Profits of doom

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In theory, the deal between capital and labour is simple. Capitalists say to the workers: you help us lift profits and we will reward you with higher wages. That way, everyone wins.

But recently this tacit agreement has collapsed. If you are a humble wage-slave you may not be aware that, across the industrialised world, companies are enjoying an era of extraordinarily high profit growth. What you may be aware of, however - perhaps painfully - is that, except for those at the very top of the income scale, pay rises are barely keeping up with inflation.

In Britain, company profits were the highest last year since records began in 1965; yet median weekly earnings, adjusted for inflation, fell by 0.4 per cent. It is the same story in all the rich countries of the west. In a recent research note on the US economy, Goldman Sachs, the US investment bank, said: "As a share of GDP, profits reached an all-time high in the first quarter of 2006. Several factors have contributed to the rise in profit margins. The most important is a decline in labour's share of national income. "

Naturally, investors and other members of the financial community welcome this as they have enjoyed the benefits of rising share prices, record levels of merger and acquisition activity and soaring bonuses. Company executives, too, have benefited through their stock options and performance-related bonuses. A survey last week showed directors' pay at Britain's biggest companies shot up by 28 per cent last year.

In fact, outside the populist media, most commentators regard high corporate profits as benign - rising corporate profitability normally translates into more investment, more jobs and higher pay.

But what about the ordinary, middle-class employees of the companies making these extraordinarily high profits? The sort of pay rises they are getting are the sort you would expect in a recession. Why are they not sharing in the boom?

One explanation might be that, at least in the private sector, trade unions have lost much of their power. But there is more to it than that. In the pre-globalisation era, western labour enjoyed near-monopoly access to western capital. That is to say, western capital was immobile, and had to treat with western labour because it had nowhere else to go.

That changed with globalisation, when the dismantling of barriers to world trade gave western capital access to vast amounts of low-cost labour in countries that were previously closed off.

Cheap labour, plus the opportunity to exploit new global markets, has brought a profit bonanza to western companies. But it has not been reflected in higher wages for employees at home because companies are no longer in thrall to employees at home. Instead, the gains have been split between capitalists, who have enjoyed higher returns; executives, whose emoluments go up with profits; and poor workers in the developing world, who have gained from the growth in jobs and rising wages that would once have gone to the west.

This is not quite how globalisation was supposed to work out. According to the principle of comparative advantage, rich countries with their skilled workforces would specialise in turning out advanced products while the poor countries with their unskilled labour would specialise in low-technology goods. Yes, there could be job losses in the rich countries among unskilled factory workers, but western workers overall would gain from the opening of new markets for their products and from cheaper imports.

With hindsight, this analysis massively underestimated the effects of globalisation on western workers. Too much of it was fixated on the threat to jobs and too little of it on the threat to wages.

In a paper he prepared for a recent Federal Reserve Bank of Boston conference, Richard Freeman, a Harvard labour economist, estimates that the entry of China, India and the former Soviet bloc roughly doubled the number of workers in the market economy, from 1.46 billion to 2.93 billion. Since those countries brought little capital with them, the number of workers in the system shot up while the amount of capital increased very little. As the law of supply and demand might suggest, when labour is abundant and capital scarce, the returns to labour tend to fall and those to capital rise.

In addition, the idea that only low-skilled factory workers have anything to fear from globalisation has turned out to be a myth. The former Soviet bloc already has many highly educated workers (the Soviets, remember, beat the Americans into space) and the less developed countries are pouring investment into higher education. "Indonesia, Brazil, China, India - name the country - have more than doubled university student enrolments in the 1980s and 1990s, " Freeman says. China is investing particularly heavily in science and engineering and "by 2010 it will graduate more PhDs in science and engineering than the US ".

In a similar vein, the developing world has inconveniently departed from the script that said it would specialise in low-tech goods. "China has moved rapidly up the technological ladder, has greatly increased its high-tech exports and has achieved a significant position in research in what is purported to be the next big industrial technology - nanotechnology, " Freeman says. "Over 750 multinational firms have set up R&D facilities in China. "

So globalisation is not just about a few blue-collar factory workers in the west losing their jobs and everyone else being better off. Because of plummeting telecom charges, all kinds of middle-class, white-collar jobs once thought of as non-tradable - not just in telemarketing and call centres but in accountancy, medical diagnostics and information technology - have started moving to the developing world.

