

TRADE, INCLUSIVENESS, INEQUALITY AND THE WTO

A SOUTH AFRICAN PERSPECTIVE ON A COMPLEX DEBATE

Peter Draper



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ABSTRACT

Economic globalisation is coming under increasing scrutiny in many parts of the world. In particular, its trade aspect is increasingly, and critically, being questioned, by populist politicians in the West and developing worlds alike. In the process important questions are being posed, particularly concerning whether trade exacerbates, or even causes, inequality in countries and leads to the exclusion of relatively marginal constituencies. This scepticism is being parlayed into the multilateral trading system, raising existential questions about the future of the WTO and of the liberal international economic order of which it is part. Accordingly, the paper reviews key issues and debates related to these themes, and applies them to African and South African contexts. It concludes with high-level recommendations for the South African government as it prepares for the 11th Ministerial Conference of the WTO in Buenos Aires.

AUTHOR

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*(I am the one in ten)
A number on a list
(I am the one in ten)
Even though I don't exist
Nobody knows me
But I'm always there
A statistic, a reminder
Of a world that doesn't care*

[UB40, 1981]

INTRODUCTION

According to Wikipedia,¹ the UB40² hit song 'One in Ten' refers to the number 9.6, being the percentage of the local workforce claiming an unemployment benefit in the UK's West Midlands in the summer of 1981. The song captured the mood in the

1 Wikipedia, 'One in Ten', https://en.wikipedia.org/wiki/One_in_Ten, accessed 31 October 2017.

2 The group's name was taken from an unemployment benefit attendance card.

industrialised West at the time – characterised by recession, relatively high rates of unemployment and concerns over ‘deindustrialisation’ in the face of competition from non-Western economies, especially Japan – and ultimately catapulted UB40 to stardom.

Similar concerns surfaced more recently in response to the ‘global’ financial crisis. ‘Global’, because while the financial and market impacts of the 2007–2009 recession did have global repercussions, most of the non-Western world recovered reasonably well, while the West remained mired in structural economic problems amid escalating unemployment and rising inequality. This time Western fears over competitors are more profound, and anchored on China especially, since China challenges the West’s economic and geopolitical hegemony in a way that Japan – a US ally, after all – never could.

These broad dynamics explain a few things about the current moment in which the Western-centred liberal international economic order, anchored on the International Monetary Fund (IMF), World Bank and WTO, finds itself. The IMF, while still the most powerful agency of its kind in the international system, is increasingly challenged by regional competitors such as the European Stability Mechanism. The World Bank already occupies a regional space that gets more crowded by the year. And the WTO has struggled to retain its relevance in a busy bilateral and regional trade agenda.

As economic power becomes more diffused in the global economy, it is to be expected that longstanding multilateral arrangements will have to adapt. However, it is crucial to recall the purpose of the international economic institutions established in the aftermath of the Second World War. This was to constrain the domestic economic policy actions of powerful countries, to mitigate harmful impacts on the rest of the world and to avoid repetition of the ‘beggar thy neighbour’ policies that drove the Great Depression of the 1930s, leading ultimately to global conflagration and the birth of the nuclear weapons age.

Given the rapidly escalating geopolitical tensions around the world today, states should be cognisant of the need to preserve and maintain those multilateral economic institutions

In this light, and given the rapidly escalating geopolitical tensions around the world today, states should be cognisant of the need to preserve and maintain those multilateral economic institutions. Yet those that perceive economic globalisation to have harmful impacts seek increasingly to constrain it, using trade, investment and other measures to do so. This has generated powerful currents, especially, but by no means exclusively, in developed countries, culminating in the recent election of President Donald Trump in the US on an ‘America First’ ticket. Other populist movements are taking root in Europe, while still others are growing in Latin America, Africa and other parts of the developing world. To be sure, this phenomenon is unevenly spread and differentially endowed with popular support.

But as recourse to nationalism seemingly escalates, so the populist genie will increasingly be let out of its bottle.

By contrast, there is something of a consensus, at least among economists, that the benefits of economic globalisation substantially outweigh the costs. This explains why a default response to the rise of populism is to explain those benefits better, and to attempt to reach a wider audience. However, even proponents of economic globalisation need to recognise that the problems associated with it are real, and must be addressed – both on their own merits, and to head off the rise of populism. At the national level this necessitates domestic policy responses designed to promote the inclusion in society of those left behind by economic globalisation. In other words, nation states still matter, and perhaps increasingly so.

This highlights the tension, present since the creation of the liberal international economic order, between yielding a measure of sovereignty to promote multilateral cohesion and international peace while retaining sovereignty to favour citizens and promote domestic social cohesion. It was famously captured, at least in international relations scholars' circles, in the term 'embedded liberalism'.³ This described the historical compromise designed into the institutional system, namely that governments would still be accorded sufficient leeway to construct welfare states at home, to promote domestic inclusion, while progressively removing international barriers to trade, to preserve and extend the multilateral trading system – ie, 'Keynes at home, Smith abroad'.⁴ Leaving aside the relative merits of Smith and Keynes' economics, the embedded liberalism compromise endured for more than 70 years. However, many scholars of international relations now worry that it may evaporate in the face of the headwinds building up against it.

Accordingly, this paper attempts to chart the implications of the current moment for the multilateral trading system, particularly the WTO, and thus the future of the international trade order. First, current debates over inclusion and inequality are briefly explored. Then the relationships between trade and inequality, much in the spotlight presently, are elucidated. Following this, policy options available at both national and international levels to promote inclusion and reduce inequalities are outlined. Subsequently, the implications of these potential policy options for the WTO are framed. The paper concludes with a brief set of recommendations for the South African government as it prepares for the 11th Ministerial Conference of the WTO in Buenos Aires in December 2017.

INCLUSIVITY AND INEQUALITY

Every society is concerned, to a greater or lesser extent, with the issue of inclusion. This entails broadening access to the economic system in meaningful and personally fulfilling ways, for relatively marginal groups in society. The latter include the

3 Ruggie JG, 'International regimes, transactions, and change: Embedded liberalism in the post-war economic order', *International Organization*, 36, 2, 1982, pp. 379–415.

4 This widely quoted phrase does not seem to be attributable to a particular scholar.

poor, the unemployed, women, people with disabilities, minority ethnic groups, indigenous populations and youth.

