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Inequality - "The Defining Issue of Our Time"

World leaders are beginning to understand and accept that current levels of economic inequality are unsustainable, argues Stewart Lansley. Without a shift in course, economic turbulence will follow, as will global-level political discontent and social unrest.

By Stewart Lansley for ISN

According to the World Economic Forum and others, rising inequality is the most significant challenge facing the globe over the next decade. Inequality – or 'severe economic disparities` as the Forum defines it - has been rising on political and economic agendas. According to President Obama, it is now the 'defining issue of our time`.

Over the last two decades, inequality has risen in three-quarters of the 34 member-states of the OECD. In both the United States and the United Kingdom, inequality, as measured by the share of national income accruing to the top one per cent of the population, has risen to levels last seen before the Second World War. Driving these widening disparities has been an uneven distribution of the fruits of economic growth. In the United States – the most extreme case – nearly all the gains from rising prosperity since the mid-1970s have gone to the top one per cent, which has left those on middle and low wages with stagnant real earnings. This pattern has been repeated elsewhere. Today, the aggregate incomes of the world's top 1.75 percent of earners exceed the combined total of those of the bottom 77 percent.

Until the financial crisis of 2008, the growth of inequality barely registered on the political agenda. Indeed, the economic orthodoxy of the last thirty years maintained that inequality was a necessary byproduct of economic efficiency. Societies, it was argued, can either have greater equality or a stronger economy – they cannot have both. Embedded in the Anglo-Saxon model of liberal capitalism, this theory justifies sharper concentrations at the top of income and wealth distributions.

That orthodoxy, however, is under serious challenge. There is now considerable evidence to suggest that allowing a small financial and corporate elite to colonize a rising share of national incomes has had a mostly negative impact on economic stability, social cohesion and political trust.

An impending political crisis?

A consequence of the uneven distribution of the fruits of economic growth has been the reversal of one of the most enduring social trends of the twentieth century. After decades of stagnant wages and opportunities, the size of the American middle class – or the group straddling the mid-point of the income distribution – has decreased by more than a quarter since the late 1970s. The same squeeze on the middle is now underway across much of the rich world, from the UK to Germany.

Both the United States and the United Kingdom – where these trends began – have become low-wage economies, with a quarter of US and a fifth of UK workers earning less than two-thirds of median earnings. This has increased levels of in-work poverty and raised the costs of state income support while today's generation is facing bleaker life chances than their parents.

The implosion of the middle is also becoming a key source of growing social anxiety. Political theorists have long concluded that a large and successful middle class is essential to stability, a vibrant democracy and the promotion of political rights. The US economist, William Easterly, has shown how the middle-income share affects key social indicators such as life expectancy, infant mortality and health outcomes. Elite-dominated societies, Easterly adds, have invested less in human and infrastructure capital for society at large because of a 'fear of empowering groups outside [its] own class.' If the middle continues to shrink, and opportunities stagnate or fall, distrust in institutions – already low in many countries – is likely to grow, ultimately posing a threat to democracy itself.

Rising inequality is associated with higher levels of political protest and social distrust. According to a study of social risk by the International Labour Office, more than a half of the 106 countries they surveyed showed a growing risk of social unrest and discontent between 2010 and 2011, a trend they attributed to rising unemployment and inequality. Countries which have delivered inclusive growth have much better records on social and political disturbance than those where the gains have been concentrated among small privileged groups. China, for example, has seen a significant increase in work-place strikes and general protest, fuelling fears of large-scale unrest among those left out of the country's long boom. In response, the authorities have built a massive security network, spending more on internal security than it does on its military.

Contributing to this malaise is another side-effect of the process of upward enrichment. A skewed concentration of wealth results in political systems that disproportionately serve the interests of wealthy elites rather than those of employees, consumers and savers. Such polarization risks undermining democratic processes, as citizens lose trust in the ability of government to protect their interests and security.

Today's global leaders appear increasingly unable to engineer the change that majority opinion now accepts is critical to a more robust political and economic future. The mechanisms that might secure change – boardrooms steering surpluses to productive use, caps on corporate pay, and tighter regulations on Wall Street and the City – have remained elusive. As the American historian, John Buenker, has argued, 'With globalization, outsourcing, off-shore schemes, and 'free trade' agreements, today's "masters of the universe" operate virtually beyond the reach of even the most progressive of governments.'

One of the greatest risks posed by excessive levels of inequality is to economic stability. There is now a growing consensus that inequality played at least some role in the 2008 financial crisis. According to economic orthodoxy, the shift in the distribution of national income away from wages and towards profits should have improved national economic health. Instead, by creating a number of damaging distortions – including fractured demand, debt-fuelled consumption and heightened economic risk – it has bred fragility and decreased growth. According to the International Labour Organisation, nearly all large economies – including the UK and the US – are 'wage-led' rather than 'profit-led`. That is, they experience slower growth when an excessive share of output is colonised by profits.

The wage-profit imbalance also helps to explain the prolonged nature of the post-2008 crisis. While living standards have been falling, corporate cash reserves have soared. American corporations have $1.45 trillion in cash, equivalent to more than 10 per cent of the American economy. This represents an all-time high and is an increase of more than 50 per cent since 2010. The same trends can be observed in the UK and parts of continental Europe. These extensive corporate cash reserves are the 'savings glut' that is at the root of so many of the world's macroeconomic imbalances. They mean that a large portion of the world's wealth is not being used to launch a sustained economic recovery. Instead, most of it is lying idle – 'dead money` in the phrase of Mark Carney, the Governor of the Bank of England.

Is the message getting through?

Belatedly, it is now being accepted at the highest levels that the current extent of income inequality is unsustainable. 'When middle-class families can no longer afford to buy the goods and services that businesses are selling, it drags down the entire economy from top to bottom,' or so argued President Obama more than a year ago. Christine Lagarde, head of the IMF, has similarly argued that economic stability and sustained growth depend on securing a 'more equal distribution`.

Despite these high-profile conversions, the best evidence is that inequality (at least within nations) has intensified through the crisis. In the US, 90 per cent of the proceeds of growth in 2010 accrued to the top one per cent. According to the ILO, the gap between wage and output growth across rich nations has continued to widen since 2008.

Some commentators are saying that the wage-output imbalance may be here to stay. The American academic, Len Kenworthy has argued that the post-1980 relationship between wage and output growth - with profit growth outdistancing wage growth - is likely to be the 'new normal` rather than a temporary blip.

It is a view shared by the conservative American economist Tyler Cowen. In his latest book, *Average is Over,* Cowen argues that little can be done to prevent the further hollowing out of wages, leading to continuing polarization between the affluent and the poor. If these experts are right, the likelihood is that much of the globe should prepare for a future of continued economic turbulence, spreading social unrest and growing political discontent.

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