



Crisis of capitalism? Perhaps, but don't blame it on globalisation

by Simon Tilford
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Donald Trump, Brexit, serious populist pressures in other EU countries: are we entering a full-blown crisis of international liberal capitalism? There is no doubt that globalisation poses policy challenges for governments. [But globalisation by itself](#) did not force governments to adopt policies that have divided their countries, exacerbated inequality and hit social mobility. Many of them did those things by choice.

The problem is not that we have allowed an increased role for markets, as many on the left (and increasingly on the populist right) argue. Open markets remain the best way of generating wealth and opportunities, of challenging vested interests and of expanding people's freedom. We are in this mess because we've forgotten the lessons of the post-war period. Basically, we have a crisis of distribution and opportunity.

Globalisation is a net positive, and has played a huge role in reducing poverty globally over the last 30 years. But there are winners and losers from increased trade and movements of capital, as there are from rapid technological change, and many countries, notably the US and the UK, have failed to take the necessary corrective action. Contrary to the anti-globalisation proselytising of the political left, the American and British governments could have acted; they were not prevented from doing so by 'international market forces'. And, globalisation does not, as the liberal economic right has tended to argue, require governments to reduce social spending, weaken unions and cut taxes on the wealthy.

For example, successive American and British governments were not forced by 'globalisation' to allow executive pay to balloon. This reflects failures of corporate governance. While pretty much all developed countries have seen rapid pay growth at the top, nowhere has the explosion of boardroom pay been as big as in the Anglo-Saxon countries.

Similarly, the US choice to cut taxes for the wealthy over the last 35 years was a domestic one, aimed allegedly at releasing animal spirits and driving entrepreneurship. US governments were not compelled to do so in order to bolster the country's attractiveness to international investors. After all, not all developed countries have followed this route and they have not suffered for it. On the contrary, many of the countries that have flourished from globalisation – the Nordics, for example – are those that levy high income taxes on the wealthy and relatively high taxes on wealth.

Similarly, high levels of wealth inequality in Germany reflect the refusal of successive German governments to tax property and inheritance more highly. Low taxes on wealth reflect a desire to keep businesses in family ownership and thus protect the country's Mittelstand. And they are partly designed to encourage higher home ownership. A high concentration of wealth hits social mobility. But the German government is not constrained by the pressures of globalisation to keep taxes on wealth and property low.

The allegedly negative impact of immigration on the wages of low paid workers has become a contentious political issue, not least in the UK. There is [scant, if any, evidence](#) of this happening. Indeed, welfare cuts have had an incomparably bigger impact on the disposable incomes of the poor than has competition from increased levels of immigration.

Globalisation did not force Western governments to engage in damaging austerity. There was little evidence that developed countries were constrained by the need to 'compete' for capital in a world of global capital markets. Some eurozone governments were limited in their freedom to boost public spending in an effort to counter the economic downturn, but this was because of the governance of the eurozone, not the forces of globalisation.

People want the benefits of free trade: the cheaper, higher quality products and choice that competition brings. But they want to be protected from the impact of competition when it comes to their own line of work. Of course, some people – typically the better-educated – enjoy the fruits of free trade without experiencing any of the down-sides. For others, the costs and benefits may be more evenly balanced.

Governments need to do much more to ease the burden of adjustment in areas negatively affected by increased trade, much as they need to do more to support areas whose established industries have been wiped out by technological change. Some countries have been successful at doing this, investing in active training policies, and infrastructure in affected areas. Others, notably the US and [the UK, have been less effective](#) in doing so.

However, some things do require greater international governance. First, there is some evidence that globalisation does make it harder to raise the tax needed to address inequality and combat declining social mobility. Multinationals can pay tax where tax rates are low rather than where they generate their revenue, and some have chosen this route. As a result, many governments have competed to lower taxes on business, which has meant having to raise taxes elsewhere, usually on low to average earners, and on consumption. Globalisation has made it easier for high earners to avoid tax, because it is now more straightforward to hold wealth offshore and the wealthy derive much of their income from wealth.

Multinationals should be taxed where they generate their cash flow or add value, not where tax rates are lowest. The OECD has done a lot of work on how co-ordination between member-states'

governments could bring this about, but implementation has been slow, not least because of opposition from governments of countries that act as tax havens. Closer coordination between national tax authorities is making it harder for the wealthy to hold wealth offshore, but here too there is a long way to go. In the meantime, national governments could also do more to ensure the tax burden is equitable, for example by increasing taxes on immobile factors, such as land, rather than loading more tax onto labour and consumption.

Second, financial globalisation is a mixed blessing. Yes, it enables firms and individuals to spread risk and hence reduces their vulnerability to economic shocks. But there is a problem with the composition of capital flows: short-term inflows are often harmful and huge capital exports from countries with excess savings, such as Germany, are a source of instability that needs to be addressed. First, countries need to defend themselves against inflows. Tougher rules requiring banks to rein in lending when it becomes excessive would be a start. Second, countries running unsustainably large trade surpluses need to be discouraged from exporting vast amounts of capital in the first place. Forcing them to pay their share of the costs of cleaning up financial crises caused by excessive flows would help: at present, when financial crises hit, the adjustment is made by the debtors; creditors are not expected to change their behaviour.

Third, persistent trade imbalances are a problem. Currently, there are no mechanisms to impose adjustments on countries running huge trade surpluses and exporting large amounts of capital. Do we need tighter rules to govern commercial and financial relations between economies – perhaps under the auspices of rebooted Bretton Woods institutions – to limit imbalances? Possibly, but proper governance of global finance might go some way to addressing the problem by reducing the excessive capital flows that lie behind the trade imbalances.

There is little mystery why popular frustration and resentment are rising in many developed countries. Economic growth has been weak for a decade. Living standards are under pressure. The benefits of what growth there has been has largely accrued to the wealthy, and social mobility is under pressure. The responsibility for these trends does not lie with remote, unaccountable global forces, but largely with national governments. Globalisation does not render them powerless. And where it does undercut their power, they could work together to bolster their influence.

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