Inclusion is obviously related to equality, but the two concepts are not identical. Many people can be included in the economic system of a society, yet the society may still suffer from inequalities. Some countries, for example, have relatively large global elites that earn high incomes yet have low rates of unemployment. By contrast, societies that have relatively low levels of inequality, yet where most people are 'equally poor', could conceivably suffer more from a lack of inclusion in the economic mainstream. No doubt other variations along this broad spectrum are conceivable, the point being that the concepts need to be disentangled, and applied contextually, since no two societies are the same.

INCLUSION

Measuring inclusion is no simple task. Probably the most widely accepted global framework for thinking about the issue is the Sustainable Development Goals. These provide a detailed set of frameworks, goals and indicators for galvanising global action in support of sustainable development. However, they range widely, from planetary sustainability (ie, the environment) to poverty. Something more precise is needed to capture intra-society concerns on a comparative basis.

In this regard the World Economic Forum's 'Inclusive Growth and Development Report' provides a useful framework for thinking about inclusion.⁵ It is premised on what the report characterises as 'secular stagnation', particularly of Western societies. In the authors' view, there are three drivers of this stagnation:

- rising in-country inequality;
- Western economic stagnation and structural fiscal challenges;⁶ and
- the information-fuelled technological disruptions posed, and to be posed, by the 'Fourth Industrial Revolution',⁷ with attendant consequences for employment disruptions and income distribution.

In searching for structural solutions to what are profound structural problems, the authors argue that new growth models may be required within which the very notion of national performance needs to be re-conceptualised. This leads to their elaboration of an 'Inclusive Growth and Development Framework' containing seven

5 WEF (World Economic Forum), 'Inclusive Growth and Development Report'. Geneva: WEF, January 2017.

6 Addressing long-term demographic change – aging societies – in the context of growing sovereign debts amid persistent economic stagnation.

7 Meaning 'a range of new technologies that are fusing the physical, digital and biological worlds, impacting all disciplines, economies and industries, and even challenging ideas about what it means to be human'. See Schwab K, *The Fourth Industrial Revolution*, WEF, <https://www.weforum.org/about/the-fourth-industrial-revolution-by-klaus-schwab>, accessed 3 November 2017.

pillars,⁸ underpinning the development of their composite Inclusive Development Index (IDI). The breadth of the exercise is impressive, as are the rich insights it delivers into a hitherto elusive concept: inclusive economic growth. The results are sobering, including the following:

- 51% of countries saw their IDI score decrease in the last five years;
- in 42%, IDI scores decreased while per capita gross domestic product (GDP) increased; and
- in 75%, wealth inequality declines were the main driver, increasing 6.3% overall.

From a South African standpoint the results are even more sobering: the country does not feature among the top 10 African countries (Table 1), and among its G20 peers it scores last (Table 2).

TABLE 1 TEN MOST INCLUSIVE SUB-SAHARAN AFRICAN ECONOMIES

RANK	COUNTRY
1	Tanzania
2	Ghana
3	Cameroon
4	Senegal
5	Mali
6	Zimbabwe
7	CHad
8	Namibia
9	Uganda
10	Kenya

Source: WEF (World Economic Forum), 'Inclusive Growth and Development Report'. Geneva: WEF, January 2017

Overall, South Africa ranked 69th out of 107 countries surveyed. That said, its score is better than many would anticipate, given its poor inequality ranking as measured by the Gini coefficient. This can presumably be ascribed to relatively high income transfers enacted through the national budget.

8 Education and skills; basic services and infrastructure; corruption and rents; financial intermediation of real economy investment; asset building and entrepreneurship; employment and labour compensation; fiscal transfers. The index covers 107 countries and is divided into two sets of indicators: policy and institutional; and key performance indicators. The latter includes statistics on metrics in three baskets: growth and development; inclusion; and intergenerational equity and sustainability.

TABLE 2 HOW INCLUSIVE ARE THE G20 COUNTRIES?

ADVANCED ECONOMIES	OVERALL IDI SCORE	IDI RANK WITHIN GROUPING	ADVANCED ECONOMIES	OVERALL IDI SCORE	IDI RANK WITHIN GROUPING
Australia	5.18	8	Argentina	4.43	10
Germany	4.99	13	Russian Federation	4.42	12
Korea, Rep	4.95	14	China	4.40	14
Canada	4.90	15	Turkey	4.30	19
France	4.83	18	Indonesia	4.39	21
UK	4.69	21	Mexico	4.13	28
US	4.44	23	Brazil	4.13	29
Japan	4.36	24	India	3.38	59
Italy	4.18	27	South Africa	3.09	69

Source: WEF, 'Inclusive Growth and Development Report'. Geneva: WEF, January 2017

PATTERNS OF INEQUALITY

Turning to inequality, there is broad consensus among economists on two points, as reflected in some key sources reviewed below. Firstly, in-country inequality has increased recently in some places, particularly in developed economies. Secondly, cross-country inequality has declined.

Increasing in-country inequality is clearly a key driver of populist, including anti-trade, sentiment, notably in developed economies. This generates some interesting analytical debates; for example, does the rise of the 'super rich' necessarily mean that the poor are worse off? Not necessarily, particularly if those super rich provide decent jobs in their companies. However, this does not obscure the fact that some businesses, especially in the financial sector, generate enormous amounts of wealth concentrated in very few people, and with no obvious broader benefit to society. Oliver Stone's *Gordon Gekko*⁹ comes to mind. It also does not obscure the fact that a few people inherit fabulous amounts of money without necessarily having to work for it.

Turning to cross-country inequality, Hellebrandt and Mauro¹⁰ make several key observations. By US standards most of the world's population lives in poverty. However, the average global Gini coefficient is in secular decline (meaning reduced

9 The main character in the film *Wall Street* (1987) is Gordon Gekko, a Wall Street financier. He famously says 'Greed is good.' Ultimately, he ends up in prison for insider trading. See Wikipedia, 'Wall Street', [https://en.wikipedia.org/wiki/Wall_Street_\(1987_film\)](https://en.wikipedia.org/wiki/Wall_Street_(1987_film)), accessed 3 November 2017.

