FOREWORD

Consistently good economic news since summer 2016 is starting to add up to a brightening global outlook. The economic upswing that we have expected for some time seems to be materializing: indeed, the *World Economic Outlook* (WEO) raises its projection for 2017 global growth to 3.5 percent, up from our recently forecast 3.4 percent. Our 2018 forecast holds steady, with the world economy's growth set to rise to 3.6 percent next year. The expected growth improvements in 2017 and 2018 are broadly based, although growth remains tepid in many advanced economies, and commodity exporters continue to struggle.

At the same time, however, the upgrade to our 2017 forecast is modest, and longer-term potential growth rates remain subdued across the globe compared with past decades, especially in advanced economies. Moreover, while there is a chance growth will exceed expectations in the near term, significant downside risks continue to cloud the medium-term outlook, and indeed may have intensified since our last forecast. The gathering recovery remains vulnerable to a range of downside risks, which Chapter 1 of this WEO describes.

One salient threat is a turn toward protectionism, leading to trade warfare. Mainly in advanced economies, several factors—lower growth since the 2010–11 recovery from the global financial crisis, even slower growth of median incomes, and structural labor-market disruptions—have generated political support for zero-sum policy approaches that could undermine international trading relationships, along with multilateral cooperation more generally.

An approach to international economic policy based on collaboration among countries took root after World War II and has evolved in scope and geographic breadth. This evolution has not always been smooth, as a history of financial and currency crises in recent decades attests, but the global economy's coping mechanisms have until now proved resilient. One result has been a notable surge in growth in a number of emerging market and developing economies, some of which have reached high-income status. Chapter 2 of this report examines aspects of their convergence toward higher incomes.

Richer countries have continued to grow as well, but with less impressive income gains over the past 10 years when compared with previous decades, and certainly when compared with the more successful emerging market and developing economies. It is not surprising, therefore, that attitudes about international trade's effects on jobs and wages, as measured by leading surveys, tend to be more positive in poorer economies.

These findings may have less to do with the overall growth disparity between rich and poor countries than with the failure of growth gains in rich economies to substantially reach those in the lower parts of the income distribution in recent decades. Inequality remains substantial within poorer countries, but with more room for catch-up and higher growth under the right policies, they have been able to lift substantially the incomes of even their poorest citizens. International trade has been a key element in those success stories.

Global trends in inequality are related to trade, but owe much, and in many countries more, to technology changes—insofar as one can conceptually separate technological advance (which facilitates trade) from trade itself (which spreads technological know-how). Chapter 3 of this report explores how the forces of technology and trade have tended to lower labor's share of national income in many countries. A fall in labor's GDP share could, in theory, be a benign response to economic developments that raise workers' real incomes—for example, fast productivity growth that benefits capital even more than labor. However, where a fall in labor's share coincides with stagnant median incomes and a worsening income distribution, as has been the case in a number of advanced economies, political pressures to roll back economic integration with trading partners can follow.

Capitulating to those pressures would result in a self-inflicted wound, leading to higher prices for consumers and businesses, lower productivity, and therefore, lower overall real income for households.

Governments should instead follow trade policies consistent with maximum productivity, supplementing those with other policies that better distribute the gains from foreign trade internally, improve the skills and adaptability of their workforces, and smooth the process of adjustment for those adversely affected by the need for economic reallocation. Unfortunately, governments often find it harder to make such domestic improvements than to restrict trade. But they need to be aware that the gains that such an approach may yield for some at home come at the expense of others in the domestic economy in addition to foreign trade partners. Even the sectoral gains from curbing cross-border economic integration disappear, and losses worsen, when trade partners retaliate in kind.

Policymakers instead must do the hard work of investing in their economies, especially in people, to create greater resilience to a host of potential and ongoing structural changes—including the changing modalities of globalization. Useful reforms can focus on active labor market policies, greater tax progressivity where helpful, more effective investment in education, and changes to housing and credit markets that facilitate worker mobility.

Many of these policies not only ease economic adjustment, but they also raise potential output over the longer term. They are key components of the set of monetary, fiscal, structural, and financial sector policies that will strengthen and secure the recovery over time.

The global economy seems to be gaining momentum—we could be at a turning point. But even as things look up, the post–World War II system of international economic relations is under severe strain despite the aggregate benefits it has delivered—and precisely because growth and the resulting economic adjustments have too often entailed unequal rewards and costs within countries. Policy must address these disparities head-on to ensure the stability of an open, collaborative trading system that benefits all.

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