possibilities of governments to reduce inequality. What is the effect on developing countries?

- There are flaws on the legal system; terms like expropriation are very broad.
- What are the effects of investment treaties, employment creation, and industrial growth?
- The domestic private sector is important, and it has to be stimulated equally, not only foreign investment. If there are subsidies for international private sector then there must be some also for domestic firms. Who regulates this? How to articulate both policies?
- What are the policies for protective industries? And the political implications?
- Need for some social policies innovations. How to regulate environmental damages as part on industrial agreements?

Comments and Discussion

Robert Vos: Tax competition and tax coordination agreements among countries. What will the net result be?

Voluntary guidelines and principles for agricultural investments: landmarks and principles? They are not binding, no accountability, but it is a start and may result in changes in behavior ⇒ responsible agricultural investments

What about tax heavens, tax exemptions? There is a high ability of the top 10% to evade taxes.

Stiglitz:

- Investment agreements: the US demands to have provisions in its contract with Europe challenges the view that we need international proceedings because we cannot rely on the national judicial system.
- Should we compensate for changes in regulation? No, because this would limit the space for government to take action.
- Individual and corporate tax shifting are very closely related; shifting one for the other may increase inequality.
- Inequality is not really capturing the top 1% because it is based on realized capital gains and the top 1% does not realize capital gains. So inequality is much higher than data shows.
- There are two things that are very difficult or impossible to move so you should be taxing that: land and sales.
- Changes in tax regimes have an effect on the supply side of employment. The only incentives that cannot be changed is where you sell.
- At this point it is very difficult to figure out where the profits are coming from, every company will say they were generated are their own country. A tax on sales could be a way to tackle this fact. Attribute tax on profit proportional on sales.
- We need to come back to questions about what can be done. Norms of behaviors and principles yes, but there must be other hard-core things. Transfer price system for taxes is flawed (wrong). We need an alternative system; this is very complicated to administer. Intellectual property rights are even more difficult. In the case of the drug industry, it is also difficult. Global profits will be distributed proportional to the sales, but it is not completely non distortionary
- Now there is tax competition to the bottom. It is very foolish of developing countries not to tax to level of the United States.
- Bilateral investment treaties on capital gains tax. How can this be aligned with national gain taxes? If the domestic rate is higher than double taxation treaties? There are some criticisms of these double taxation treaties.

Manuel Montes: Tax heavens used to be for individuals. Now almost all the corporations have tax heavens. The big question is how to discipline the corporations.

OCDE has been working on transfer pricing issues but these models are very complicated for development countries. The OCDE proposes a very complicated system; there must be a simpler one.

2.2. Intellectual Property Rights: Susan Sell and Carlos Correa

Some considerations

- There is a lot of fragmentation and incoherence
- Multiple scales of governance: regional, bilateral, unilateral, multilateral.
- There are no status quo players. Continual process of consultation.
- Hypocrisy about different areas.
- These areas are marked by magic numbers. Not transparent process of pricing.
- Role of multilateral institutions should be better defined

- What is the most effective locus of government to affect change? Who will be able to implement them?
- The role of state power and the role of state capacity. Strong connection with domestic power of the USA and the USDAR power system. Private power from the top 1% becomes international power through international treaties.
- How does intellectual property protection prevent others from getting access to technology, education, seeds, medicines? Royalty payments have been a massive source of resources.

Carlos Correa

- No doubt that intellectual property is a major factor that exacerbates inequality. Medicines are a clear example. It creates exclusion, monopoly, and concentrates power.
  - Price fixation exacerbates inequality, they don't take into account promoting inclusive access.
- Intellectual property is not only about medicines. Agriculture is a very important issue. Copyrights is another area were inequalities are created with negative effects on the quality of education.
- But there is another side of this inequality. Distribution of the benefits from intellectual property. Who is benefiting from these? Mainly big companies. Evidence shows that small and medium enterprises even in developed countries are not really benefited from intellectual property.
- South center: interest in having a policy oriented research.

<u>Comments and Discussion</u>

There is asymmetry agreement compliance.

A growing area is the connection between investor agreements and intellectual property.

Is there a distinction between investor agreements state and traditional WTO judicial process? The endpoint must be around national judicial systems.

