Article

Trade, Inclusive Development, and the Global Order

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Economic globalization has increasingly affected countries across the world, through participation in global value chains (GVCs) and helping to lift over one billion human beings out of extreme poverty since 1990. However, there are still too many people living in poverty, even in rich countries, and so concerns over exclusion of certain groups from the gains of economic globalization are rising internationally. Using the concept of inclusiveness based on Amartya Sen's capability approach, we find that G20 countries perform better than non-G20 countries. We then review how economic theory contributes to understanding the causes of (missing) inclusiveness by reviewing the literature pertaining to five drivers: growth, technology, structural change, trade, and political economy. Overall, domestic policies tailored to specific national circumstances are the main instruments for promoting inclusiveness. The danger is that in pursuing these domestic policies, states may undermine international arrangements constituting the liberal economic order. We argue that the liberal economic order generates insufficient global governance because there is always a fraction of countries opposing global policy coordination as they believe it harms them, and that this group of countries is increasing propelled by the surge of populism. This dynamic implies that global governance focus will increasingly shift to "coalitions of the willing", rendering multilateralism an increasingly challenging, and a la carte, proposition.

Introduction

Enabled by innovations in the information and telecommunication (ICT) and transport sectors, economic globalization has increasingly affected countries across the world, enabling them to participate in global value chains (GVCs). Innovations and GVCs accelerated various country catch-up processes and helped to lift over one billion human beings out of extreme poverty since 1990 (Chen and Ravallion 2013). However, there are still too many people living in poverty, even in rich countries, in part since the world-wide financial and economic crisis of 2008. Most of the non-Western world recovered reasonably well, while the West experienced a slower

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recovery in terms of growth rates. European countries, additionally, experienced rising unemployment (IMF 2015, 3).

Notwithstanding the post-crisis recovery in the global economy, perceptions that inequality and lack of inclusiveness are worsening remain widespread. This trend has generated powerful political currents, especially, but by no means exclusively, in developed countries. The political currents culminated in the election of President Donald Trump in the U.S. on an "America First" ticket. Other populist movements appear to have taken root in Europe, while still others are growing in Latin America, Africa and other parts of the developing world.

Political leaders have acknowledged that current growth models are outdated and need to be updated to be more socially inclusive (Samans 2018). This included the 2016 Hangzhou G20 Communiqué which calls for and seeks to promote inclusive growth and inclusive structural transformation, especially in Africa and in the least developed countries (LDCs) (G20 Leaders 2016).

The new mainstream sentiment towards globalization is—globalization needs "fixing". Policies should try to offset harms created, especially to marginalized groups (e.g. Birdsall 2002; OECD 2017). At the national level, for example, this may necessitate domestic policy responses designed to promote the inclusion of those left behind by globalization. States still matter. And, it appears, increasingly so with states looking at addressing social inclusion.

These political currents highlight the tension present since the creation of the liberal international order. The tension evident for states is between yielding a measure of sovereignty to encourage multilateral cohesion and international peace, and a desire to retain national sovereignty to favor citizens and promote domestic social cohesion. It was famously captured in international relations scholars' circles with the concept "embedded liberalism" (Ruggie 1982), which described the historical compromise fashioned in the institutional system: governments would still be accorded sufficient policy leeway to construct welfare states at home and promote domestic inclusiveness, while progressively removing international barriers to trade to extend the multilateral trading system—"Keynes at home, Smith abroad". Leaving aside the relative merits of Smith versus Keynes' economics, this embedded liberalism compromise endured in the core of advanced western societies for many years, notwithstanding the rise of neoliberal economic policies in the 1980s. However, many scholars of international relations now worry that it may evaporate in the face of the headwinds building up. In relation to this, Western fears over competitors are becoming more profound, and targeting China especially, since China challenges the West's economic and geopolitical hegemony in a way that Japan—a U.S. ally, after all—never could.

These broad dynamics, just described, explain the current moment in which the Western-centered liberal international economic order, anchored in part on the International Monetary Fund (IMF), World Bank, and World Trade Organization (WTO), finds itself. Each of these formal institutions reveals growing struggles to keep up with global dynamics.[1] As economic power becomes more diffused in the global economy, it is likely that

[1] *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 occupies*

longstanding multilateral arrangements will have to adapt. This adaptation is reinforced through the actions of those that perceive globalization to have harmful impacts and as a result seek to constrain it, using trade, investment and other measures to do so.

Against that background, the purpose of this article is to analyze three specific issues:

1. How do G20 countries, as the putative "system shapers", perform with respect to inclusive development? Our focus on the G20 is based in part on the group's own claim to represent the most systemically significant countries in the world economy. Our focus on "inclusion", as opposed to the narrower concept of "inequality", is designed to address perceptions that globalization has widened societal divisions, particularly in these "system shapers". For this analysis, we consider factors that explain differences amongst these countries, using the Inclusive Development Index (IDI),[2] and between G20 and non-G20 countries.
2. How does economic theory contribute to understanding the causes of exclusion and inequality, and what domestic policy recommendations does the economic theory suggest?
3. What challenges arise for the international economic order from the perceived lack of inclusiveness that may reflect a main cause for the surge of populism, and associated domestic economic policy propositions?

