CENTRE FOR EUROPEAN REFORM

Conference report: Brexit and the economics of populism

Ditchley Park, Oxfordshire
4-5 November 2016

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Executive summary

November's conference brought together 50 leading economists and commentators to consider Brexit and the economics of populism. Was Britain's vote to leave the EU the first rebellion in a developed country against globalisation? Was further globalisation of trade and finance compatible with political stability? To what extent should we blame the macroeconomic policy response to the financial and euro crises for rising populism? Did we need stronger institutions to regulate, stabilise and legitimise markets? Did we need more income redistribution to counter inequality, more investment, and stronger action against rent-seeking? Could governments counter anti-immigrant feeling by employing the right mix of economic and social policies? Or could immigration be limited without damaging side-effects?

The participants largely agreed that globalisation had not been the driving force behind the Brexit vote. Rising inequality and economic insecurity had been factors, but reflected the deregulation of labour and financial markets, technological change and tax and housing policies, more than globalisation itself. Social and cultural factors had also played a major role in the vote. The relationship between economic wellbeing and backing for populists was loose. Brexit supporters were much older than average, had not been affected economically by immigration or suffered disproportionately from the financial crisis.

Support for central bank independence was fraying, there was now broad-based support among economists for government intervention to bolster demand, and an acceptance that financial stability required the authorities to actively regulate markets. There was a case for fiscal expansions and for ending the prohibition on monetary financing, but this would be no silver bullet: the productivity slowdown had started before the financial crisis, and the savings glut pre-dated it. A shock and awe strategy could also backfire by feeding populist resentment against central banks in Germany, the US and elsewhere.

For some, defending free trade and macroeconomic stability required controls on capital flows between countries. Others disagreed: financial globalisation helped individuals and states to diversify their risks and to insure against shocks. The problem was the composition of capital flows and the lack of burden-sharing between creditors and debtors. Several participants argued that there were losers from trade and they had to be compensated. Others agreed governments needed to help them, but argued that there was no more reason to worry about people who lost jobs from trade than from technological change.

For many, inequality had little to do with populism. Populist movements did not draw much support from the poor and the dispossessed, but from among older voters, who had been less affected by rising inequality, both of income or wealth, but felt alienated from cosmopolitanism. But others stressed that technology and globalisation had increased the bargaining power of the high-skilled who lived in large, rich cities relative to the lower-skilled who lived in more isolated and struggling areas. And it was in these places that populism was flourishing.

The participants agreed that hostility to migrants was rooted in nativism, not economics. Governments should stress immigration's benefits; devote more resources to areas where immigration was high; and ensure housing was affordable. A minority thought that the link between migration fears and political extremism justified tighter curbs on immigration. They were divided over whether the EU's single market required free movement of labour to work, but agreed that it was essential within the eurozone. However, it would cause serious tensions if it was the only mechanism for adjustment between members of the currency union.

Was Britain's vote to leave the EU the first rebellion in a developed country against globalisation? There were some specific British issues behind the country's vote to reject the EU. But it would be a mistake to dismiss Britain as an anomaly. The factors driving populism in the UK – resentment at stagnant living standards and inequality, discontent about migration, hostility towards elites and a sense of powerlessness – are present across the EU. So far, it is nationalists and nativists who have profited from this trend by exploiting fears over immigration to divide societies. But how should mainstream political forces respond to what has happened? Is further globalisation of trade and finance compatible with political stability? Is there a case for less labour mobility between countries, and is that possible? To what extent should we blame the macroeconomic policy response to the financial and euro crises? Do we need stronger institutions to regulate, stabilise and legitimise markets? Do we need more income redistribution to counter inequality, more investment, and stronger action against rent-seeking?

Session 1: Was Brexit a rebellion against globalisation?

On the face of it, Britain was not the obvious candidate to mount a rebellion against globalisation. After all, its economy has performed relatively well over the last 20 years, at least in a European context. No doubt, there were peculiarly British problems behind the UK's vote to leave the EU, not least, antagonism towards free movement and the EU's democratic deficit. But many of the grievances that led to the Brexit vote, including hostility towards immigration, depressed incomes, the UK's unequal society, resentment of elites in the UK and elsewhere, and a desire for more national control, can be linked to globalisation in one way or another. Which lessons should other European countries draw from the British experience?

A panel of economists, commentators and politicians were divided over the extent to which globalisation or populist politics drove Britain's vote to leave the EU. The **first panellist** considered a mix of the two to have been responsible. There was no doubt that the hyper-globalisation period, during which trade and financial flows had grown at a faster rate than global output, had come to a close. This period had been driven by China opening its markets, and also by the revolution in logistics and information technology. However, the world was at a point of diminishing returns to further internationalisation of supply chains. Financial globalisation, meanwhile, had been driven by deregulation, which was going into reverse.

On the other hand, the populist surge had three motors – anti-establishment, authoritarian and nativist. Experts had brought anti-establishment sentiment upon themselves. International trade creates losers – and the media and experts pretended otherwise. Authoritarianism – a strong leader who expresses the will, as he or she perceives it, of the people – did not play a big role in the Brexit campaign but was a major factor behind Donald Trump's victory in the US. As for nativism, the immigration issue was more symbolic than substantively economic. What linked populism with globalisation was economic insecurity, of which globalisation was just one factor: the deregulation of labour and financial markets were also important in this regard, as was tax policy.