Jeff Faux, founder of the labour-leaning Economic Policy Institute in Washington D.C. and author of The Global Class War: How America's Bipartisan Elite Lost Our Future - and What It Will Take to Win it Back, says: "A few years ago the phenomenon was dismissed as: 'Well, perhaps some people in the automobile industry or steel or electronics will lose their jobs, but their kids are going to be better off because they'll go to college and become accountants and engineers and people like that.' Now, of course, we're offshoring those jobs as well, so offshoring has gone up the ladder. "

But it is not just the offshoring that counts. According to Andrew Glyn, an Oxford University economics lecturer and author of Capitalism Unleashed: Finance, Globalization, and Welfare, western companies are investing in the developing countries only 4 per cent of the sums they are investing in the west. "So although it's quite a large proportion of the investment going into China, as a proportion of what's going into North America or Britain or Germany, it's really small potatoes so far. "

No; the force that is acting to suppress western wages is not so much offshoring as the threat of it. As Freeman says in his paper, by giving companies a new supply of low-wage labour, the doubling of the global labour force has weakened the bargaining position of workers - not, by the way, in the rich west alone, but in Latin America, South Africa and the more advanced economies of Asia, too.

"Firms threaten to move facilities to lower-wage settings or to import products made by low-wage workers if their current workforce does not accept lower wages or working conditions, to which there is no strong labour response, " Freeman says.

This has been vividly illustrated in Germany, where several big companies have obtained agreements from their employees to accept reductions in pay or longer working hours by threatening to move production to eastern Europe. But usually the threat does not need to be so openly expressed. That vast reserve army of low-wage labour is always there in the background, the curse of over-supply condemning employees to accept what they are offered.

At the same time, wages in one sector respond to those in another. If globalisation depresses wages in tradable sectors but leaves them unaffected in, say, retailing, then more people will seek jobs in retailing, depressing wages in that sector too.

Certainly, globalisation has fulfilled part of its promise to western workers. Cheap imports have brought down the cost of many consumer goods, often very noticeably. Paradoxically, however, these gains have been offset by big increases in energy costs, caused in part by rising demand for energy from the very factories that produce these

cheaper goods. That in turn has produced a vast redistribution of income from energy consumers to oil producers in the Middle East and elsewhere.

Some western workers may also have benefited from rising share prices, either through direct investment in shares or through their pension funds. But rich people are much bigger shareholders than poor people, so they will have reaped greater gains.

Indeed, the gains of globalisation have flowed disproportionately to the people who least need them - the rich and super-rich. According to the US Census Bureau, the top fifth of American households received 50.4 per cent of all household income last year, the largest share since records began in 1967, and the biggest gains have been going to those at the very top.

On the other hand, the gains are also flowing to the people who most need them: the poor workers of the developing world. While wages in the advanced countries are stagnant, wages in the developing world are rising rapidly, albeit from a small base. Freeman estimates that if Chinese wages double every decade, as they did in the 1990s, they will reach the levels found in the advanced countries today in about 30 years. Absorbing the labour forces of other countries could take a little longer but the transition could be complete in 40 to 50 years - at which point, presumably, western wages will start rising again and the balance between capital and labour will be restored.

Fair enough; but you do not have to be a wild-eyed anti-globalisation protester to have a bit of a problem with this. As Stephen King, chief economist of HSBC, the London-based international bank, and Janet Henry, the bank's global economist, put it in a research note on the global economy: "Globalisation isn't just a story about a rising number of export markets for western producers. Rather, it's a story about massive waves of income redistribution, from rich labour to poor labour, from labour as a whole to capital, from workers to consumers and from energy users towards energy producers. This is a story about winners and losers, not a fable about economic growth. "

But if western workers are emerging as globalisation's losers, how come consumer spending has held up? Rising house prices have made a lot of people feel richer, encouraging them to lift their spending by saving less and borrowing more. Also, more spouses and partners are taking jobs or working longer hours, increasing total household income.