To answer these questions, in section 'The Complex Relationships between Inequality and Inclusiveness', we briefly disentangle the relationship between 'inequality' and 'inclusiveness' since these are often conflated. Then we show the measurement of, and some evidence for, focusing on inclusiveness both within and outside the G20. In section 'Empirical Evidence: The State of Inequality and Inclusiveness', we present a brief discussion of the economic drivers of inclusiveness. Section 'Implications' derives policy conclusions at domestic and global levels, highlighting the importance of domestic economic policy solutions to perceived gaps in inclusiveness, provided these do not harm other countries. Finally, the Conclusion section sums up and rounds off the article by making a qualified case for the G20, as an institution capable of delivering 'multilateralism a la carte', which to us seems to be the direction global economic governance is headed.

The Complex Relationships between Inequality and Inclusiveness

Every society, we would suggest, is concerned, to some extent with the issue of inclusiveness. This entails broadening access to the economic system in meaningful and personally fulfilling ways for relatively marginal groups in society.[3] Since there is no clear, or standing definition of what inclusiveness is we can try to illustrate the need for inclusive policies with Amartya Sen's capabilities approach, which argues that every person must be

in fact a regional space that gets more crowded by the year. Moreover, the WTO has struggled to retain its relevance in a busy bilateral and regional trade agenda world.

[2]*As an amendment of the World Economic Forum's Inclusive Growth and Development Report, the current IDI was first established in the Inclusive Growth and Development Report 2017 (World Economic Forum 2017).*

[3]*These are often framed in terms of the poor, the unemployed, women, people with disabilities, minority ethnic groups, indigenous populations, and youth.*

provided with the capabilities to lead the life he or she has reason to live (Sen 1992, 1999). If circumstances and/or policies marginalize persons or groups, then there are individuals who are denied the capability to lead the life they want to. The extent of this marginalization can be used as a reasonable working definition for inclusiveness.

Equality is usually measured in terms of variables such as income or wealth and describes the relative position in this variable from one individual in a society to another. Inequality becomes a problem when it is associated with an unjust distribution of income and wealth and leads to a lack of inclusiveness through marginalization.

However, these definitions do not imply that equal societies will naturally guarantee inclusiveness, since although the two concepts are obviously related, they are not identical. Inclusiveness in the terms introduced in the first paragraph of the section, would, among others, express whether individuals have the opportunity (or capability) to earn incomes and generate wealth if they wish to. Many people can be included in the economic system of a society and therefore have the opportunity to earn incomes, yet the society may still suffer from inequalities. This problem may apply to countries, for example, the United States which has been characterized by a relatively small economic elite with high incomes but historically low rates of unemployment at the same time (as of mid-2018). In contrast, societies that have relatively low levels of inequality, yet where most people are "equally poor," could possibly suffer more from a lack of inclusiveness[4]. 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.

It is obvious, however, that it is hard to distinguish between equality and inclusiveness. Yet, both concepts must be perceived as important for sustainable, broad social development. Therefore, when analyzing inclusiveness there are likely natural overlaps between the two concepts. Since there have been, however, many treatments of the inequality issue, in this article we focus more on inclusiveness.

Empirical Evidence: The State of Inequality and Inclusiveness

Inclusiveness and the Inclusive Development Index

With decreasing poverty, inclusiveness is on the rise. Specifically, Lakner and Milanovic (2013) show that in the 20 years from 1988 to 2008 growth was highest in the lower and middle components of the global income distribution and below average in the "richer world", i.e., from the 80th to the 99th percentile. In recent studies (Chen and Ravallion 2013, 2010) researchers identify that the growth in global income of lower and middle components was mostly driven by India and China. In the period from 1981 to 2005, the percentage of people living on $1.25 or less in South Asia declined from about 60 percent to about 40 percent; in East Asia from almost 80 percent to under 20 percent; and in Africa it stayed around 50 percent.

[4]A classic example of this is the Chinese economy during the late Mao period. The Gini coefficient (a measure of inequality) was estimated to be in the range of 0.24 – a very equal measure but one that suggested that the Chinese people generally were equal but all very poor.

Nonetheless, recently there has been increasing focus on making these positive developments (more) inclusive. Probably the most widely accepted global framework for thinking theoretically about the issue of inclusiveness is the Sustainable Development Goals (SDGs). These provide a detailed set of frameworks, goals and indicators for galvanizing global action in support of sustainable development. They range widely, however, from planetary sustainability (i.e., the environment) to poverty reduction.