10 Hellebrandt T & P Mauro, 'The Future of Worldwide Income Distribution', Peterson Institute for International Economics Working Paper, 15-7, April 2015, <https://piie.com/publications/working-papers/future-worldwide-income-distribution>, accessed 16 November 2017.

global inequality). This is mostly driven by rising incomes in developing countries, particularly in China and India. Yet, in projecting these patterns to 2035, they note that higher-than-expected Chinese growth could increase global inequality, simply because China would be above the mean and carry enormous relative economic weight. By contrast, with India below the mean, higher-than-expected Indian growth could decrease global inequality. Overall, by 2035 global poverty, by their projections, will largely be concentrated in sub-Saharan Africa and South Asia.

They also highlight the fact that these huge income shifts will change global consumption patterns significantly, especially in sub-Saharan Africa and South Asia, which, paradoxically, are characterised by the most rapid population increases and relatively high economic growth. While poverty will thus be concentrated in these two regions, their rapid urbanisation and the move from subsistence to urban consumption profiles will generate attendant opportunities for higher living standards and social inclusion, although this will be an uneven process.

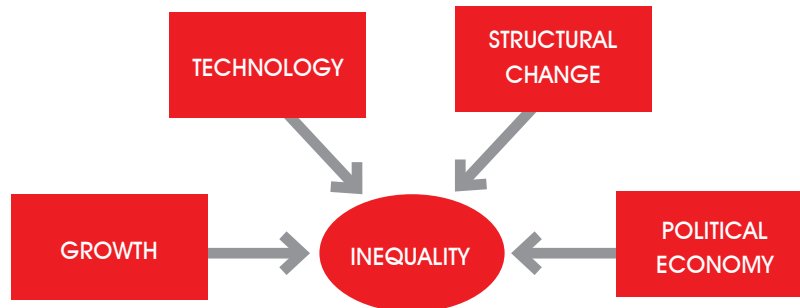
It is apparent that the world is steadily becoming more affluent, even as some regions are left relatively far behind

From these analyses and numbers, it is apparent that the world is steadily becoming more affluent, even as some regions are left relatively far behind. This fact should be cause for celebration, yet much of the international debate, at least outside technocratic policy and academic circles, either does not acknowledge this or wilfully ignores it. Economic globalisation, especially trade, is regularly singled out as the main culprit. Clearly the in-country inequality story plays a significant role in this, and is a key driver of populism and its attendant anti-trade, nationalist manifestations. This means it is important to understand the drivers of in-country inequality.

WHAT DRIVES INEQUALITY?

It is important to appreciate that there are many influences on inequality. Figure 1 sets out some key impact channels, besides trade.

Economic growth is a major influence. In China rapid economic growth generated enormous income gains, lifting hundreds of millions of people out of poverty through a process of historically unprecedented modernisation and including them in the economic mainstream. Trade and investment (discussed in more detail in the next section) played an important role in this transformation and in other successful transformation experiences, notably in East Asia. This positive story is, nonetheless, marred by the fact that a small elite stratum became extremely wealthy in the process, meaning that in-country income inequality in China rose substantially through the period of rapid growth.

FIGURE 1 NON-TRADE INFLUENCES ON INEQUALITY

Source: Tutwa Consulting Group

Many economists would argue that the greatest cause of rising in-country inequality is technology, captured in the notion of the Fourth Industrial Revolution. The idea of lawyers or even doctors being replaced by artificially intelligent machines is no longer far-fetched; never mind the implications for factory workers being replaced by industrial robots, or for low-wage, unskilled labour in developing countries hoping to benefit from the ‘flying geese’¹¹ phenomenon of industrial relocation out of China. While trade also has something to do with this, particularly the intensification of global value chain (GVC) development in relation to labour-intensive work, it is technology that enables coordination of those value chains and their relocation back to the developed countries that are at the origin of most GVCs.¹²

The previous two points highlight the fact that as economies develop over time, so they undergo structural change. This is an unavoidable feature of economic development, generating spatial inequalities. The phenomenon was integral to the UB40 song highlighted at the beginning of the paper, namely the shift of industries out of the structurally uncompetitive north and West Midlands of the UK in the 1970s and 1980s, leaving behind regions that were not equipped to participate in the rapidly evolving international division of labour. This phenomenon could also be

11 The term was coined by Akamatsu and originally applied to Japanese investments in South-East Asia. See Akamatsu K, ‘A historical pattern of economic growth in developing countries’, *Journal of Developing Economies*, 1, 1, March–August 1962, pp. 3–25. Interestingly, the theory predicts that some countries on the periphery will, over time, emulate the advanced country’s (Japan, in Akamatsu’s theory) industrial capabilities, and thereby come to compete directly, generating tensions in the process.

12 3D printing technologies allow for the possibility of decentralised production at the point of demand, bypassing the need for huge, labour-intensive GVCs with parts and components crossing borders multiple times. In this vision of the future, footwear designs can be downloaded off the Internet and the shoes printed in home offices. The premium on intellectual property rises inexorably as these technologies advance.

called ‘deindustrialisation’. It is a key feature of politics in some Western societies. Take the US, where Trump successfully mobilised less affluent, predominantly white, working class voters in the traditionally Democratic ‘rustbelt’ states on an anti-trade, ‘America First’, ticket. Similar impulses are in play in parts of the modern UK, as well as in Western European states. They are also to be found in developing countries, such as South Africa, with relatively diverse industrial structures currently facing major competitive headwinds from China, and Asia more broadly, inter alia. In fact, the problem is worse in developing countries facing the prospect of the ‘middle-income trap’ – squeezed from below by labour-intensive, low-cost producers and from above by developed countries that dominate the intellectual property-intensive heights of GVCs.