The problem is, these trends cannot go on masking workers' stagnant wages forever. And as voters are confronted with the reality of the processes now taking place, they are likely to start demanding an end to outsourcing and a return to trade protection.

Concerns about this are already growing in the US. In a recent speech, Ben Bernanke, Federal Reserve chairman, noted that there had been eras of globalisation before, but none where the greater part of the earth's population was engaged, at least potentially,

in the global economy. Neither was there any precedent for the degree to which companies were fragmenting production and moving everything to the cheapest possible location. Social and political opposition to openness could be strong, he warned, saying the challenge for policy-makers was to ensure that the "benefits of global economic integration " were "sufficiently widely shared ".

Princeton economist Alan Blinder, a former Federal Reserve vice-chairman, went further. In the US journal Foreign Affairs, he said economists had underestimated both the importance of offshoring and its disruptive effect on wealthy countries. "We have so far barely seen the tip of the offshoring iceberg, the eventual dimensions of which may be staggering, " he wrote. The "governments and societies of the developed world must face up to the massive, complex and multi-faceted challenges that offshoring will bring ".

As so often is the case, identifying the problem is easier than finding a solution. Education and training, the politicians' usual panaceas, will not by themselves protect western workers from competition with the increasingly well-educated workforces of the developing world.

In any case, says Faux, the Global Class War author, it is unlikely that pay levels in China will converge with those of the west until workers in China have the same sort of hard-won rights and protections as those in the west. As it is, "We are in the process of creating a global market without a global social contract. " We take it for granted that the west must have its child labour laws, workplace safety regulations and so on, but in the global market, no such rules apply.

Ideally, Faux says, you would have rules to protect all workers set at the global level, "but I think that's kind of Utopian at this moment ". More realistically, he says, such rules should be built into all future and existing trade agreements so that they protected the interests of workers as well as those of investors.

Freeman's paper says the over-riding goal of labour market policy around the world in the next decade or so should be to make sure the absorption of China, India and the ex-Soviet bloc into world capitalism goes as smoothly as possible. "The bent of policy in the US and elsewhere should be in the direction of favouring labour rather than capital, which ought to take care of itself in a global economy with twice as many workers, many available at low wages. "

Clearly, taxes could be used to divert some of the gains made by capital and the rich towards ordinary wage-earners. Globalisation has made high taxes unfashionable because they encourage companies or people who pay them to move to countries with more forgiving tax regimes; yet if a voter backlash emerges, governments will have to find some way of responding.

Jeffry Frieden, a Harvard political economist and author of Global Capitalism: Its Fall and Rise in the Twentieth Century, says a consensus is emerging across the political spectrum that "although there are tremendous benefits to be gained from globalisation

and from international economic integration, these benefits need to rest upon some way of compensating or accommodating those who are harmed by market processes. "

Perhaps this is all just a false alarm. Some commentators believe that, as the post-war baby-boomers retire, the crisis facing the west will turn out to be a shortage of labour rather than a surplus.

Freeman demurs. "If I am wrong and there is to be a great labour shortage in the foreseeable future, it will come not from demography but from events the shortage soothsayers ignore - a global pandemic that kills millions of people; climate change that destroys parts of economies; [or] political insanity that produces barriers to trade, migration and capital flows around the world. With reasonable policies and a bit of luck, however, none of these events will up-end the movement towards a single and more egalitarian world economy. "

Still: imagine, at the birth of globalisation, western politicians had made an amazing proposition to voters. "Together, " they could have said, "we are going to end world poverty. In order to achieve this, we are going to ask you to accept a pay freeze in real terms for as long as it takes for the wages of workers in the developing countries to catch up, which we estimate will be about half a century. Until the adjustment is complete, the reduction in labour costs will produce the side-effect of extraordinarily high profits for companies, enriching many of those who are already among the richest in society.

"So there will be winners and losers. The bad news is that you, the ordinary, middle-class employees of the west, will be losers and everybody else will be winners. But the good news is, your sacrifice will make poverty history. "

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