A more focused attempt on inclusiveness is contained in the "Inclusive Growth and Development Report" (World Economic Forum 2017). It is based on the World Economic Forum's (WEF) Inclusive Development Index (IDI), which we focus on in this section given its potential richness in relation to our concern over how perceptions of rising exclusion are driving populism. The IDI is intended to capture intra-society concerns on a comparative basis. In the authors' view, "secular stagnation," particularly of Western societies, is a significant drag on inclusive development. They identify three drivers of this stagnation:

- rising within-country inequality;
- Western economic stagnation and structural fiscal challenges[5]; and
- the information-fueled technological disruptions posed, and to be posed, by the "4th Industrial Revolution",[6] with attendant consequences for employment disruptions and income distribution.

In searching for solutions to these structural challenges, the WEF argues that a new growth concept may be required, within which the very notion of national performance needs to be re-conceptualized. Their attempt is contained in the report's "Inclusive Growth and Development Framework" (World Economic Forum 2017) (IDI) containing seven pillars, underpinning the development of their composite IDI. The seven pillars comprise:

- education and skills,
- basic services and infrastructure,
- corruption and rents,
- financial intermediation of real economy investment,
- asset building and entrepreneurship,
- employment and labor compensation, and
- fiscal transfers.

Summarized, they yield the policy and institutional Indicators.

The IDI consists of 12 variables which are grouped into three domains:

1. Growth and development, which comprises GDP per capita (p.c.), labor productivity, healthy life expectancy, and employment.
2. Inclusion, which contains net income Gini, poverty rate,[7] wealth Gini, and median income.
3. Intergenerational equity and sustainability, consisting of adjusted net savings, carbon intensity of GDP, public debt and the dependency ratio (non-working age/working age population).

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

[6] *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" (cf. Schwab 2017).*

[7] *Which has different definitions for "advanced" and "emerging" economies.*

The IDI[8] summarizes these national key performance indicators. We now turn to the latest IDI 2018 covering 103 countries (World Economic Forum 2018).[9]

3.2 Inclusiveness Has Slightly Increased, but Not Everywhere

First indicative results are moderately positive, including the following:

- 64 percent of countries saw their IDI score increase in the last five years.
- In 27 percent of all countries, the IDI score decreased while GDP increased.
- For 50 percent of countries wealth inequality increased (and decreased for the other 50 percent).
- For more than half of the countries (53.4 percent) income inequality decreased, while it increased for 43.7 percent of countries, and stayed equal for 3 percent.

Considering the full sample of countries included in the IDI, on average countries have improved their IDI score by 0.91 percent in the 5 years from 2012 to 2016. The most progress has been made in reducing the poverty rate [by 3.3 percentage points (p.p.)],[10] increasing GDP per capita (p.c.) (by 2 percent per annum) and reducing carbon intensity of GDP (by 6.6 kilotons/billion dollars (kt/bil. $) GDP). The largest deterioration can be observed in public debt, which has increased by 8 p.p. on average.

More interestingly, there are notable differences between the performance of G20 and non-G20 countries:

- G20 countries have improved their overall IDI score about three times as much compared to non-G20 countries (1.63 percent vs. 0.47 percent). GDP p.c. growth was slightly higher in non-G20 countries, as can be expected from recent slow growth experiences in the highly developed countries. One should consider that this development may well be driven to some extent by China and India. Excluding China and India from the sample decreases the average GDP p.c. growth from 1.63 to 1.58 percent. This difference must be acknowledged but remains negligible. However, China and India are by far the most populous G20 members with substantial real-world impact which is not accounted for when excluding them.
- In the growth and development area, all subcomponents are trending positively. However, there are only small differences between G20 and non-G20 countries: Increases in life expectancy are larger in G20 countries, which might hint at successes in the health sector. Additionally, the employment to population share is growing faster in G20 countries. This might mirror higher population growth rates in non-G20 countries. However, it also implies that on average unemployment has not been increasing either in G20 or in non-G20 countries (included in the sample).

[8]All quantitative data indicators are converted to a 1-to-7 scale using a linear min-max transformation (worst to best). Thereby, it is possible to aggregate the data from the indicator up to the index level. In case of outliers a benchmark is created and applied for the whole set of data to reduce the bias on the arithmetic mean of the sample. This way the order of, and the relative distance between, country scores is preserved to allow for unbiased comparison. However, it remains unclear how the lower and upper boundaries are defined. Also, it is not transparent whether all National Key Performance Indicators are weighted equally.

[9]A technical paper (Draper et al. 2018) was prepared for this purpose, and is available on request to the authors. Here the results are summarized.

[10]Without China and India, the poverty rate reduces by "only" 3.0 p.p.