The **second panellist** put the question in historical context. The interwar backlash against free trade and the gold standard was well-documented, but what allowed the reconstruction of European trade after World War II? One thing was the introduction of government transfers and insurance to compensate losers and insure people against risks. This had been forgotten by western policy-makers. But it might be necessary to go further, and reduce flows of labour and capital – so-called 'factor flows'. According to the Harvard political economist Dani Rodrik's globalisation trilemma, it is only possible for a country to reconcile two of the following: globalisation, national sovereignty, and democracy. The EU mostly worked through a 'golden straitjacket': nation-states agreeing rules that were chosen in a largely undemocratic way. The alternative was an EU federation, which would mean economic integration with democracy, but which would downgrade the nation-state's role in decision-making. But the third possibility – less economic integration – could be considered, mirroring the Bretton Woods compromise of controls on capital flows and more limited trade. It may be that EU trade integration might require limits to factor flows – the movement of labour and capital – in order to shore up the trade integration that had already been achieved.

What drove the Brexit vote, given that according to one opinion survey, 62 per cent of Britons would pay nothing to reduce immigration? The cost of Brexit was forecast at anywhere between 3 and 6 per cent of GDP. This would create losers. Then why had status quo bias, which usually reigns in referendums, been so weak? One reason could be economic geography, with the deindustrialised Midlands and North of England having benefitted less from EU membership than the south of the country. And the popular anger at free movement showed that co-ordinated policy was important – it was a mistake for the UK to have spurned the seven-year transitional period limiting free movement which most other member-states had used.

The **third panellist** argued that the previous speakers had advanced a centrist story of populism: that globalisation created winners and losers, which increased inequality and led to populist revolt. That story was not altogether wrong. But inequality was not a universal phenomenon, with some countries suffering from it much more than others. In the UK and the US, the top decile of the population – and in particular the top 1 per cent – had received a growing share of income. But this reflected very fast pay growth in the financial and corporate sectors in those countries, which was only loosely to do with globalisation. And the stagnation of median household incomes since 2008 partly reflected compositional changes such as higher immigration and smaller household sizes.

More than anything, Brexit reflected a loss of faith in political elites. Why did the elite prevail in the UK's 1975 referendum but not in the 2016 one? In the post-war period, the politics of Western Europe had been organised with socialism on one side, and those opposed to socialism – liberals and nationalists – on the other. After 1989, the centre-left suffered from a shrinking working-class vote and a shift towards metropolitan liberalism. Globalisation undercut the centre-left's core constituency – by promoting deindustrialisation – and as socialism receded, groups on the right realised that they had little in common with each other. Thus the Brexit vote was about factions on the right splitting up, with liberals supportive of the EU, and nationalists turning against it.

The **fourth panellist** said that globalisation was not the main factor behind the Brexit vote. The economist Branko Milanovic's famed 'elephant chart' showed that, along the global income distribution, poorer people in rich countries had seen no income growth between 1988 and 2008, while the middle of the distribution, which were largely in emerging economies, had seen fast growth. But the chart also masked a composition effect: growing numbers of people in China and other emerging economies had moved into the 80^{th} percentile, and dragged down income growth in that bracket. If one removed them, the incomes of the rich world's poor had grown by over 20 per cent between 1988 and 2008. Globalisation had therefore not had such a big impact on the global income distribution as claimed: over the last 10 to 15 years, the biggest causes of inequality were an increase in housing costs, technological change, increasing returns to skills, and weak productivity growth. These could be tackled in a globalised world. And the relationship between the economic wellbeing of voters and their support for populists was loose: for example, low employment rates in particular areas were less correlated with support for Brexit than were levels of education or home ownership. And Trump supporters were richer than the average US voter.

In the **Q&A** session that followed, most participants agreed that social and cultural factors were more important causes of Brexit than the economic consequences of globalisation. One participant pointed out that Brexiters were not anti-globalisation – even UKIP supported free trade. Leave voters were rather social conservatives and authoritarians: support for the death penalty correlated strongly with support for curbs on immigration. And another noted that Poland had been economically successful, especially compared to Ukraine, but had voted in the hard-right Law and Justice party. But a third participant suggested that the coalition of nativist populists and globalisers who wanted more free trade was peculiar to the UK and less apparent in other countries. The Leave coalition of culture warriors and nationalists, said a fourth, was not an epiphenomenon of the contradictions in global capitalism: immigration was widely blamed for stagnant living standards, but government policy was a more important factor behind this. And a fifth said that people answered the referendum question as though it were "Are you happy with what's going on?" A generalised unhappiness and anger drove both support for Trump and the Scottish National Party. People in work voted to Remain, and it was the retired who had led Britain out of the EU. These were not people who had been troubled economically by immigration.

Yet some participants thought that globalisation had played a major role in the Brexit vote. One pointed out that the international order could only work if there were common rules. Take the case of England and Scotland's footballers defying FIFA's ban on wearing political symbols by wearing poppies in international football matches. FIFA's rule was in place so that every country did not end up wearing symbols, some of which could be objectionable. But such international rules meant that some people were left feeling marginalised. The old establishment in the UK voted for Brexit because they felt alienated from the EU's arrangements, and by David Cameron and George Osborne's liberalism, which they felt was a continuation of the Tony Blair-Gordon Brown period. So the UK was moving back towards communitarianism. Another participant said that, while inequality had risen in unequal measure in different countries, that did not mean that rising inequality and economic insecurity did not matter. And the timing of the revolt meant that the global financial crisis and its aftermath had played some role in the vote. A third said that the state rescue of the banking system had led to distrust of elites and experts. And a fourth saw the 2007-08 crisis as the breakdown of the previous two decades of economic liberalism. Social liberalism and economic liberalism had come as a package, and people had turned against both.