Finally, a paper covering South Africa and Africa would not be complete without mentioning political economy. While the concept is broad, encompassing many possible meanings, here the structure of power relations in African societies is

The structure of power relations in African societies is central, since these determine distributional arrangements and, therefore, inclusion and inequality patterns

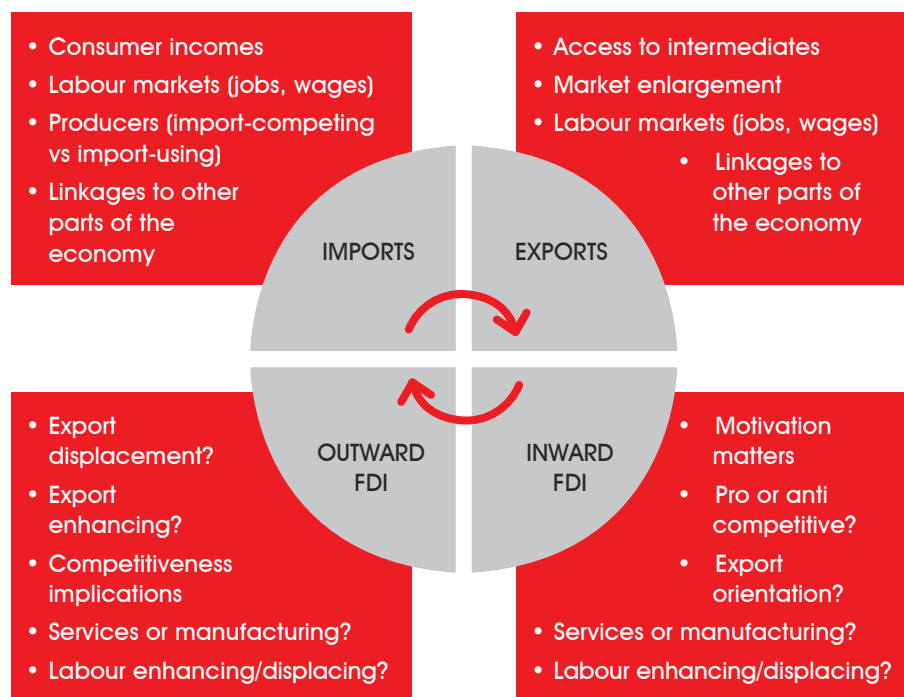
central, since these determine distributional arrangements and, therefore, inclusion and inequality patterns. Central to this are predominant neo-patrimonial and patriarchal relations. The latter structure access to resources along gender lines, particularly in rural areas. The former are characterised by the continuing salience of ethnicity in access to power and the associated distribution of the benefits of power, leading some to question whether a ‘development ethic’ is precluded in certain sub-Saharan African societies.¹³ While this may be an extreme view, it is evident that in some societies neo-patrimonial relations continue to play a crucial role in development patterns.

Clearly, these forces are mutually reinforcing, meaning that there is a powerful cocktail of drivers of in-country inequality. But what role does trade play?

WHAT ROLE DOES TRADE PLAY IN GENERATING INEQUALITY?

Trade, and its close counterpart, investment, impact on inequality through four channels, as shown in Figure 24. It is important to bring investment into the discussion, since it is a vital driver of economic globalisation and a key mode of entry for multinational companies (MNCs) looking to access new markets. Indeed, the world of GVCs cannot be understood without reference to both trade and investment.

¹³ In this regard many South Africans are concerned about state capture and associated corruption linked to government procurement.

FIGURE 2 CHANNELS OF TRADE AND INVESTMENT IMPACTS ON INEQUALITY

Source: Tutwa Consulting Group

The most controversial channel is imports of goods. These could impact positively on consumer incomes in three ways – cheaper prices, higher quality, and availability of goods where none had previously been obtainable. However, they could also impact negatively on labour markets, displacing workers in import-competing companies and/or suppressing wages, both effects caused by lower prices. This points to effects on producers; again, these could be positive (access to previously unavailable or high-priced and/or lower quality inputs) or negative (directly competitive products threatening the bottom line). The issue of intermediate inputs is particularly important, since it highlights linkages to other parts of the economy. For example, cheap Chinese steel imports may be bad for Mittal Steel in South Africa, but could be beneficial for downstream steel fabricators otherwise beholden to import parity pricing. Therefore, impacts on production cannot be disentangled from broader value chain considerations. This makes producer impacts complex to discern and controversial, unlike the consumer impacts, which are much easier to fathom and are generally positive.

At this point it is pertinent to state trade economists' long-observed dictum that the gains from import protection are concentrated in those seeking it (typically

producers and labour unions) whereas the costs are dispersed (consumers). This is derived from Mancur Olson's classic work *The Logic of Collective Action*.¹⁴ As he demonstrated theoretically, it is far easier to mobilise a small group and, through this small group, influence or even capture¹⁵ a policy process. In Olson's theory this leads to an accumulation of special interest groups in society over time, generating resistance to structural change and ultimately, as Olson argued in a subsequent work,¹⁶ creating structural economic stagnation. Like barnacles clinging to the hull of a ship, these interest groups clog up the regulatory and policy system, weighing the ship down. In this Olsonian perspective, trade opening plays a crucial role in shaking up the structure of special interest groups invested in avoiding import competition, in favour of consumers, which by implication promotes income growth and may reduce in-country inequality. At the same time, trade opening promotes cross-country convergence, reducing cross-country income inequality.

Inward foreign direct investment (FDI) is the investment counterpart of the import competition story. The motivation behind the investment matters, since it determines how the investment will be conducted in the host country. Market-seeking FDI, by definition, is likely to be directly competitive with local producers, raising the prospect of negative reactions from domestic incumbents. Such reactions may generate backlashes from powerful special interests, leading to policy changes that attempt to close the market to competition. In other words, market-seeking FDI leads to the exercise of political power by special interest groups. This still leaves open the question as to whether the investment in question enhances or reduces welfare. On balance, most economists would probably argue that market-seeking FDI is welfare enhancing, but much is contingent, defying blanket generalisations. Nonetheless, it is instructive that governments around the world generally encourage and, through their investment promotion agencies, actively promote such FDI.

Resource-seeking investments are less likely to generate negative reactions since they are apt to be export-oriented. They may generate other policy reactions, such as 'resource nationalism', but those are unlikely to have significant implications for inequality patterns and debates, although where resource exports are involved that may not be true (this is discussed below). Efficiency-seeking investments, such as the vast electronics assembly platforms to be found in East and South-East Asia, generate their own controversies. Do they result in exploitation of low-wage labour? To which the counter-factual question is, would such labour be better off being employed by local companies? Or would they find employment at all? Again, much is contingent on the country, investor and sector concerned, and its relationship to

14 Olson M, *The Logic of Collective Action: Public Goods and the Theory of Groups*. Cambridge MA: Harvard University Press, 1965.

15 Again, South Africans reading this paper will be intimately familiar with the term 'capture'. While events around this issue are still rapidly unfolding, they concern a small group of businesspeople and politicians around President Jacob Zuma that has systematically subverted state institutions in order to extract rents and fund a patronage network, on a grand scale.

16 Olson M, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities*. New Haven and London: Yale University Press, 1982.