Non-G20 countries, however, perform slightly better in increasing GDP and labor productivity. Therefore, it seems that non-G20 countries are catching up slowly.
- The inclusion variables have all improved, on average, especially in non-G20 countries. Income inequality (Gini coefficient) increased slightly (by 0.1) in G20 countries but decreased moderately (by 0.6) in non-G20 countries. Wealth inequality (Gini coefficient) decreased twice as much in G20 countries (by 2.5). This is in contrast to slightly increasing income inequality in G20 countries. The poverty rate (p.p.) decreased much faster (by 4.5 p.p.) in non-G20 countries than in G20 countries (−1.37 p.p.). Without China and India these average poverty reduction changes quite substantially to "only" −0.58 p.p. Again, this simple average does not account for country size. For instance, Nepal and Tajikistan have had larger reductions in poverty and are weighted equally to China and India in this calculation.
- Unfortunately, the area capturing Intergenerational equality and sustainability shows mostly downturns. Adjusted net savings increased in G20 countries by almost 1 p.p. but decreased in non-G20 countries by 1.5 p.p. Carbon intensity of GDP, that is kilotons of carbon emissions per billion dollars of GDP, has decreased substantially in both G20 and non-G20 countries (by about 6 and 7 kt/bn $GDP, respectively). This is in itself good news but is not sufficient to mitigate climate change because world GDP growth is higher (a cumulative 11.3 percent from 2012 to 2016, or 10 percent in the sample). Public debt increased almost three-fold in non-G20 countries compared to G20 countries (10.4 p.p. vs 3.9 p.p.). Lastly, the dependency ratio (ratio of people younger than 15 or older than 64 as fraction to 15–64 years old) which has remained almost stable in the full sample. Closer examination reveals that for the G20 countries it increased by over 2 p.p. This is probably driven by aging societies such as Japan, Germany, and China. Contrarily, it decreased by almost 1 p.p. in non-G20 countries, obviously driven by the youth bulge in developing countries. This indicates increasing pressures on the working age population in the richer world but decreased pressures in the less developed world.

A Broader View of the Drivers of Inclusiveness

After introducing the IDI and taking stock of the mostly positive changes that occurred from 2012 to 2016, the immediate question is: What are the drivers of inclusiveness and how have they changed? In our view, the main factors are:

- growth,
- technology,
- structural change,
- trade, and
- political economy.

We should note, however, that these factors are complemented by many other factors.[11] Including and discussing all these factors in detail would be

[11] *These range from the quality of infrastructure (Calderón and Servén 2004; Seneviratne and Sun 2013), human capital and workforce skills (Barro and Lee 2000) as well as macroeconomic resilience as expressed in moderate inflation rates and output volatility (Ramey and Ramey 1995). Another important*

beyond the scope of this article. We focus instead on those that we perceive to be the most important.[12] It must also be mentioned that in large parts the literature deals with inequality and has almost entirely neglected inclusiveness. Therefore, we attempt to adapt the theoretical arguments to cover inclusiveness.

Growth

First, economic growth must be seen as a major influence on inclusiveness. Before distributing wealth and prosperity and thereby increasing capabilities, there must first be an increase in production. The outstanding example is China. China shows how income gains can lift hundreds of millions of people out of poverty. The process of a historically unprecedented modernization has brought an extremely large group into the economic mainstream. Trade and investment, discussed in more detail in subsection 'Trade', have played an important role in this transformation, as well as in other successful transformation experiences, notably in East Asia.

This positive story of growth and inclusiveness is, nonetheless, marred by the fact that a small elite stratum has become fabulously wealthy during the process, meaning that within-country income inequality in China, for example, rose substantially through the period of rapid growth (Xie and Zhou 2014). This is in line with classic theory, which assumes a positive relationship between inequality and growth (cf. Stiglitz 1969). Temporary differences in production factor endowments and a lack of coordination lead to growth disparities between countries or even between regions within countries. However, the movement of the production factors labor and capital mitigates the regional differences. Empirical evidence suggests that labor migration, driven by differences in labor income (Borts and Stein 1964), reduces regional gaps in unemployment and income (Lipshitz 1987; Todaro 1969). As the economy restructures, capital flows into remote regions until the marginal rates of productivity are equalized (Vining Jr and Strauss 1977; Miyao and Shapiro 1979; Burns 1987; Tabuchi 1988). Transition theory proposes that regional inequalities increase in the early stages of a country's development but typically decline as markets become more effective and capitalist development progresses.

However, these problems might also be of a more permanent nature as analyses by Friedmann (1973) and Friedmann and Weaver (1979) suggest: inclusiveness is less secure than in cases of a short-lived inequality wave. First, political economy writers argue for negative impacts of a lack of inclusiveness on social stability (Alesina and Perotti 1996) and credit market imperfections on growth (Galor and Zeira 1993). Second, others, such as economic geographers, argue that markets lead to the cumulative concentration of the factors of production in certain regions at the expense of others. Neither social nor spatial systems have built-in mechanisms for stability. Therefore, a "backwash effect" might exist (talented individuals leave and go to growing

aspect is the access to capital on financial markets (Beck et al. 2007; Demirgüç-Kunt and Levine 2009). Despite concerns that financial development could hamper entrepreneurship (Levine 2012), it enables new innovative firms to enter the market. Increased competition facilitates the Schumpeterian process of creative destruction (Aghion and Howitt 2008). This will translate into higher growth rates that have a "disproportionately positive influence on lower income households" (Levine 2012). In early development stages, however, financial development has predominantly benefitted people at the top end of income scale (Roine et al. 2009).