There was a fair amount of soul-searching about the state of the economics profession. One participant said that people did not believe that Brexit would affect their living standards, and people did not trust experts. This mistrust had been reinforced by the vast majority of economists having (wrongly) forecast that there would be an immediate hit to GDP following the vote to leave the EU. Economists could not forecast well because they had lousy models, and needed to look at themselves before criticising Leave voters. Another participant said that the long-range forecasts were about trade openness and productivity, which were relationships economists understood better than near-term forecasts, which involved many variables that were difficult to model. A third said it was legitimate for people to vote to make themselves poorer, but the disdain for experts coupled with xenophobia was troubling.

Session 2: Time to rethink the macroeconomic policy consensus?

Western countries have become increasingly dependent on monetary policy as a tool for macroeconomic stabilisation and demand management. Despite borrowing costs at historic lows and negative output gaps, European governments have eschewed fiscal stimulus, leaving central banks to try and boost economic activity and inflation. Is this contributing to rising popular disillusionment with globalisation? Do governments need to rethink and employ fiscal policy more aggressively? Or is the effectiveness of macroeconomic policies hindered by openness to trade and capital flows? If so, what does this say about the political sustainability of globalisation in its current form?

The **first panellist** sought to distinguish between the cyclical problems facing the European economy, and its longer-term structural challenges: the decline in the rate of productivity growth, the fall in working-age populations, and the slowdown in the rate of growth in world trade. The problem of excessive debt in many countries – both public and private – was not a cyclical phenomenon but here to stay, limiting governments' ability to stimulate demand and weighing on private sector activity. However, there was still a short-term demand problem that needed to be addressed. Co-ordinated macroeconomic policies – those countries with the capacity to boost public spending should do so – together with country-specific supply-side reforms offered the best hope for rescuing the world economy. The problem was that opposition to expansionary fiscal policies was strong in many of the countries that had the resources to increase spending – not least, in Germany. Finally, we should not assume that anti-immigrant feeling had its roots in rising xenophobia; it was possible that it would dissipate quickly if we could get on top of the current economic problems.

The **second panellist** described the changes in macroeconomic policy thinking since the 2008 financial crisis. Before then, the consensus had been that monetary policy should be delegated to independent authorities, fiscal policy should be set to autopilot – that is, automatic stabilisers should be allowed to work but governments should not get involved in macroeconomic management by using discretionary spending or investment – and financial risk management should rely on market discipline. Since the crisis, this consensus had broken down: the unanimity in favour of a high degree of central bank independence was fraying, there was broad-based support for government to intervene where necessary to bolster demand, and financial stability required the authorities to regulate markets rather than giving them free reign.

Had the UK drawn the right policy lessons from the financial crisis? Fiscal and monetary policies had not been ideal but had not deviated dramatically from what would have been optimal. While the institutional fiscal policy setting could be improved by more delegation to independent bodies and less rigid rules, monetary policy was organised as it should be. The challenge for monetary policy was that economists did not agree on which instruments central banks should be employing when inflation expectations had fallen as low as they had. To mitigate the economic fallout from the Brexit vote, UK policy-makers needed to impart both monetary and fiscal stimulus.

The **third panellist** argued that there was no macroeconomic policy consensus, at least in Europe. The disagreement over the future direction of monetary policy was especially stark, with hostility to the European Central Bank's (ECB) expansionary stance growing in Germany; ECB policy was likely to be an issue in 2017's general election. Nor was there any consensus over the appropriate fiscal response to the ongoing weakness of economic activity. Whereas many eurozone governments were – with tacit European Commission backing – taking their time in meeting their budget targets, there was no consensus in favour of a pan-eurozone stimulus. As things stood, the only politically feasible steps were off-budget investment measures such as the 'Juncker plan'.

There were two standard narratives of the rise of populism: one was unchecked globalisation and the other was mounting inequality and arrogant elite disregard for it. But globalisation was not a new phenomenon, and other factors such as lower potential growth and technological change were bigger causes of insecurity. One reason that globalisation had taken on such salience was that middle-class voters had now become aware of the risk to their living standards from lower growth and technology, and globalisation was a convenient scapegoat. Populations were ageing rapidly, and the old were bound to be more risk-averse and change-averse, and that uncertainty, rather than inequality per se, was driving middle-class anxiety. Finally, irresponsible leaders were part of the story, especially in the UK and the US.

The **final panellist** started by observing that economists did not have much to contribute to the debate around populism – and then went on to outline what was wrong with macroeconomics. Macroeconomic processes were very complex. Balance sheets, history and institutions mattered for macroeconomic outcomes. And the macroeconomic problems we were experiencing had multiple sources. Some problems that had already existed prior to the financial crisis included the slowdown in the rate of productivity growth; population ageing to which migration was no solution, at least politically; and the chronic excess savings in some parts of the world. The crisis added a host of new problems: unresolved debt overhangs; weakened financial institutions; damaged confidence; deep competitiveness problems; and slowing growth in China, the world's post-crisis growth engine.