GVCs. That said, the empirical evidence, at least from East Asia with its ‘flying geese’ pattern of development, seems to suggest that this kind of investment can be hugely beneficial for development, if appropriately managed by the host government.

The empirical evidence, at least from East Asia with its ‘flying geese’ pattern of development, seems to suggest that this kind of investment can be hugely beneficial for development, if appropriately managed by the host government

Outward FDI generally attracts less controversy than inward FDI. In principle it can lead to an ‘export pull’ force, as the company looks to leverage its home base to service the new investment location. The home base may also be upgraded in the value chain, since it is the site of coordination of the value chain, leading to accumulation of knowledge and the repatriation of profits. However, outward FDI is controversial in some countries, for example the US, where the core thrust of Trump’s current tax reform initiative is to entice US companies to repatriate capital shifted offshore many years ago, as well as to shorten their value chains by relocating production back to the US. The latter is a key driver of the Trump administration’s push to renegotiate the North American Free Trade Agreement. This issue has also featured in South African policy debates, with concerns being expressed in some quarters that jobs have been exported from the country, and that there have been negative impacts on African hosts. Overall, it is difficult to generalise about the impacts of outward FDI on inequality, since much is, again, contingent.

Finally, almost all governments encourage exports. Exports earn foreign exchange, which enable imports, and lead to relatively sustainable employment creation, since the productive activity is presumably relatively competitive. All of this should be welfare enhancing, and may also reduce in-country inequalities while promoting social inclusion. Cross-country inequalities may be reduced through the positive consumer and producer effects on the receiving country, as cited in the paragraph on imports. Clearly, however, it could also generate the negative labour and producer effects discussed there. Furthermore, with resource nationalism gaining ground in certain parts of the world, it is evident that export restrictions are being revisited as a policy tool. This is linked to broader desires to promote domestic value addition within the value chains built on the resources in question. In the South African case, this policy thrust is termed beneficiation. In theory, upgrading within value chains, which is the orientation of this policy thrust, makes sense. However, it also raises many questions, such as whether the country concerned has sufficient financial and technical resources, and the productive capacities, to invest in what are typically capital-intensive processes, and whether the opportunity costs relative to other potential investments (eg, educating the poor) are worthwhile. Furthermore, restricting exports constrains other countries’ production options further down the value chain, and is likely to be unfavourably received, inviting potential retaliation

or trade disputes. For this reason export restrictions have long been an issue of interest to WTO members.

Pavcnik¹⁷ highlights a number of other determinants of inequality patterns within countries that bear some relationship to trade and investment channels. These are captured in Figure 3.

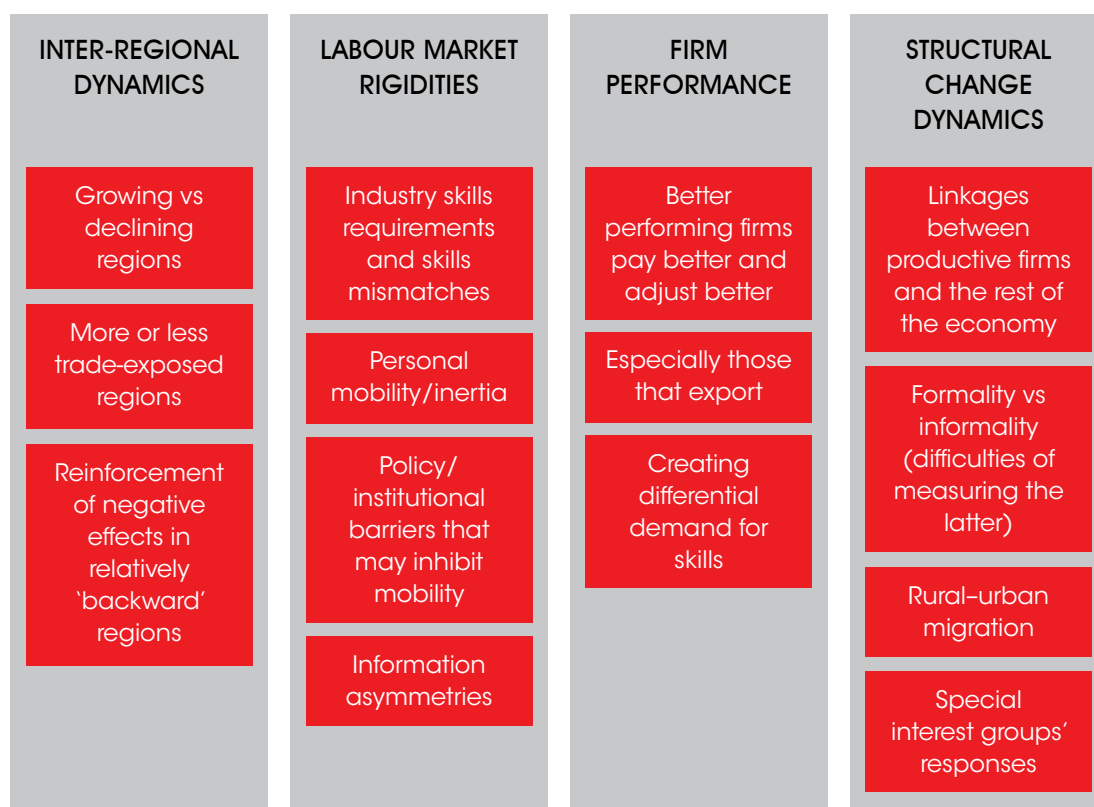
It is obvious that within countries different regions have different socio-economic bases and prospects. It follows that import liberalisation will have differential impacts on these regions. Some are more or less trade exposed, with the former perhaps being more resilient and adaptive to import shocks. Others, like the UK's West Midlands of the 1980s, are in relative decline and/or suffer from relative economic backwardness.

These regional dynamics are clearly connected to labour market dynamics. Depending on which industries are growing or declining in the region in question, there could be skills mismatches – both shortages (growing industry; low supply of required labour) and surpluses (declining industry; over-supply of labour). How workers respond to these dynamics is an important issue. Pavcnik notes that for various reasons many people living in structurally repressed regions choose not to migrate to where their work opportunities could be better. There could also be policy or institutional barriers that inhibit such migration. In the Chinese case, for example, internal worker mobility is still tightly regulated. In many countries there might be housing shortages in the growing region, resulting in high or even prohibitive rentals. On top of this, workers in structurally repressed regions may not be fully aware of the opportunities opening up in advancing regions; in other words, there may be information asymmetries in play. Few of these issues have much to do with trade per se; rather they condition how workers respond to trade shocks.

