

## Globalisation and the rise of inequality

# Rich man, poor man

### A poisonous mix of inequality and sluggish wages threatens globalisation

Jan 18th 2007 | From the print edition

GLUERS and sawyers from the furniture factories in Galax near the mountains of Virginia lost their jobs last year when American retailers decided they could find a better supplier in China. At the other end of the furniture industry Robert Nardelli lost his job this month when Home Depot decided it could find a better chief executive in his deputy. But any likeness ends there. Mr Nardelli's exit was as extravagantly rewarded as his occupation of the corner office had been. Next to his \$210m severance pay, the redundant woodworkers' packages were mean to the point of provocation.



James Fryer

That's the way it goes all over the rich world. Since 2001 the pay of the typical worker in the United States has been stuck, with real wages growing less than half as fast as productivity. By contrast, the executive types gathering for the World Economic Forum in Davos in Switzerland next week have enjoyed a Beckhamesque bonanza. If you look back 20 years, the total pay of the typical top American manager has increased from roughly 40 times the average—the level for four decades—to 110 times the average now.

These are the glory days of global capitalism. The mix of technology and economic integration transforming the world has created unparalleled prosperity. In the past five years the world has seen faster growth than at any time since the early 1970s. In China each person now produces four times as much as in the early 1990s. Having joined the global labour force, hundreds of millions of people in developing countries have won the chance to escape squalor and poverty. Hundreds of millions more stand to join them.

That promises to improve the lot of humanity as a whole incalculably. But in the rich world labour's share of GDP has fallen to historic lows, while profits are soaring. A clamour is abroad that Mr Nardelli and his friends among the top hundredth—or even the top thousandth—of the population are seizing the lion's share of globalisation's gains. Meanwhile everyone else—not just blue-collar factory workers but also the wider office-working middle class—shuffles along, grimly waiting for the next round of cost-cuts. They are not happy.

## Fear and clothing

Signs of a backlash abound. Stephen Roach, the chief economist at Morgan Stanley, has counted 27 pieces of anti-China legislation in Congress since early 2005. The German Marshall Fund found last year that, although most people still say they favour trade, more than half of Americans want to protect companies from foreign competition even if that slows growth. In a hint of labour's possible resurgence, the House of Representatives has just voted to raise the federal minimum wage for the first time in a decade. Even Japan is alarmed about inequality, stagnant wages and jobs going to China. Europe has tied itself in knots trying to “manage” trade in Chinese textiles. The Doha round of trade talks is dying.

What is to be done about this poisonous mix? If globalisation depends upon voters who, as workers, no longer think they gain from it, how long before democracies start to put up barriers to trade? If all the riches go to the summit of society and that summit seems beyond everybody else's reach, are the wealth-creators under threat?

## Should you blame China or your computer?

The panic comes in part from a rush to lump all the blame on globalisation. Technology—an even less resistible force—is also destroying white- and blue-collar tasks in a puff of automation and may play a bigger role in explaining rising wage inequality and the sluggish growth of middling wages. The distinctions between technology and globalisation count, if only because people tend to welcome computers but condemn foreigners (whether as competitors or immigrants). That makes technology easier to defend.

For economists, the debate about whether technology or globalisation is responsible for capital's rewards outpacing those of labour is crucial, complicated and unresolved. One school, which blames globalisation, argues that the rocketing profits and sluggish middling wages of the past few years are the long-lasting results of trade, as all those new developing-country workers enter the labour market. This school says that technology helps workers by increasing their productivity and eventually their wages. The opposing school retorts that technology does not increase wages immediately, and some sorts of information technology seem to boost the returns to capital instead (think of how much more a dollar's worth of computing power can do these days). And it questions whether Western incomes will remain flat: recent wage rises in America and pay claims in Europe and Japan may start to reverse the balance back away from capital.