What needed to be done? Developed economies needed strong fiscal support and radical monetary policies. But in order to return to a 'normal' economy – that is one without large output gaps and with real interest rates at pre-crisis levels – debt also needed to be written down and the world economy rebalanced. It was crucial to understand that the problems we faced were global, and not simply the failure of particular countries to push through structural reforms; countries with excess savings had to work hard to reduce them. The creation of the euro had been the biggest geopolitical blunder ever because it was a mechanism for mutual antagonism. There were still very large competitiveness differences within the currency union. And migration could not be the mechanism for adjustment because this would lead to huge political challenges.

The **Q&A** session kicked off with a discussion of whether or not there was a macroeconomic policy consensus. There was certainly a consensus among those present that macroeconomic policy needed to be more expansionary, but less agreement on what form that should take and over the impact that more expansionary macroeconomic policies might have on the potential rate of economic growth. Some participants thought that monetary policy still had a role in boosting economic activity. For example, innovations such as the Targeted Long Term Refinancing Operations (TLTROs) and tiered negative deposit rates showed that there was still more the ECB could do. Others stressed that there were two ways in which policy could work: either by getting people to spend more, or by selling them long-term safe assets (government bonds) and spending the proceeds on private assets (equity). Central banks had focussed on the former but now needed to try the latter.

Unfortunately, central banks were not set up institutionally to buy private assets, and doing so would be politically contentious, especially in the eurozone. Indeed, several participants highlighted the risk of populist attacks on central banks. They had become much more public actors, partly because of the crisis, but also because they had been left shouldering the lion's share of the responsibility for macroeconomic stabilisation. This was leading to a politicisation of monetary policy, not least in Germany. If the ECB lost credibility in Germany, it would be much harder for it to carry out the needed action.

A number of participants questioned the economic case for more monetary stimulus. The data did not support the view that it was helpful: productivity growth was soft, the correlation between markets high, inflows into passive funds high, and those into start-ups down. Very low interest rates could be counter-productive if they weakened bank profitability, forcing banks to shrink their balance sheets. One participant stressed that it did not matter how expansionary monetary policy was if capital markets were not working properly and if financial regulation was being tightened at the wrong point in the cycle. However, others challenged the idea that monetary stimulus had been ineffective, arguing that interest rates were low for good reason – a surfeit of savings over profitable investment opportunities. And the problem was going to get worse as Chinese savings fell less quickly than Chinese investment, leading to a renewed increase in Chinese capital exports. Low interest rates encouraged firms to substitute capital for labour. If that meant banks had to change their business models, then so be it.

There was some optimism that fiscal policy would be used more actively as a tool of demand management in the US and the UK, but less optimism about this happening in the eurozone because of German opposition. A number of participants stressed that the Germans did not seem to appreciate the Europe-wide implications of their policies. Germany's current fiscal strategy might serve Germany's interests, but it was inimical to the broader eurozone interest, which needed debt write-downs and fiscal stimulus. Several participants noted that if Germany generated a large capital surplus, this implied higher investment and hence higher debt levels elsewhere. By opposing a pan-eurozone fiscal stimulus, the Germans had opened the way for the kind of monetary stimulus they resented, and unless they changed track, would eventually open the way to monetisation of debt. This was why the eurozone needed a fiscal union to survive. Without it, it would be impossible to agree the needed fiscal strategy for the currency union as a whole.

There was broad agreement that conventional macroeconomic models were poor at capturing what was going on in the global economy. But several participants stressed that we still knew what to do. We needed to think big: stop worrying about debt levels (US, UK), write down debt (the eurozone), put in place large fiscal expansions, and get rid of the prohibition on monetary financing. The problem was that we no longer trusted ourselves to take such bold steps. And once such radical policies had been implemented and had had the desired impact they would need to be reined in and the old taboos reinstated. However, a number of participants were sceptical that such a demand management approach would have a lasting impact. After all, it was worth bearing in mind that the productivity slowdown had started before the financial crisis, and that the savings glut pre-dated the financial crisis.

Finally, the discussion turned to structural reforms. A number of participants stressed that these were essential, but that they could only be effective if implemented in the context of healthy growth in demand. Others were sceptical about the efficacy of structural reforms per se. If they worked at all, they did so by depressing wages and hence labour's share of the cake. And weak wage growth was the biggest obstacle to a recovery in consumption and hence investment. We needed to consider stronger redistribution of income in order to combat the decline in labour's share of it. Tax avoidance of tech firms, in particular, had not gone unnoticed by voters. Another participant added that slow growth in the capital stock – which was still 2 percentage points lower than its pre-crisis level – was a far bigger reason for the weakness of productivity growth than supply-side problems. Demographics were also crucial: while structural reforms might add 0.3 per cent to annual growth, declining working-age populations lowered growth by much more than this.

Session 3: Have trade liberalisation and financial globalisation gone too far?

Over the last 30 years a strong elite consensus has emerged in developed countries over the benefits of trade liberalisation and the globalisation of finance. Is this consensus justified or has it become a source of economic and political instability? Are there significant gains to be made for developed countries from further trade liberalisation? Are these big enough to outweigh the potential social and environmental costs? Is capital mobility an unalloyed good, or is there now a case for throwing some sand in the wheels of global finance?