Faced with either import competition or export opportunities, firms are differentially endowed to respond. Pavcnik notes that better performing firms are better placed to export, and therefore to grow and pay their workers better. But how do you ensure – as the worker – you pick the right firm? In addition, the better performing firms are also in a stronger position to choose the workers they want and invest in technological upgrading by leveraging the Fourth Industrial Revolution. This could displace some workers within the firm, particularly at the lower end of the skills chain. And so on.

These issues add up to determine structural change patterns within the economy in question. How different regions within the country respond to trade shocks is a function of their initial endowments, labour market dynamics, population of productive firms in growing and/or declining sectors, and mix of government policies constituting the business and living environments, inter alia.

17 Pavcnik N, 'The Impact of Trade on Inequality in Developing Countries', Paper delivered at Annual Jackson Hole Symposium, Federal Reserve Bank of Kansas City, 25 August 2017, <https://www.kansascityfed.org/publications/research/escp/symposiums/escp-2017>, accessed 4 November 2017.

FIGURE 3 INTRA-COUNTRY FACTORS INFLUENCING INEQUALITY IN RELATION TO TRADE

Source: Tutwa Consulting Group

Overall, therefore, the impacts of trade on in-country inequalities defy generalisations. They also seem to be relatively small compared to the range of factors discussed in this section. Additionally, it is crucial to consider their net effects: some countries are likely to benefit from trade and investment openings overall while experiencing in-country differential impacts; others may lose overall even though regions within the country experience dynamic gains.

DOMESTIC POLICY RESPONSES

The conclusion from the previous section necessarily means that domestic policy responses must also be contingent, and calibrated to the likely differential impacts across all regions within the country concerned. Depending on the political system in the country concerned, some policy responses may best be targeted at decentralised levels rather than remaining within the purview of national government. Furthermore, countries are differentially endowed with the requisite

institutional capacities to respond to trade shocks, never mind to formulate and implement economic policies overall. What works in Western Europe is not necessarily transferable to Africa, and vice versa.

With this in mind, Figure 4 sets out a framework capturing potential national and sub-national policy options, drawing on Pavcnik¹⁸ and a recent Organisation for Economic Co-operation and Development report.¹⁹

Figure 4 provides a menu of policy options, contingent on the country's circumstances. These options are not discussed in detail here, but suffice to say that there are many policy options, each with its own cost–benefit set, and controversies. None of this, of course, should detract from the need for countries to continue anticipating structural change (since this is a given in the international economic order) and implementing policies that assist with that inevitability rather than resist it.

Many, if not most, of these measures likely would not impact negatively on trading partners' rights; in other words, they are liable to be WTO compatible. Where they veer into provision of subsidies, import protection, export restrictions and discrimination against foreign investors – all of which are meant to change value chain control and rents, albeit in different ways – they are more likely to be challenged. An additional point worth considering is that poor countries, such as in Africa, often lack the resources and/or institutional capacity to implement many of these policies. This fact highlights the danger of Western bias in debates over trade and inequality. It should also alert African policymakers to the need to be aware of the potential impacts of measures invoked in the name of redressing inequality arising from trade shocks, since those impacts could be highly prejudicial to African export interests, and therefore African countries' development prospects. Indeed, African countries should assert the principle that such measures, no matter who applies them, need to be in conformity with WTO principles and law. However, by the same token African countries need to recognise that if they pursue such policies at home, their trading partners are likely to respond.

Moreover, there is a case to be made that advanced countries should continue to support poor countries' structural adjustment efforts, and through this their continued integration into the global economy. Several multilateral efforts address different dimensions of this issue, notably Aid for Trade, the Sustainable Development Goals and international development finance. In addition, efforts to combat base erosion and profit shifting (BEPS), to build the domestic resource mobilisation capacities of poor countries, are critical. In this both poor countries prone to corruption and rich countries whose MNCs avoid paying taxes through BEPS, need to step up. All these efforts need to be continuously updated and intensified, with increasing focus on those where global poverty is likely to be increasingly concentrated, ie, sub-Saharan Africa and South Asia.

18 Pavcnik N, *op. cit.*

19 OECD (Organisation for Economic Co-operation and Development), *Economic Outlook*, 2017, 1, ch. 2.

FIGURE 4 **EXAMPLES OF DOMESTIC POLICIES FOR PROMOTING INCLUSION AND REDUCING INEQUALITY**

COMPENSATION/REDISTRIBUTION?	LABOUR MARKET INTERVENTIONS, EG:
<ul style="list-style-type: none"> • 'Automatic stabilisers' such as unemployment benefits, notably those to be found in European welfare states • Income support measures <ul style="list-style-type: none"> » Many countries cannot afford them; even developed countries are struggling to maintain them in the wake of the global financial crisis » Cannot fully compensate for loss of jobs/income, and very often difficult to access, especially in poor institutional environments 	<ul style="list-style-type: none"> • Requiring firms to give longer layoff notice periods • Vocational training/reskilling, matched to education investments • Employment subsidies • Addressing information asymmetries through provision of 'job-matching' services • Making rights portable with workers, rather than with jobs • Adapting institutions to sub-national contexts <ul style="list-style-type: none"> » Effectiveness and costs are disputed, especially trade-specific programmes » May require well-established social partnership traditions and institutions (eg, in Sweden, Germany) » Can be controversial
PROVISION OF PUBLIC GOODS, ESPECIALLY IN DEPRESSED SUB-NATIONAL REGIONS	PROTECTIONISM?
<ul style="list-style-type: none"> • Subsidised schooling • Housing policy reforms • Transport policies and provision • Public services • Promote integration into cross-border value chains (provision of complementary services; R&D support; business environment upgrading) <ul style="list-style-type: none"> » Fiscal implications and management can be difficult, especially where different tiers of government are involved » Governments dependent on import duties to fund the fiscus can be particularly hard hit by liberalisation 	<ul style="list-style-type: none"> • May slow decline of depressed regions <ul style="list-style-type: none"> » Creates its own distributional consequences » Undermines long-term competitiveness » Inhibits export expansion, potentially penalising productive firms

Source: Tutwa Consulting Group, based on Pavcnik N, 'The Impact of Trade on Inequality in Developing Countries', Paper delivered at Annual Jackson Hole Symposium, Federal Reserve Bank of Kansas City, 25 August 2017, <https://www.kansascityfed.org/publications/research/escp/symposiums/escp-2017>, accessed 4 November 2017; OECD (Organisation for Economic Co-operation and Development), *Economic Outlook*, 2017, 1, ch. 2

IMPLICATIONS FOR THE WTO

Elaborating implications is a complex affair. So much of the terrain traversed in this paper is contingent on country circumstances, and those country circumstances vary so widely that drawing general conclusions is always going to be risky. Moreover, trade (and investment) are relatively marginal influences on inequality levels yet receive a disproportionate share of the blame; within this, thinking and positions are deeply entrenched.