[12]*In another paper (Draper et al. 2018), we test and largely confirm these considerations empirically.*

regions), while a "spread effect" (flows in opposite direction) is negligible (Myrdal 1957). Similarly, Hirschman (1958) identifies "polarization" and "trickling down" effects, and concurs with (Myrdal 1957) on the central roles of capital and labor as determinants of regional growth.

In contrast, Richardson (1980) suggests that market forces reduce inequality and thus increase inclusiveness via spread effects. Peet (1975) counters that growth-enhancing dynamics are prompted primarily by interaction of companies in metropolitan regions. Furthermore, income growth in peripheral regions is hampered by high regional population growth and "brain drain" (Brown and Lawson 1989). Once regional development becomes divergent, state intervention is needed in this perspective to overcome spatial inequalities.

Empirically, there are mixed results for the relationship between growth and inequality (Caraballo et al. 2017). The direction of the effects depends largely on the initial development stage.[13] These results, together with the theoretical considerations above, lead us to assume a generally positive connection between economic growth and the degree of inclusiveness, with potential exceptions rooted in spatial variations.

Technology

Many economists argue that the greatest cause of rising within-country inequality is technology (Aghion et al. 2002; Jaumotte et al. 2013). This clear-cut relation cannot be seen between technology and inclusiveness. Friedmann (1973) highlights the importance of technological innovation for growth which, in turn, has the positive effects on inequality and inclusiveness discussed in the previous subsection. However, the regions within a country must possess sufficient absorptive capacities to apply and utilize technological innovations (Shefer 1990).

Technology transfer will potentially enable formerly remote countries to benefit from the "flying geese"[14] phenomenon of industrial relocation. While trade also has something to do with this, particularly the intensification of GVC developments in relation to labor-intensive work, fourth industrial revolution technologies enable coordination of those value chains and their relocation back to the developed countries that are at the origin of most GVCs. This already shows the ambiguity in the relation between technological change and inclusiveness.

The scale of potential economic impacts are becomes clear recalling that recent innovation, especially in ICTs, make the idea of "lawyers or even doctors being replaced by artificially intelligent machines no longer far-fetched [.] Implications for factory workers being replaced by industrial robots, or for low-wage, unskilled labor in developing countries" (Draper 2017) may affect a larger number of people and are thereby even more devastating.

[13]*While classic theory (Stiglitz 1969) postulates a positive impact of inequality on growth through high saving and investment rates, the political economy approach suggests a negative impact of inequality on growth through risks of social unrest. Empirical findings support that, in line with the Kuznet's curve, the impact depends on the initial income level (Delbianco et al. 2014; Lee and Son 2016). While for poorer countries the political economy aspects dominate, the negative impact can turn positive in countries with high income.*

[14]*The term was coined by Akamatsu and originally applied to Japanese investments in South-East Asia. See (Akamatsu 1962). 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.*

In addition, a high proportion of the research and development (R&D) carried out in the world is directed by large multinational corporations (MNCs) based in the United States, Japan, and Western Europe. "MNCs play a major role in the generation and international diffusion of technology, accounting for around 80 per cent of world trade in technology and the majority of private research and development" (Held et al. 2000).

Higher inequality in relative wages and thus declining inclusiveness can be a consequence of steady skill-biased technical change (Katz and Murphy 1992). Recent ICT innovations have helped to boost productivity and improved well-being but increased the skill premium for skilled labor translating into higher labor-income inequality (Dabla-Norris et al. 2015). This skill-bias can be observed since the 1970s (Acemoglu 2002) and it might be accelerating with new technologies (Acemoglu 1998; Autor et al. 1998).

Structural Change

The previous two points highlight the fact that as economies develop over time, so these economies undergo structural change. This is an unavoidable feature of economic development but impacts spatial inequalities as well as the degree of inclusiveness. The shift of industries out of the structurally uncompetitive areas leaves behind regions that were not equipped to participate in the rapidly evolving international division of labor. This phenomenon could also be called "deindustrialization", and is a key feature of politics in some Western societies (Alvarez-Cuadrado and Poschke 2011; Herrendorf et al. 2014; Felipe and Mehta 2016), most prominently in the United States. Similar impulses are in play in parts of the modern UK, as well as other Western European states. They are also to be found in developing countries, and related to "premature deindustrialization" (Rodrik 2016). In fact, the problem is worse in developing countries facing the prospect of the "middle-income trap" (Eichengreen et al. 2014) which means they are squeezed from below by labor-intensive, low-cost producers and from above by developed countries that dominate the intellectual property-intensive heights of GVCs.