The **first panellist** focused on the interaction between international trade and financial globalisation, arguing that the latter reduced the gains from trade integration. Financial globalisation made it harder for nation-states to raise tax, which in turn had made it more difficult to tackle inequality flowing from the growth of trade. Unimpeded capital flows had also increased the volatility of the system: it was now harder to stabilise an economy. This went beyond the classical financial trilemma, which stated that it was impossible to have an open capital account, a fixed foreign exchange rate and an independent monetary policy simultaneously. As new research by Hélène Rey had shown, it was increasingly hard to ensure stability regardless of the type of exchange rate regime a country employed. To make globalisation sustainable, there needed to be some renationalisation of finance, policy co-ordination at the global level, and mechanisms to share the gains from globalisation more equally.

The **second panellist** started where the first left off, focussing on the losers from trade globalisation, stressing that this was a major political issue, even among the young. The standard economic narrative that displaced workers would be re-trained and re-employed in higher value-added activities was a myth. The reality was that many of those workers affected by trade competition suffered permanent income losses. This explained why regions with a lot of import-competing sectors tended to show strong support for extremist political parties. There had been a collapse of the old social contract that mandated a fair distribution of the economic rents between capital and labour. The only solution was to redistribute income from the wealthy and from capital to the less well-off through the tax and welfare systems, and via investment in infrastructure, health and education in the affected areas. Unfortunately, it was hard to raise the necessary taxation because capital and the wealthy were now internationally mobile. So there should be more global governance of taxation.

The **third panellist** started by asking what the benchmark was for globalisation going 'too far'. If it was about efficiency, it could never go 'too far'. But efficiency was not the same thing as welfare, with the result that more globalisation might not be politically viable. The problem was also not so much one of globalisation, but of the dynamics of capitalism per se. The case for compensating the losers from globalisation was weak because it was difficult to determine when compensation was justified. For example, national monopolies lost their privileges following the EU's telecoms deregulation, but no one argued that they should be compensated for their loss of monopoly rents. Yet this was basically what was happening with trade liberalisation: economic rents were being lost as producers faced more competition. This was not a bad thing, and it had only become politically contentious because it was now affecting the privileged middle-classes – explaining the fate of the European Commission's ill-fated Services Directive – and not just working-class factory workers. Governments had to work hard to combat geographic inequalities of opportunity, but this was easier for federal states such as Germany than for centralised ones like the UK.

The **fourth panellist** argued that the job description of politicians had changed. They were no longer responsible for taking big decisions about global prosperity, but instead were focused on much less exciting decisions about distribution within a rules-based economic order. For this loss of political autonomy to be sustainable, the rules needed to be half-decent, but this was not the case. For example, taxation was rigged in favour of large multinationals. The international financial and monetary rules had not been, and were still not, ideal, despite some positive changes. International capital markets were a powerful tool for risk-sharing but that did not mean that all capital flows were positive. Short-term inflows were often harmful and huge capital exports from countries with excess savings, such as Germany, were a source of instability and needed to be addressed. We were still living in a world of asymmetric adjustment (all the adjustment was made by the debtors, whereas creditors were not expected to change their behaviour). This was a particular problem in the eurozone, and was a major reason for the currency union's continued economic vulnerability. Given the rigidity of the eurozone's product and labour markets, it was also essential that European banks raised more capital, but eurozone governments had led the charge against Basel. Finally, the four freedoms of the European single market were political, not economic; the single market did not require free movement of labour to work effectively.

In the **Q&A** session that followed several participants argued that free capital flows were not economically beneficial: there was little to be gained from international risk-sharing via financial markets. If we wanted to shore up support for free trade and give governments the policy tools needed to maintain macroeconomic stability, we should consider limiting capital mobility as part of a Bretton Woods II. For another, the issue was with financialisation, which beyond a certain level was bad for growth and productivity, rather than globalisation of finance, although the latter could also be destabilising. Others countered that it was very difficult to determine the impact of financial globalisation on economies, and that the evidence we had did not justify a wholesale condemnation of financial integration. Financial globalisation helped individuals and states to diversify their risks and hence to ensure themselves against local shocks. The problem lay in the poor governance of global capital markets – the composition of capital flows and absence of effective burden-sharing agreements between creditors and debtors – not globalisation per se. Another participant argued that populist uprisings happened more often after financial crises, and speculated about the possible reasons, ranging from increasing inequality in the run-up to the crisis, to elites that lost touch with the concerns of ordinary voters during and after the crisis.

There were also disagreements over the merits of further trade liberalisation. For some, trade had undoubtedly led to efficiency gains, but not necessarily to improvements in welfare. One participant argued that we needed to strengthen collective wage bargaining to make sure more trade translated into higher welfare. Another stressed that we had to distinguish between trade between rich and poor countries and trade between rich countries. Whereas there was some evidence that increased trade with China had left some people in the US and EU worse off, there was no evidence that trade between the US and EU or between EU countries themselves had had this impact. Trade between rich countries boosted competition and hence productivity growth, whereas trade between rich and poor tended to provide a one-off boost to real incomes from a more efficient division of labour. Others said that the China effect was now diminishing and that we should be careful about retreating from globalisation. Protectionist measures would benefit some groups at the expense of others, and make everyone collectively worse off. There was no more reason to worry about people who lost their jobs from trade than about those that lost them from technological change. The focus needed to be on how to compensate the losers.