Many advocate the need to avoid a ‘race to the bottom’ globally, in terms of institutions and standards. This is one potential implication should the multilateral rules-based order unravel, freeing countries to pursue ‘beggar thy neighbour’ policies in order to increase their share of global FDI and trade. Historically, this has not turned out well for international order, peace and security. Furthermore, it is evident that as economic development and integration march inexorably onwards, there is a growing need to update the regulation of business and international economic conduct.

Therefore, rather than risk levelling down the playing field, proponents advocate a gradual levelling up in several policy domains, inter alia labour, environment, competition policy, state-owned enterprises, investment and e-commerce. The idea is to continuously upgrade and update the rules framework, both to adapt to new economic circumstances and to prevent regulatory competition from undermining the system. These rules areas are also important to the MNCs that operate, and control, GVCs. According to this logic, therefore, improving the environment within which these firms operate is likely to increase the propensity to invest, thereby generating positive welfare effects – both for the host country and for the planet.

However, this idea has its critics. That populist politicians find the WTO to be a convenient scapegoat for domestic troubles is to be expected, unsettling though it may be. Yet there are sound intellectual foundations for a sceptical approach. The introduction highlighted Ruggie’s seminal insight that the WTO system is founded on the notion of embedded liberalism. It was always expected that countries would be differentially placed in terms of their national policy agendas and problems, and so the system was meant to accommodate such differences.

Taking this critique further, Dani Rodrik²⁰ argues forcefully for reasserting the rights of states to regulate according to their institutional capabilities and needs, rather than being straightjacketed by the WTO or other trade agreements. He is sharply critical of what he terms ‘hyper-globalization’, which he regards as ultimately incompatible with both deepening democracy at the national level and sustaining this democracy through sovereign regulatory preferences aimed at promoting social inclusion. He comes down clearly on the side of sovereignty and promoting national democracy, arguing for a light approach to global regulation in order to accommodate the many

20 Rodrik D, *The Globalization Paradox: Why Global Markets, States, and Democracy Can’t Coexist*. Oxford: Oxford University Press, 2011.

national and subnational circumstances undoubtedly in play. Although he does not explicitly acknowledge Ruggie, his argument is in essence similar.

The literature reviewed above is largely supportive of this approach. However, there are some wrinkles.

First, and this question is perhaps not best posed to economists, does the multilateral trading system need to keep moving forward in order not to come unstuck? This notion is captured in a popular Geneva term: the ‘bicycle theory’. Currently, the WTO is mired in the doldrums, with the action on the trade negotiations front having moved some years ago to the many regional trade arrangements being

The longer the WTO’s negotiating mechanism is bypassed, the more likely it is that key rules will be set in regional and bilateral forums, and primarily by the powerful players, potentially at the expense of poorer, weaker countries

established across the world. The WTO still provides a baseline of rules and institutions, backed up by its jewel in the crown: dispute settlement.²¹ However, the longer the WTO’s negotiating mechanism is bypassed, the more likely it is that key rules will be set in regional and bilateral forums, and primarily by the powerful players, potentially at the expense of poorer, weaker countries. Trump’s trade policy approach, if not yet his practice, is premised on the notion of bilateral rather than regional or multilateral deals (the WTO). The longer the US remains committed to this path the more likely it is that the WTO will suffer from benign neglect, and will be at risk of becoming irrelevant.

Arguably, therefore, countervailing power to revitalise the WTO needs to be exercised by a broad coalition of developed and developing countries. The paradox is that this will require reviving the WTO’s negotiations function, and cutting some deals. Many WTO observers, this author included, think that this will require a plurilateral approach to negotiations, given the inherent difficulties involved in forging deals among so many countries with such diverse interests, notwithstanding the success of the Trade Facilitation Agreement (TFA). Where plurilaterals prove elusive or too controversial, it also points to taking limited pairs of issues with a view to providing sufficient scope for cross-issue trade-offs to facilitate deals in more than one area at a time. In advance of Buenos Aires, agriculture and e-commerce

21 It is important to note that, as national delegations head to Buenos Aires for the 11th Ministerial Conference of the WTO, a potentially major crisis is brewing in the Dispute Settlement Mechanism (DSM), specifically the Appellate Body. This issue has a long lineage, predating the advent of Trump, but has reached crisis point now as the US is blocking the appointment of Appellate Body members, rendering the institution potentially dysfunctional. If the Appellate Body ceases functioning, then disputes cannot be resolved in the DSM, meaning that the rules cannot function. If the rules do not function then the WTO, which is built on its rules, will not function either.

come to mind. Overall, this goes against all-encompassing, single-undertaking negotiating rounds such as the dead, if not buried, Doha Round.

This highlights a second wrinkle. Implicit in Rodrik's work is the idea that states will naturally cooperate in order to develop global regimes, however lightly they may be framed. Yet balance of power orders historically have proved unstable, particularly when premised on mercantilist ideologies.²² Should the WTO fail, and the liberal international economic order with it, the world would undoubtedly find itself back in a more overt balance-of-power, mercantilist (dis)order. It is difficult to see how this would be in the interests of poor countries, notably in Africa.

