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CAPITAL
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The Case for Taxing Globalization's Big Winners

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A new argument is emerging among the pro-globalization crowd in the U.S., the folks who see continued globalization and trade as vital to the country's prosperity: Tax the rich more heavily to thwart an economically crippling political backlash against trade prompted by workers who see themselves -- with some justification -- as losers from globalization.

FORUM

What do you think is driving the angst over globalization? [1]

The sharpest articulation of this view comes not from one of the Democratic presidential campaigns, but from economist Matthew Slaughter, who recently left President Bush's Council of Economic Advisers to return to Dartmouth's Tuck School of Business.

"Policy has become more protectionist because the public is becoming more protectionist," Mr. Slaughter and his frequent collaborator, Yale political scientist Kenneth Scheve, write in the new issue of Foreign Affairs magazine. "And the public is becoming more protectionist because incomes are stagnating or falling."

Globalization, the two academics argue with unswerving conviction, is good for the U.S. It has boosted productivity and made the country wealthier. It's done the same for many other countries. But the benefits of this global integration -- and the accompanying revolution in information and communications technology -- have been distributed unevenly.

There are some very big winners. Think investment bankers, hedge-fund partners, Wall Street lawyers, others whose skills are in high demand globally and those with big stock portfolios. But there are a lot of Americans -- even many college grads -- whose wages haven't kept pace with inflation.

The recent widening of the gap between economic winners and losers is "entirely without precedent in the postwar period," Lawrence Summers, the former U.S. Treasury secretary and Harvard president, said at a Washington forum this week.

"Individuals are asking themselves, 'Is globalization good for me?' and in a growing number of cases, arriving at the conclusion that it is not," Messrs. Slaughter and Scheve write. (You can see why Mr. Slaughter waited until he had left the Bush administration to speak his mind.)

The conventional response from fans of globalization, including the Bush administration, is rhetorical support for more aid for workers hurt by imports to salve the immediate pain and better education to equip the next generation of Americans with skills needed to command high wages in a global economy. Both are crucial. Progress on both is painfully inadequate.

But trade-adjustment assistance is traditionally targeted narrowly at workers hurt by imports. Today's angst about globalization is far more pervasive. Whatever the actual impact of offshore outsourcing today, it has millions of white-collar workers frightened. And education takes generations to pay off.

What to do? To preserve political support for the globalization dividend, spread the benefits more broadly by taxing winners more and losers less.

"It is best not to address increasingly salient concerns about inequality by interfering with trade," Mr. Summers argued at a forum sponsored by the Hamilton Project, the think tank he and others founded to provide intellectual fodder for like-minded politicians. His solution: use progressive taxation to offset some, but not all, of the increase in inequality. For starters, return tax rates for couples with incomes above $200,000 to the levels they were under President Clinton.

"Truly expanding the political support for open borders requires making a radical change in fiscal policy," Messrs. Slaughter and Scheve argue. Their particular proposal: eliminate the Social Security-Medicare payroll tax on the bottom half of workers -- roughly those earning less than $33,000 a year -- and make up the lost revenue by raising the payroll tax on others.

This, obviously, would be a sea change in fiscal policy. Mr. Clinton raised taxes, especially at the top, to bring down the deficit. Mr. Bush cut taxes, especially on the top. But all this talk is likely to influence any Democrat who takes the White House in 2008. He or she will almost surely move to raise taxes on the best-off Americans -- both to raise revenue to pay the bills and to resist the three-decade-old inequality trend.

ADDITIONAL RESOURCES

- Slaughter-Scheve essay[2]
- For more on the Hamilton Project[3]
- Economist Stephen Rose's challenge to the conventional wisdom on inequality[4]

There's a lot of argument about the extent and cause of widening inequality, and a lot about the damage higher tax rates can do to economic growth. That will go on. But the gap between winners and losers has widened persistently, and the palpable resentment of the losers is producing growing resistance among politicians -- acutely sensitive to public sentiment -- to further lowering barriers to trade and promoting globalization. Consider just a few recent headlines: the rise and fall of the immigration bill in Congress; the hostility toward China; Sen. Hillary Clinton's opposition to the U.S.-Korea free-trade pact.

Counting on the inevitability of globalization is imprudent; politics and policy can interfere. Expecting market forces to reverse the recent trend toward ever-bigger winnings for those at the top is unwise; the forces are too strong. Taxing winners isn't without risk; as Mr. Summers says, globalization makes it easier for them to "pick up their marbles and go somewhere else."

But using the tax code to slice the apple more evenly is far more palatable than trying to hold back globalization with policies that risk shrinking the economic apple.

Mr. Wessel responds to reader comments at WSJ.com/CapitalExchange[5]. Or email him at *capital@wsj.com*[6].

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