However, there was little agreement over how to go about doing this. For some, the compensation of losers was far from easy, and the politics of compensation tricky. It was difficult to identify winners and losers even at a disaggregated industry level. But others pointed out that entire communities or regions were affected and that we should think about ways to give them confidence in the future. For one participant, there were three stages at which we could intervene: in the endowment of skills and other production factors, in the market phase itself, and in the post-market phase. The EU was only present in the market phase, while national governments set the first and the third stages, which he argued was unsustainable, and opened the EU to criticism from populists. One needed creative solutions, an area were the UK in particular underperformed. The UK spent a sixth of what Denmark did on active labour market policies. There was too much focus on employment rates in the UK and too little on the quality of employment. Poor quality employment bred resentment: people need the prospect of better jobs.

Finally, the discussion turned to trade deals. It was important to understand why people were opposed to them. This derived not from hostility to trade as such, but rather from the fear that trade deals were eroding national democracy and control. Modern trade deals, which included varying degrees of regulatory convergence, had different distributional consequences than the trade deals of the past which basically involved cuts in goods tariffs. It was understandable that people were concerned about the implications of TTIP for public services or that the Investor-State Dispute Settlement (ISDS) provisions could lead to firms going offshore to settle legal disputes. There was disagreement over the role migration should play in future trade deals. For some, rising migrant flows was eroding faith in globalisation, and this required more global governance of the issue. For others, migration was a form of trade and needed to be preserved.

Session 4: Is inequality behind the rise in populism?

Income inequality has risen significantly in developed countries over the last 30 years, and this is no doubt a factor behind rising populism. How should governments respond? Does globalisation constrain governments from dealing with inequality? Or are they using the supposed exigencies of globalisation to justify policies that benefit particular constituencies? Is technological change aggravating inequality? If so, how could governments respond to its distributional consequences? What is the appropriate balance between taxes on consumption, carbon, labour and wealth? And how much international co-ordination is required in order to strike this balance?

The **first panellist** offered several myths about inequality. One was that income inequality was not a big problem, and was in any case falling. People underappreciated the degree of wealth inequality and the lack of social mobility, which showed that economies were not providing opportunities for people from poor backgrounds to climb the ladder. Thanks to redistribution, the cash in individuals' pockets in many countries was not falling sharply, but market income was a better reflection of opportunity, not income after taxes and benefits: the opportunity to earn more pay was the opportunity that people wanted. The second myth was that globalisation and financial deregulation were the major drivers of rising inequality, but in reality technological change, education and government policy were more important. Another myth was that there was a trade-off between economic efficiency and equality: if governments sought to reduce inequality, they would increase inefficiency. This was not true if governments concentrated on boosting equality of opportunity. Indeed, redistribution of income was less important than increasing social mobility, through investment in early years' education and active labour market policies.

The **second panellist** focussed on France, where income inequality had risen by less than in other OECD countries. But it still mattered politically: growing inequality between places and regions was linked to the rise of the far right. And France had a problem with low social mobility: educational attainment was closely correlated with the social status of parents. The authorities were trying to reduce the costs to employers of hiring low-skilled workers. But wage competition between EU countries was a problem: the lack of a national minimum wage in Germany had meant very low wages in some sectors – slaughterhouses being a good example – which had made France less competitive. Governments had finite resources to combat inequality, because taxes were already high and tax competition between countries constrained governments' ability to raise additional taxes in any case. Instead, family transfers should be linked to household income, rather than being universal. Corporate tax rate competition in particular was a problem, as it had led to an erosion of tax revenues from this source. The OECD's Base Erosion and Profit Shifting initiative was an important attempt to address the problem, and deserved stronger political backing from governments.

For the **third panellist**, culture mattered more than economics in explaining the link between inequality and populism. Populist parties emphasised the same traditionalism and nationalism, but on a traditional left-right economic policy axis, they were all over the place. And perceptions mattered to people's political response to inequality. In the US, when asked the shape of the income distribution, most thought it was circular, with a large middle-class and a smaller number of poor and rich. By contrast, the French thought the income distribution was a pyramid, with very large numbers of poor people. In reality, the US was more pyramid-shaped and France more circular. Inequalities of opportunity helped to explain populism rather better than inequality. Researchers in Canada had found that the bottom and top of the income distribution showed very little mobility, while those in the middle suffered from heightened economic insecurity, as people moved up and down the income scale. And spatial issues were also important: populism flourished in areas that were distant from prosperity, social networks and opportunities.

Local economic development policies were key, because improved public services, infrastructure and housing would help to tackle both political alienation and the downsides from globalisation. There were some problems that had to be considered, however: trying to promote local development might act to counter beneficial agglomeration effects in leading cities. One participant noted that centralised states, such as France and Britain, might struggle to promote local development as effectively as more federalised ones. For its part, the EU needed stronger mechanisms for sharing risks and for compensating regions that had lost out from globalisation and heightened competition within the single market. It had regional development funds but expanding them was difficult politically.

The **fourth panellist** agreed that geography was a major determinant of populism. Donald Trump's support was in the middle of the income distribution (people on low incomes tended to vote for the Democrats), and these people were less exposed to trade. His support was strongest in areas with weak educational attainment and high levels of drug use, and in communities that were socially isolated and less diverse. Their local economies were not working well, and they were seduced by Trump and the conservative media's arguments that foreigners and elites were to blame for this.