Structural transformation gave other regions opportunities to upgrade their economies in goods and services value chains. As pointed out by Hausmann et al. (2007) and Spatafora et al. (2012) this creates growth momentum with implications for inequality. Structural change often goes with increases in the productivity of service sectors. Besides the modernization in manufacturing sectors, the globalization of highly mobile and tradable services is a crucial determinant of economic growth in many emerging countries (Mishra et al. 2011). Additionally, R. Anand, Mishra, and Peiris (2013) observe empirically that upgrades in manufacturing and increasing sophistication of services make growth even more inclusive, especially in the service sectors. However, developing countries suffer from low skills in the labor force translating into low productivity in service sectors despite large wage differentials. Therefore, they struggle to attract foreign direct investment (FDI) into sectors with high added value and growth potential to finance upskilling, presaging learning-by-doing periods in which companies often make losses. This slows down structural change and traps these countries in sectors in which they had comparative advantages in the first place (Khan 2012, 18).

Trade

The fourth single determinant of inclusive development we consider is trade. There has been a large number of works examining the relationship between trade, growth and increase in income translating into reduced poverty and higher inclusion (Hoekman et al. 2001; Berg and Krueger 2003; Aksoy and Beghin 2004; Dollar and Kraay 2004;; Ravallion 2007). There is evidence that trade openness facilitates growth which, in turn, reduces poverty as suggested by Berg and Krueger (2003), Dollar and Kraay (2004) and Sachs and Warner (1995). Countries that increasingly participate in international trade display higher growth rates (Dollar and Kraay 2002). As an effect of trade integration countries are enabled to exploit comparative advantages more efficiently and boost development in export-oriented regions and sectors. Again this means the growth is not only higher, but also more inclusive (Anand et al. 2013).

Kanbur and Venables (2005) identify spatial inequalities as "a consequence of the uneven impact of trade openness and globalization." In case advanced countries continue offshoring, the demand for labor-intensive products from developing countries can lead to higher wages of low-skill work forces in those countries (Dabla-Norris et al. 2015). However, the effects for unskilled labor in developed economies is mixed. The demand for labor-intensive products increases competition in low-skilled labor-intensive sectors, potentially driving down nominal wages and displacing jobs, but could increase real wages due to lower import prices at the same time (Munch and Skaksen 2008), while leading to job creation in other parts of the economy.

Inclusive integration into world trade depends on economic and political characteristics. According to Higgins and Prowse (2010) macroeconomic stability, initial poverty levels, investment climate and the export goods portfolio, as well as the political economy context are most consequential. Especially the latter has been identified as critical. Chang (2007) and Rodrik (2008) suggest that trade integration is the yield of inclusive development, rather than a precondition for it as it "will influence the extent to which poor people benefit from trade expansion" (Higgins and Prowse 2010).

Understanding comprehensive impact of trade is hardly possible without considering the effects of investment, which constitutes "a vital driver of economic globalization and a key mode of entry for Multinational Corporations (MNCs) looking to access new markets. Indeed, the world of GVCs cannot be understood without reference to both trade and investment" (Draper 2017). The effects are inseparable but may work in contrary directions. Jaumotte (Jaumotte et al. 2013) argues that global trade integration reduces, but financial globalization, especially FDI, increases global inequality. In contrast, the IMF (2007) finds a significantly positive impact of FDI on inclusive growth owing to spillovers and knowledge transfers.

Political Economy

While the concept of "political economy" is broad, we use it in this article to introduce political factors such as interests and power structures into an otherwise exclusively economic sphere. In the literature, it encompasses many meanings. More recent contributions from institutional economists (Acemoglu et al. 2001; Acemoglu and Robinson 2013) argue that only inclusive institutions allow for the possibility of prosperity. Inclusive institutions are pluralistic, i.e., allowing differing views in society in the process of setting the rules. In a similar vein, North et al. (2009) point out that the major difference between the developed and the undeveloped parts of the world is that the former allows for channeling the problem of taming violence (creating stability) into a system of open access and competition via institutions such as markets, elections, and corporate law as opposed to creation of stability by elites through arbitrary power. Thus, the differences in the performance of the institutions depends not only on the design of the institution itself but also on the surrounding social orders (North et al. 2007).

From a liberal perspective, the emergence and existence of pressure groups and vested interests are a threat to the open society (Olson 1965). As Olson demonstrated theoretically, it is far easier to mobilize a small group and, through this small group, influence or even capture a policy process in search of rents. Not only does rent seeking imply a resource cost since resources are used up in these activities, but it can also subvert the formulation and implementation of policies in ways that prevent the resolution of the market failure (Khan 2000).

In Olson's theory, these rent-seeking processes lead to an accumulation of special interest groups in society over time, generating resistance to structural change and ultimately, as argued in a subsequent work (Olson 1982), 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 perspective, trade opening plays a crucial role in shaking up the structure of special interest groups invested in avoiding import competition, in favor of consumers, which by implication promotes income growth and may reduce within-country inequality.

