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**W**ith a quarter of a million people on the streets of London [protesting against the UK budget cuts](#), and with the US government days away from a potential [shutdown](#), the social divisions over fiscal policy are deepening. It is not hard to see why. Both the US and UK have experienced a profound shift of income distribution from the poor and the middle-class to the rich in the past 30 years yet the fiscal adjustments are dominated by sharp cuts on public services combined with reductions on corporate tax rates. The social contract is under threat. Only international co-operation can now solve what is becoming a runaway social crisis in many high-income countries.

The underlying political and economic forces tearing our societies apart are very powerful. The rise of globalisation, and especially the [entry of China and India](#) into the world markets, has put extreme downward pressure on wages of low-skilled workers while giving new opportunities for financial and business investments. The pre-tax income of the top 1 per cent of households has soared, from 10 per cent of household income in 1979 to 21 per cent in 2008 in the US, and from 6 per cent in 1979 to 14 per cent in 2005 in the UK.

With capital globally mobile, moreover, governments are now in a race to the bottom with regard to corporate taxation and loopholes for personal taxation of high incomes. Each government aims to attract mobile capital by cutting taxes relative to others. Governments like Ireland have created tax havens that drain revenues from the rest and act as conduits to tax-free Caribbean hideaways such as the Cayman Islands. The rich are doubly benefited: by the underlying market forces of globalisation and by their governments' policy response.

Another reason for the lavish attention to tax cuts at the top is of course the tawdry role of big money in political campaigns. No country tops the US in shamelessness. US national campaigns cost several billion dollars every two years, and fundraising is relentless. The main difference between the two parties is that Big Oil tends to finance the Republicans while Wall Street tends to finance the Democrats. Otherwise, both parties are in the hand of big-money interests that exacerbate the dangerous inequalities opened by globalisation.

The end result is that both the US and UK are [battling deficits](#) of about 10 per cent of gross domestic product. The situation in the US is far graver. Total government (federal, state, and local) revenues as a share of GDP in the US are now 32 per cent, roughly 9 percentage points below the UK and 15-20 percentage points below countries such as Denmark, Finland, Norway, and Sweden, which all have much lower budget deficits (or a surplus in the case of Norway) and highly effective public services.

The Cameron-Clegg-Osborne team deserves great credit for battling the UK budget deficit before it is too late. And slowly and grudgingly the US may finally be starting to close the deficit as well after years of naive Keynesianism and fiscal opportunism. The problem is that both the US and UK are aiming to do the impossible: run a modern, high-technology, prosperous 21st-century knowledge economy without the requisite tax base, largely to satisfy the upper classes and multinational companies, which threaten to decamp to milder tax regimes, or direct their campaign contributions elsewhere, if they do not get the tax cuts they obsessively crave.

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The symptoms of a devastating race to the bottom are everywhere. In the UK, the government asks for further cuts in the corporate tax rate in the face of swingeing budget cuts. To his credit, the chancellor of the exchequer is leaning against the wind with new taxes on banks and oil companies, and other UK taxes have been raised. In the US, the tax-cutting mania is shockingly unrestrained. The Obama White House and Republicans agreed just last December to a \$900bn two-year tax cut (extending the expiring Bush-era cuts) and then turned around to cut domestic spending programmes that protect the poorest communities. The White House has also come out in favour of a further cut to the corporate tax rate to be negotiated. In Canada, the Conservative government, brought down in a no-confidence on Friday after being found in contempt of parliament, had just proposed a new budget with a further cut to the corporate tax rate, while Ireland has clung to its irresponsible tax-haven status in the middle of a crippling turn to austerity.

For too long, fiscal politics between the left and right has been debated on false premises. Left-of-centre politics has tended to play down the importance of closing the budget deficit, arguing against spending cuts on the basis that deficits do not matter. Right-of-centre politics has tended to play down the importance of taxing higher incomes, arguing that only spending cuts can reduce the budget deficit. A more responsible position takes a note from both sides. We surely need to reduce the deficits but in a fair, efficient, and sustainable manner, by levying higher taxation on the rich, who are enjoying a boom in living standards and a share of the national income unprecedented in modern history.

Yet to get to the right place, countries cannot act by themselves. Even the social democracies of northern Europe, with their balanced budgets and high tax rates, are increasingly being pulled into the vortex of tax cutting and the race to the bottom. The political defences in the US and the UK against the power

of the rich are crumbling. Multinational companies and their disproportionately wealthy owners are successfully playing governments against each other. The game is clear, and it is working fiercely well.

As a starting point, the Organisation for Economic Co-operation and Development countries should urgently convene a meeting of finance ministers to enunciate basic principles of budget fairness: that fiscal adjustments towards budget balance are needed for medium-term solvency but must be carried out in a fair way; that the basic needs of citizens need to be protected in this period of fiscal stringency; that recent trends towards unprecedented inequalities of wealth and income require increased, not decreased, taxation of higher incomes, including corporate profits; and that tax and regulatory co-ordination across countries are vital to prevent a ruinous fiscal race to the bottom.

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