Technology and globalisation had reduced the bargaining power of the low-skilled relative to the high-skilled that tended to live in large rich cities. This process was sharpening group identities, which in turn was further increasing the importance of geography. Income convergence between rich and poor places in the US had come to a halt and gone into reverse. People in these poorer places were increasingly dependent on welfare and other forms of government transfers. And technological change was likely to make these divides worse. Income redistribution was no panacea. For example, a universal basic income would make immigration toxic, because it would comprise permanent, large transfers to newcomers.

In the **Q&A** session, a number of participants argued that inequality had little to do with populism. After all, populist movements did not draw much of their support from the poor and the dispossessed. Support for populist parties also came disproportionately from older voters, who had been less affected by rising inequality, both of income or wealth. Rather, backing for populism had its origins in cultural preferences. Supporters of populist parties considered themselves marginalised culturally and were alienated from what they considered the dominant liberal cultural trends. Others pointed to the importance of status anxiety. While populist voters were not among the principal losers from globalisation, they perceived themselves to be a lot further down the income scale than they actually were. One participant noted that while Alternative für Deutschland (AfD) voters were not poor they did see themselves as having been left behind. And although many older populist voters had not suffered from rising inequality, they were fearful that their children would not enjoy the same living standards as they did. Another stressed that support for populism was best understood as an expression of generalised unhappiness stoked by demagogic leaders.

Some participants thought that greater equality of opportunity could actually boost populism: an environment where economic growth was low and adults – and especially their children – might slide down the social scale would raise status anxiety and support for populism. People worked hard to prevent equality of opportunity, by gaming the education system or paying for it privately, and by voting against inheritance taxes. And as immigration rose and native birth-rates declined, clashes over education funding would increase. But others argued that policies to promote more equal access to a decent education worked and would be popular. London schools had become some of the best in the UK thanks to government policy, and that policy had not led to a backlash. The problem was that resources invested in education had been declining across Europe. One reason for this was the prevalence of very low birth-rates: people were reluctant to pay tax to educate other peoples' children. Another was that it was hard to find resources to boost spending on education. Given the existing weakness of consumption, additional revenue had to be raised from the wealthy and capital, which required global governance because these factors were internationally mobile.

There was disagreement over the importance of wealth as opposed to income inequality in driving populism. One participant argued that housing was a far bigger cause of the rise in inequality, at least in the UK, than globalisation and technological change. Housing was also a major factor behind the growth of generational inequality: the wealthy had benefitted from asset price inflation, which had largely come at the expense of the young. For several participants, land taxes were the best way to counter wealth inequality, especially as land was immobile, unlike other forms of capital. Another raised the possibility of governments buying equities in companies and giving them to the poor, since the ownership of capital had become so unequal. People disagreed on whether low interest rates were increasing inequality, by raising the price of assets, or reducing it, by supporting employment and cutting income from savings.

Finally, the discussion turned to the role of geography. Differences in social mobility between US cities were larger than between the US and other developed countries, and these regional inequalities were growing. This was replicated in Britain: a poor child in Bristol was three times less likely to go to university than a poor child in London and the comparable figures for Manchester or Liverpool would be even worse. An easy way to promote social mobility would be to allow people to move to cities with higher levels of social capital, by building more housing, but the UK had been extremely bad at ensuring a decent supply of affordable housing. Another speaker stressed that this was not a UK-specific problem: cosmopolitan metropolitans were using housing restrictions to inflate land prices and to ensure the exclusivity of their areas.

Session 5: How should governments respond to migration fears?

Labour mobility is rising between developed countries, as is migration from developing to developed ones. There is a robust academic consensus that wealthy economies benefit from this, and that immigration is not a significant factor behind wage stagnation and rising inequality. But are these economic benefits big enough to justify the political backlash that has ensued? Can governments succeed in countering anti-immigrant feeling by employing the right mix of economic and social policies? Are higher rates of immigration something that developed countries will have to learn to cope with, or can they be limited without damaging side-effects?

The **first panellist** argued that nativism was behind the populist upsurge against immigration, but that the prevalence of nativism was not strongly correlated with levels of migration. Indeed, regions within countries that were home to the most migrants displayed the least hostility to them. Where there were problems in areas with lots of migrants, it tended to be in places were migration was a very recent phenomenon, and which were struggling economically. Even though there was little evidence that immigration depressed wages, even of those workers at the bottom of the labour market, popular perceptions mattered. In order to combat hostility to immigration, governments needed to demonstrate its benefits rather than pandering to anti-immigrant fears; make sure that areas experiencing high levels of immigration received additional funds; ensure that housing was affordable; and establish high minimum wages so as to head off resentment at alleged 'social dumping'. An explicit migration fund financed from hypothecated taxes might be a way of addressing grievances.

The confusion of EU free movement, refugees and terrorism was unique to the UK – in other EU countries people understood the distinction better and thus expressed less hostility to free movement. And EU citizens were not really seen as immigrants in other EU countries in any case. Even in countries that had suffered far more economically than Britain and where unemployment was high, such as Italy and Spain, there was little of the hostility seen in the UK to workers from Eastern Europe. On the question of whether the four freedoms were indivisible, it was possible to have free trade in goods and unimpeded capital flows without free movement of labour. But it was much harder to have free trade in services without free movement of labour. The provision of services often required people to move freely across borders. It was also important to remember that free movement of people promoted the diffusion of ideas and encouraged investment between countries.