3. Third session: Analysis of domestic distributive implications: George Gray and Sanjay Reddy.

Sanjay Redd

- There is no robust evidence on growth and pareto improvements. Has the developing process been a pareto improvement? Does growth always bring pareto improvements? Some empirical evidence shows this is not always true.
- There are long periods of time in which there might be growth and not pareto improvements. There is an elasticity of poverty with respect to growth, shown in the growth incidence curves, but sometimes growth is not poverty reduction.
- Almost 50% of the countries reflect an increase inequality of income between 1980 and 2010, and 49% show lower inequality.

- The common assumption is that LAC is the most unequal region of the world, but it is not completely true. It is a measurement problem. LAC poverty and Gini measurements are based on income whereas African countries have consumption measurements. So when imputing consumption survey data, sub Saharan Africa shows a higher inequality than Latin America.
- The top income database used by Piketty is not very representative for developing countries. We do not know much about top incomes, and no cross-country analysis.
- Many of the econometrics that have been used to represent the effect of globalization are not appropriate. One does not need to see changes in trade volumes to assess effects on inequality. It could be some non-observable variable. For example, the changing power of bargaining between labor and capital owners. Change in policies gives better information than trade values.
- It is easier to improve your environmental, trade, and health standards if others are doing it as well. There are many areas where the costs of undertaking a particular action decrease if other countries undertake them. This is why international rules matter.
- Nordic countries show the possibility of having open economies that also have labor unionism and labor mobility.
- It is not to roll back international integration but to reconcile it with more coworker outcomes.
- Thinking about the system as a whole, one of its core problems is that it has been austerity oriented. Public investment matters in increasing life chances.

George Gray

Latin America's mainstream story is a story of growth, poverty reduction and inequality reduction, but there are caveats.

In the best of times, it was business as usual. Three important features: Metrics, channels, and political economy.

- How do we measure the impacts of global governance and macro policies at the micro and household level? We need to include an intermediate level, a political economy level.
- 3 key determinants when decomposing inequality: labor income, social transfers, and financial transfers to the top income.
- Political elites will always negotiate the deal that is less painful. The low hanging fruit police.
- Political effort will yield a small impact, but if complemented with international rules the impact will be better.
- Political and institutionally painful reforms are always pushed to the future.
- Middle income countries: we are not having more low hanging fruit policies. More of the same will not yield more of the same. High growth is not delivering poverty reduction and redistributive impact. This is the moment for structural institutional and political reforms.

<u>Comments and Discussion</u>

Jose Antonio: Where do we stand? Either Rodrick's paradox or Ingle's Paradox? There are many cases were global rules can be effective, for example child labor protection. There are also negative cases: investment protection (which overturns democratic principles).

Consider the domestic inequalities of developing countries and use the international asymmetry to help the nations that might benefit from these agreements. There must be support for the countries to implement these laws.

Brazil, Honduras, Costa Rica, and Dominican Republic have had an increase in inequality since 2012.

There are problems on compliance with international agreements, but also what are the mechanisms of implementation? Should we punish countries? Or support countries to meet the standards?

There is an interdependence and externality problem for poor countries to improve labor and environmental. Individual decisions of a developing country will have an affect other south countries. If Sri Lanka wants to improve its standards it has to think about Mozambique.

Labor costs could be even doubled or tripled without affecting the fundamental competitive advantage of north-south trade.

Final stage-Closing remarks

Eric

- The causal arrow is going to international rule creating national inequalities.
- Some of them are macro, some of them are micro, some of them are constraining on what national governments can do.
- Constraints: how do international rules constrain national governments to do things about inequality? International rules are too detailed and those details allow elites to gain. Investment disputes are very ambiguous and the key factors come in the interpretation
- Can we think about how national inequality transfers in international rules? What is the 1% doing as it has become more powerful? There are lots of examples in the ways in which they do that: lack of transparency, secrecy, and litigation expenses.
- Disjuncture between high degree of politicization of high inequality and the absence of that politicization translating into international trends.
- Political reaction is growing in many countries but has not translated in enabling international economic regimes in responding to this.
- The policy input of this project could be to make concrete policy proposals on how to reinforce national efforts towards more equality.
- In addition to mapping the causal arrows is to making concrete proposals.

Jose Antonio

- Punitive versus promotion approaches.
- ILO pressure has been very positive in Colombia, it have been very good for increasing standards for union leaders.
- Many international rules can be good in the sense of putting pressure.
- It is not only the kind of rules but also how to make them a reality.
- Implications for national judicial systems. Democratic deficit, how it has being enhanced.

- Two main links to work on: protection of capital in different ways and how it has promoted non-equalizing forces.

Methodological issues: how to measure inequality? There is a need to go beyond income inequality.