In practice, it is hard to parcel out the blame between technology and globalisation, because the two are so intertwined. Ask IBM, which is hastily shipping bits of its services arm to India; or the call-centre worker who sees off the threat of his job going abroad by settling for only a tiny pay rise. And from a policymaker's point of view, it matters little what is causing the pain: the remedies are broadly the same.

The first rule is to avoid harming the very miracle that generates so much wealth. Take for instance the arguments about high executive pay. Some say this is simply a matter of governance—and forcing company boards to work better. If only it were that simple. High pay is, by and large, the price needed to attract and motivate gifted managers, as our special report argues in this issue. The abuses of companies such as Home Depot obscure how most high pay has been caused not by powerful bosses fixing their own wages, but by the changing job of the chief executive, the growth of large companies and the competitive market for talent. Executive-pay restrictions would not put that horse back in its box, but they would harm companies.

If the winners are difficult to curb without doing damage to your economy, the losers are tough to help. Doling out aid for the victims of trade makes sense in theory; but in practice it is increasingly hard to do (see article (/node/8548661) ). When the jobs going abroad are not whole assembly lines, but bits of departments, how exactly do you pick out the person who has lost his job to globalisation from the millions of people changing jobs for other reasons? And, hardhearted though it may sound, most of the gains from trade and technology alike come from the way they redeploy investment and labour to activities that create more wealth. That, like all change, can be painful; but it is what makes a country richer. A policy locking people into jobs that could be better done elsewhere is self-defeating.

The same goes for protectionism—especially now that the victims of globalisation are so scattered throughout the rich world, not camped in embattled industries. Trade has always created losers and it has always been in their narrow interest to seek protection (even if it hurts everyone else). But if many workers across many different industries were to demand protection at once, the selfish appeal of such a shield would fade.

Because hardship from globalisation is so difficult to distinguish from hardship in general, it would be open season to put up trade barriers in industry after industry. Widespread protection would surely meet with retaliation from abroad. Even if people gained as workers they would lose as consumers, investors and future pensioners. Moreover, the protection of jobs and pay would be short-term, because it would gradually lead to companies losing competitiveness as rivals in India and China innovated (see article (/node/8559758) ). Paradoxically, therefore, the greater the number of people threatened by globalisation, the less each of them is likely to gain from getting their governments to stand in its way.

## The limits of redistribution

If protectionism will not help the losers, what about using the tax system? Some argue that redistributing more cash from the Nardellis to the Galaxians would not just make society less unequal; it would also buy middle-class support for

globalisation. In fact the two arguments should be kept separate.

This newspaper has long argued that a mobile society is better than an equal one: disparities are tolerable if combined with meritocracy and general economic advance. For decades America has shown how dynamic economies are better than equality-driven ones at generating overall prosperity. That still leaves plenty of room to debate how progressive to make taxation (some of George Bush's tax cuts were needlessly regressive), or how lavish to make public services (American welfare is hardly generous). But a society would want compelling evidence that the social contract had been torn up before flexing the tax system to offset what may turn out to be only temporary fluctuations in relative incomes. And it makes little sense for free-traders to use taxes to buy off people from voting for protectionism, when doing so would in any case be against their interests.

## **Active, not reactive**

Instead, the way to ease globalisation is the same as the way to ease other sorts of economic change, including the impact of technology. The aim is to help people to move jobs as comparative advantage shifts rapidly from one activity to the next. That means less friction in labour markets and a regulatory system that helps investment. It means an education system that equips people with general skills that make them mobile. It means detaching health care and pensions from employment, so that every time you move your job, you are not risking an awful lot else besides. And for those who lose their jobs—from whatever cause—it means beefing up assistance: generous training and active policies to help them find work.

None of that comes cheap—and much of it takes years to work. But an economy that gains from globalisation can more easily find the money to pay for it all. The businesspeople and politicians gathering on their Swiss Alp next week should certainly spend more time worrying about the citizens of Galax; but they also need to be far more courageous about defending a process that can do so much good even if its impact can sometimes appear so cruel.

From the print edition: Leaders