Implications

The theoretical analysis in section 'A Broader View of the Drivers of Inclusiveness', above, shows that the drivers of inclusiveness are not fully researched yet and that the directions and channels of impact are rather ambiguous. Nevertheless, it is clear that the results do not challenge certain relevant domestic policy tools, which have proven robust in the past. These include a liberal domestic supply-side agenda, sound and universal education and social policy, and an international order based on rules rather than individual countries' strength and size.

Domestic Policy Choices

The domestic challenges to increase the degree of inclusiveness are manifold.

There is ample evidence that growth is a necessary, but not sufficient, condition for governments to increase inclusiveness. All measures that are growth enhancing, while not detracting from sustainability, are welcome. These include open markets with high scale of competition, an incentivizing tax policy, proper education policies, sufficient provision of infrastructure, etc.

Many of these growth policies are implemented at the national level. These domestic policies are e.g. connected to labor market dynamics. As a consequence of growth or decline of certain industries in a region in question, skills mismatches can result—both shortages (growing industry; low supply of required labor) and surpluses (declining industry; over-supply of labor). How workers respond to these dynamics is an important issue. Pavcnik (2017) notes that for various reasons many people living in structurally repressed regions choose not to migrate to where their work opportunities could be better.

Advancements in technology have substantial repercussions for domestic policy. As noted in Pavcnik (2017), more efficient firms are in a stronger position to be more selective in their recruitment practices and invest in technological upgrading by leveraging the "Fourth Industrial Revolution". This could displace workers within the firm, particularly at the lower end of the skills chain. If this displacement of workers can be offset with appropriate social policies (such as policies that increase human capital), technological upgrading can have a large and positive influence on inclusiveness.

Trade liberalization is another important domestic policy field. Overall, the impact of trade on countries defies generalizations. Nonetheless, it seems to be relatively small compared to the range of factors discussed in this article. Additionally, it is crucial to consider the net effects: some countries as a whole are likely to benefit from trade and opening up for investment while within-country effects diverge, and single regions may face adverse experiences. Other countries, however, may lose overall even though regions within the country achieve dynamic gains. Hence, the inclusiveness effects of such domestic policies are hard to grasp. But again, the point being made is that if trade liberalization polices are accompanied with domestic policies that cushion asymmetrical impacts on parts of the population, they are more likely to have a positive impact on inclusiveness than a negative one.

Policies for growth, technological change, and trade add up to determine structural change patterns in the economy in question. As argued above, if polices are set in a way that allows potential upgrades in the value chain and avoids middle income traps this can bolster inclusiveness of the development process.

Political economy poses other domestic policy challenges including fields such as migration policies. 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. Other, more intangible, domestic policies that affect inclusiveness are e.g. the (effective) protection of civil liberties or participation in the political system which are closely connected to inclusiveness, as argued in 'Political Economy' section.

The conclusion from these remarks necessarily means that domestic policy responses must also be contingent and calibrated to differential impacts on the regional level. Depending on the institutional framework of the political system, some policy responses may best be targeted at decentralized levels rather than remaining within the purview of national government.

Ultimately, all domestic policy choices are highly contingent on the specific country and are embedded into a system of global governance which we focus on next.

The Global Order

In his classic dissection of the foundations of the liberal international economic order, the German social market economist, Wilhelm Röpke, argued that the most important ingredient was liberal democracy at home (Röpke 1959). He 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, the foundation of the liberal international economic order is the (Western) liberal states that built it.

Against this background, elaborating global implications is a rather complex matter. So much of the terrain traversed in this article is contingent on country circumstances. Those vary so widely that drawing general conclusions will always be particularly difficult. However, we can attempt a small interpretation of how global order affects the five drivers of inclusiveness and inclusiveness itself.

The growth environment on the global level is largely determined by political economy factors such as social stability, labor migration policy, trade policy, and policies that deal with spatial variations (as has been argued in 'Growth' section), which in turn affect inclusiveness. A global order for growth promoting policies still relies heavily on the World Bank and the IMF, but with a much stronger weight given to, or claimed by, the emerging world. This trend is mirrored in increasing potential importance of the G20, which needs to be sharpened in the face of increasing resort to unilateralism by major countries. In addition, even the focus of the Washington institutions has shifted with the Millennium Development Goals (MDGs) and the Sustainable Development Goals (SDGs) towards the promotion of more non-pecuniary inclusiveness objectives. This should be welcomed and fostered in the light of non-G20 countries' lagging performance in inclusive development.

Technologies allow for and increase spillovers, both positive and negative, which can affect inclusiveness via growth but in an indirect way mostly through other channels (see section 'Technology'). Consequentially, a global order that is beneficial to positive spillovers is beneficial to inclusive development. Trade and investment relationships are welcome in this regard, as might be foreign aid relationships if they increase technological spillovers between countries. Moreover, trade (and investment) are relatively marginal influences on inequality levels yet receive a disproportionate share of the blame. Thinking and positions are deeply entrenched.