There is a third, perhaps more fundamental, wrinkle. Rodrik's conception of how to promote people-centred globalisation, centred on democracy at home, assumes that liberal democracy is both the natural direction of political evolution and where the critical mass is to be found at the international level. Indeed, in his classic dissection of the foundations of the liberal international economic order, the German Social Market economist Wilhelm Ropke argued that the most important ingredient was liberal democracy at home.²³ He is worth quoting at length:²⁴

[E]verything depends on whether we are dealing with states which are not merely 'democratized' but with liberal states where the constitution guarantees justice to the individual, where the government is kept within rigid and narrow limits, and where by means of federalism, economic freedom, the prevention of the amassing of gigantic fortunes and of monopolies, by free intellectual life and a division of power, the supreme power has been so decentralized as to make it innoxious [sic] both at home and abroad ... This programme ... derives from a deep insight into the nature of man, confirmed in the course of thousands of years, which teaches us that there is no concentration of power which is not abused.

Ropke strongly cautions against pursuing 'false internationalism' by engaging in international institutions with no intention of implementing anything that might impinge on sovereign states' prerogatives to pursue illiberal policies at home. For him, charity begins at home, and the foundation of the liberal international economic order is the (Western) liberal states that built it.

Or, to adapt Ruggie to Ropke's framework, 'embedded illiberalism' is doomed to fail. Yet that may be the direction in which the world is headed. Consider Trump's election and the largely negative global reaction it engendered, along with mounting concerns over his commitment to the liberal international economic order; coupled with the simultaneous consolidation of power in China under President Xi Jinping

22 Findlay R & KH O'Rourke, *Power and Plenty: Trade, War, and the World Economy in the Second Millennium*. Princeton: Princeton University Press, 2007. This book provides a magisterial, detailed and nuanced history of the intersection between power and politics in shaping the modern world trading system.

23 Ropke W, *International Order and Economic Integration*. Dordrecht: D Reidel Publishing Company, 1959.

24 *Ibid.*, p. 23.

a year later, along with his explicit promise to internationalise China's model of development. Some scholars observe that China's party state-driven model of economic development poses profound challenges to the WTO as currently conceived, and may ultimately be incompatible with the WTO system.²⁵ This is notwithstanding Xi's overt statements that China is ready to lead.²⁶ Look beyond China, and there are growing signs that illiberal authoritarianism is taking root in different parts of the world, from Turkey to East Africa. Some have dubbed this phenomenon the rise of state capitalism.²⁷ As the world becomes more multipolar, it is increasingly likely that the leaders of these countries will not worry too much about the normative requirements of the liberal international economic order. The growth of Western (and other) populisms reinforces this trend.

In the end these trajectories need not be fatal to the WTO system, but they do point to the declining influence of the system's founders, namely Western liberal democracies.

HIGH-LEVEL RECOMMENDATIONS FOR THE SOUTH AFRICAN GOVERNMENT

What is the South African government to make of all this? The following recommendations, in keeping with the thrust of the paper, are necessarily high level.

ORIENTATIONS TOWARDS THE INCLUSIVENESS/INEQUALITY DEBATE

South Africa has a strong interest in this issue, based on its apartheid past, and therefore much to contribute. However, when it comes to the role played by trade in generating inequality, it is far less obvious what the nature of that contribution might be. Overall, therefore, South Africa should support the debate, the legitimacy of which is not in question, while keeping a close eye on the policy orientations it engenders. Since South Africa is a strong advocate of sovereignty at the international level – especially in the WTO, where it consistently argues for policy space – it should align itself with those seeking flexibility in the development and application of WTO rules as a general orientation. However, it needs to guard against such flexibilities being too widely interpreted and too widely applied, resulting in the system itself being undermined, with detrimental consequences for South Africa and its poorer African neighbours.

25 Wu M, 'The "China Inc." challenge to global trade governance', *Harvard International Law Journal*, 57, 2, Spring 2016.

26 Xi asserted this at the January 2017 Annual Summit of the World Economic Forum in Davos, Switzerland. The author was present. Reactions were mixed, with many welcoming his leadership in the context of the great uncertainty attendant on Trump's then impending inauguration; many were also sceptical, for the reasons sketched out in *ibid.*, *inter alia*.

27 See *The Economist*, 'The visible hand: Special report on state capitalism', 21 January 2012, <http://www.economist.com/node/21542931>, accessed 21 November 2017.

THE WTO SYSTEM IN RELATION TO POLICY SPACE

Since inequality and social inclusion are such pressing issues in the country, this raises a challenging dilemma for South Africa, which experiences the ‘embedded liberalism’ compromise perhaps more sharply than many other states. On the one hand, South Africa has much to lose if the WTO system unravels, leaving it, and its neighbours, at the mercy of more powerful trading partners. Therefore the country must strive to maintain and strengthen the system. On the other hand, South Africa’s policy space imperatives increasingly propel it to implement domestic policies that its trading partners may come to view as illiberal and not in keeping with the embedded liberalism compromise. At some point this is bound to invite retaliation and lodging of disputes in Geneva. Such disputes may help the country to clarify the limits of policy space, but may also strengthen the hand of special interests that seek greater import protection at home, and of local populists that seek more radical solutions. Should these groups get their way, in the view of this author, it would be likely to result in outcomes detrimental to social inclusion and the fight against inequality.

CONSTRUCTING THE WTO’S FUTURE NEGOTIATING AGENDA

So how best to build the WTO system without encouraging those advocating potentially harmful policy space or even withdrawal orientations? Overall, the best approach is an incremental one. This starts with recognising that the Doha Round, if not its Development Agenda, is dead, as a practical proposition. This all-encompassing approach to WTO negotiations does not have a short- to medium-term future, if indeed it has one at all. Rather, South Africa should identify a handful of key issues on which it seeks to negotiate multilateral solutions, and then look for the most appropriate methodologies for delivering on these.²⁸ That is likely to involve a mixture of plurilateral and single-issue general negotiations, drawing on the approaches pioneered in the TFA negotiations. Clearly this needs to be premised on a strong appreciation of where South Africa has ‘offensive’ interests, in relation to how pursuit of those interests may impact poorer countries, using the inclusion/inequality frameworks currently being debated internationally. Defensive interests are far more likely to be clearly defined, not least because those most prone to be impacted will be the first to queue at the government’s door. However, these specific interests need to be weighed against broader societal interests.

28 These issues and approaches are explored in detail in Draper P *et al.*, ‘Restoring Multilateral Trade Cooperation: Reflections on Dialogues in Five Developing Countries – Diagnostic Report’, SAIIA (South African Institute of International Affairs), 9 December 2015, <http://www.saiia.org.za/general-publications/950-2015-12-09-restoring-multilat-trade-cooperation-diagnostic-report/file>, accessed 21 November 2017.