The **second panellist** said that the Brexiters' slogan 'take back control' was fundamentally about migration, which the British had shown an unusually high degree of concern about for a number of years. The number of immigrants living in the UK was not out of line with other comparable EU countries. The UK also received the highest share of tertiary-educated migrants in the EU. For example, young, skilled Poles came to the UK, whereas older, unskilled ones tended to go to Germany. One reason for this was that the UK labour market was very open: both public and private sector employers were more willing to recognise foreign qualifications than were their German or French counterparts, and there were fewer regulations in the UK stipulating who had the right to do particular jobs.

There was no empirical evidence of a connection between immigration and unemployment in the UK. Immigration had held back the wages of the poorest decile of workers a bit, but public policy – changes to taxes and benefits – had done much more to depress their wages. EU migrants made a substantial net contribution to public finances, estimated at around £20 billion in the 2001-11 period. Brexit would introduce additional red tape and reduce the pool of labour available to British employers to recruit from. It would enable Britain to reduce unskilled immigration from the EU – which was running at about 35,000 per year – but this would cause big problems for certain industries, in particular in the agricultural sector.

The **third panellist** kicked off by arguing that we lacked a clear understanding of the EU single market, which went far beyond a free trade agreement or customs union. In his view the single market comprised three distinct elements: common institutions to create common standards; a common legal order; and transfers to struggling regions in the form of regional funds. These regional funds helped poorer member-states to adjust to the cost of market integration and were a quid pro quo for opening up their markets to richer, more productive economies. Another part of this quid pro quo was free movement of labour, which held out the prospect of wage convergence. Without structural funds and free movement, political support in these countries for the other parts of the single market would whither.

If we wanted to reduce labour flows, we would either need to reduce capital flows or trade or both. However, within the eurozone it was imperative that trade in goods and services was free and capital movements unrestricted; a monetary union could not survive long if these conditions were not met. As a result, it was impossible to place barriers in the way of free movement between eurozone member-states. However, for countries in the EU but not the eurozone or for Britain, the issue was less clear cut. For example, it might be possible for Britain to negotiate far-reaching membership of the single market while placing some obstacles in the way of free movement.

The **fourth panellist** focused on how governments should respond to the populist backlash against migration. First, they should avoid legitimising fears – examples of this were Nicolas Sarkozy's use of arguments peddled by France's National Front and Hillary Clinton following Trump's anti-trade stance in the US. Instead, governments needed to combat prejudice and ignorance towards migrants by refuting pervasive myths about them, such as that they were responsible for housing shortages or the pressures on public services. Governments needed to deliver robust rates of economic growth and to boost funding for areas experiencing high rates of immigration. The link between migration-related fears and political extremism also meant that there might be an argument in favour of migration curbs. However, this did not apply to the EU: the four freedoms were indivisible for political reasons. Finally, a long-term strategy was needed to address the inevitable rise in migration from North Africa to the EU. The EU needed both more legal routes for migrants from this region but also more credible deportation procedures for illegal migrants.

The **Q&A** discussion focused initially on the economics of migration. There was broad-based agreement that hostility to immigrants had little to do with economics, but was rooted in nationalism. Several participants noted that the problem was not with the level of immigration, but with its rate: the areas most vulnerable to populism were isolated, economically struggling places which had gone from being home to few immigrants to many of them in a short space of time.

A number of participants stressed that restricting migration was not a solution to the identity and status fears of older voters. Younger voters across Europe were much more open to immigration than older ones, despite it having been the young who had suffered economically. Eventually, there would be a cosmopolitan backlash against populism and the emergence of new, more inclusive identities. One participant argued that Europe would have to cope with economic migration for decades and should invest in an open cosmopolitan identity. The US had succeeded in creating a common myth, where national identity was drawn from migration (although the US was hardly free from nativist politics, which were a big reason for Trump's victory). Another suggested that the backlash against free movement in the UK could be traced to the country's print media, which had played a major role in fostering hostility to immigration rather than simply feeding pre-existing prejudices.

The discussion then turned to the EU single market and its four freedoms. For a number of participants, labour mobility was an indispensable element of the integrated market and that we tended to underestimate the benefits of immigration by ignoring its dynamic benefits on productivity growth and innovation. One cited research by Gianmarco Ottaviano, which showed how immigration boosted the trade in services between host and home countries. Others were more sceptical, however. While labour mobility was clearly part of the political quid pro quo within the EU, it could not be the mechanism for adjustment within the eurozone. This would concentrate highly skilled workers and their capital in the core, cementing imbalances within the currency union and eventually pulling it apart. Another argued that free movement was not fundamental to the single market – Germany and Italy had many more labour market restrictions than the UK, but were more economically integrated within the single market.

Several participants argued that populist movements would be strengthened if countries could pick and choose from the single market's four freedoms. This explained why EU governments were taking a tough line with the UK; they were wary of setting a precedent that could embolden populists in other member-states.

But another predicted that if the UK refrained from aggressive posturing in the negotiations, the rest of the EU – led by Germany – might compromise on free movement, allowing the UK to place some controls on EU migration while retaining some single market membership. This would not establish a damaging precedent because few others would be attracted to such a deal. After all, the UK would still have to pay into the EU budget and abide by the rules and regulations of those bits of the single market it remained part of.

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