Structural change is hardly guided by global polices. However, some global governance policies are adjacent to it. For example, development agendas might ameliorate premature-deindustrialization to avoid downturns in inclusiveness. They might be relevant for global policy coordination. Furthermore, above we have identified value chain upgrading as one important aspect of structural change. International policy efforts for this are again in the reach of trade and investments policies and therefore substantially within the WTO framework. Inclusiveness will be facilitated by productivity gains that come along with more sophisticated value chains.

As argued in section 'Political Economy', political economy is another driver of inclusiveness. This was illustrated in the previous paragraphs on how the trade system is part of a liberal global governance system. They do shape the global governance agenda, especially with respect to development policies and therefore inclusive development. Here lies potential for reshaping the agenda to be more inclusiveness-focused, not only for G20 countries themselves but, also and especially, for non-G20 countries who have had a weaker track record of inclusiveness and inclusive development owing to relative domestic political economy limitations.

Many advocate for 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 neighbor" 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. Therefore, it seems natural that the longer there are no changes in the international regulatory framework, the need to update the regulation of business and international economic conduct will grow.

Therefore, rather than risk levelling down the playing field, proponents advocate a gradual levelling up in several policy domains, *inter alia* labor, 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 recent economic developments 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, improving the environment within which these firms operate is likely to increase the propensity to invest and, thereby, generate positive welfare effects—both for the host country and for the globe. In other words, a "race to the top".

However, the idea of strengthening global governance has its critics, which manifests itself in the current populist sentiments. That populist politicians find international organizations, such as the WTO and the G20, to be convenient scapegoats for domestic troubles is to be expected, unsettling though it may be. Yet, there are sound intellectual foundations for a skeptical approach. In the introduction, we highlighted Ruggie's seminal insight that the WTO system (earlier the General Agreement on Tariffs and Trade, or GATT) is founded on the notion that the postwar system was built on "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, Rodrik (2011) argues 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 inclusiveness and avoiding social dumping. 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 national and subnational circumstances undoubtedly in play. Although he does not explicitly acknowledge Ruggie, their arguments are similar.

In response, we want to highlight three important caveats to these critiques.

First, the multilateral trading system is perceived to be stuck. Consequentially, national policy makers choose to bypass the WTO and focus on regional or bilateral forums to bolster "national sovereignty" (as illustrated by President Trump's focus on bilateral trade deals). Many WTO observers, including us, think that a feasible way forward will be 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. Following the Buenos Aires Ministerial in December 2017, this approach has been pursued for e-commerce, for example. Overall, this goes against all-encompassing, single-undertaking negotiating rounds such as the dead, if not buried, Doha Round.

This highlights a second caveat. 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 (Findlay and O'rourke 2009). This implies with a failing of the international institutions (including the WTO), the global economy would undoubtedly find itself back in a more overt balance-of-power, mercantilist (dis)order. It is difficult to see how this can be in the interests of poor countries and beneficial for inclusive development within them.

There is a third, perhaps more fundamental, caveat. Rodrik's conception of how to promote people-centered globalization, based 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. The current move of some countries towards populism and, in some cases authoritarianism, suggests otherwise.

Should the international order become substantially less liberal and more driven by policies that raise protectionism, this naturally affects inclusiveness in that it decreases the capability set of people.

Conclusion

There are mounting concerns over U.S. commitment to the liberal international economic order, exacerbated by President Trump's orientation towards it. This has been coupled with the simultaneous consolidation of power in China under President Xi Jinping a year later, along with his explicit promise to internationalize China's illiberal model of development. 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 and will be more concerned with economic inclusiveness at home.

Against this background we first asked how G20 countries, as the putative "system shapers," perform with respect to inclusive development. We found that G20 countries perform better than non-G20 countries and concluded that G20 countries should celebrate their relatively positive achievements and assist non-G20 countries to follow suit. In other words, the "system shapers" should target their shaping more towards the "non-shapers" than towards reversing the gains of globalization through domestic policy actions.

We then asked how economic theory contributes to understanding the causes of (missing) inclusiveness. We considered the evidence from the literature for our chosen five drivers. They yielded rather mixed evidence regarding their effect on inclusiveness. Consequently, we discussed domestic policy responses for promoting inclusion. These are rather straightforward but not uniform: growth enhancing, trade opening, and structural change promoting regional participation in national economic development stand out. Also, a suitable regulatory framework for technology uptake is important (educating the work-force, creating incentives for innovation, promoting the dissemination of new technologies, etc.). Overall, domestic policies are the main instruments for promoting inclusiveness. However, domestic policy responses can't be generalized, and need to be tailored to specific national circumstances.

Third, we asked: What challenges arise for the international economic order from the perceived lack of inclusiveness that may serve as a main cause for the surge of populism? We found that the liberal international economic order generates insufficient global governance because there is always a fraction of countries opposing global policy coordination since they believe it harms them. This dynamic implies that global governance focus will increasingly shift to "coalitions of the willing," rendering multilateralism an increasingly challenging, and tailored, proposition. Ultimately, this supports an argument for increased importance of global governance institutions such as the G20, using an a la carte approach.

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